

## LOBSTERS, HOT AIR BALLOONS, AND THE HOMETOWN TAX: A JAPANESE MODEL FOR REVITALIZING RURAL ECONOMIES IN THE UNITED STATES

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*Many municipalities in the United States are short of the tax revenue they need and have had to cut spending on public goods, which has lowered the quality of life for their residents. Municipalities in Japan face the same problem. Japan has developed an effective method for raising tax revenue for local governments and revitalizing languishing economies. Japan's "Hometown Tax" system empowers taxpayers to divert tax revenue from affluent urban governments to struggling rural governments, stimulates small businesses and enables rural governments to be more autonomous and financially independent.*

*Under the Hometown Tax, a taxpayer that makes a charitable contribution to a local government receives a tax deduction and credit amounting to almost the entire value of the charitable contribution. At almost no extra cost, the taxpayer can select a Return Gift to receive from a local business in the region. Return Gifts range from deliveries of fresh locally-caught lobsters to vouchers for hot air balloon rides, and are listed on online portals that connect taxpayers to municipal and prefectural governments throughout Japan. The online portals have also become donation channels for regions experiencing natural disasters.*

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*Implementing a Hometown Tax system in the United States would require the addition of state and municipal tax credits, and allowing for Return Gift selection would require the modification of U.S. quid pro quo contribution law. A Hometown Tax has risks, and could result in an excessive diversion of tax revenue from urban to rural governments. This Note concludes that, given its potential to enable struggling municipalities to prosper, increase the demand for goods produced by small businesses, and further the financial independence of local governments, the United States should consider instituting some variation of a Hometown Tax system.*

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## I. INTRODUCTION

Many municipalities in the United States are short of the funds they need,<sup>1</sup> and many rural communities are struggling to survive amidst the population shift to urban areas.<sup>2</sup> Local

<sup>1</sup> Michelle Wilde Anderson, *Dissolving Cities*, 121 YALE L.J. 1364, 1400–02 (2012) (explaining that budgetary crisis and depopulation due to industrial or rural abandonment are causes of cities being dissolved into “unorganized territory”); *Class Dismissed, Forever: Rural Schools Face Closures*, NBC NEWS (June 27, 2014, 4:50 AM), <http://www.nbcnews.com/news/education/class-dismissed-forever-rural-schools-face-closures-n141556> [perma.cc/Z9ZW-NUAW].

<sup>2</sup> According to a June 2015 report from the U.S. Department of Agriculture, the outmigration of young adults of childbearing age has outpaced retiree

governments facing shortages of tax revenue have had to cut spending on public goods in ways that have lowered the quality of life for their residents.<sup>3</sup> Beyond the need to raise local government revenue to maintain residential quality of life, in an increasingly capricious political environment in which cities or states may not want to be subject to federal government demands, state and local governments could benefit from decreased dependence on federal funding.<sup>4</sup> State

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attraction over several decades, and nine hundred counties (including nearly three hundred counties for the first time) faced population declines during 2010–2014. ECON. RESEARCH SERV., U.S. DEP'T OF AGRIC., RURAL AMERICA AT A GLANCE: 2015 EDITION (2016), [https://www.ers.usda.gov/webdocs/publications/44015/55581\\_eib145.pdf](https://www.ers.usda.gov/webdocs/publications/44015/55581_eib145.pdf) [perma.cc/S7UR-3QM4].

<sup>3</sup> According to the program director at the National Conference of State Legislatures, “Without money coming in, you don’t pave the roads, you don’t pick up the trash, you don’t upgrade the sewer system.” For example, due to lack of local government revenue, Branson, Colorado has shifted schools online and towns in North Dakota and Michigan are reverting from paved to gravel roads. TI Henderson, *Nebraska, Other States Fight Rural Population Flight*, TRIB. NEWS SERV. (Sept. 1, 2015), [http://journalstar.com/news/state-and-regional/nebraska/nebraska-other-states-fight-rural-population-flight/article\\_f0763826-4dbb-5837-b768-64830e0f5977.html](http://journalstar.com/news/state-and-regional/nebraska/nebraska-other-states-fight-rural-population-flight/article_f0763826-4dbb-5837-b768-64830e0f5977.html) [perma.cc/ABE6-X2MJ].

<sup>4</sup> For example, U.S. cities like Boston, New York, and San Francisco want to maintain their “sanctuary-city” status amidst the immigration ban instituted by the Trump Administration. In response, President Trump signed an order to cut off federal funds to those cities, requiring U.S. officials to ensure that sanctuary cities “are not eligible to receive federal grants, except as deemed necessary for law enforcement purposes.” Scott Calvert, Alejandro Lazo, & Jon Kamp, *Donald Trump, ‘Sanctuary City’ Mayors Set to Clash over Immigration Policies*, WALL ST. J. (Jan. 25, 2017, 7:03 PM), <https://www.wsj.com/articles/sanctuary-cities-brace-for-proposed-funding-cuts-1485373756> [perma.cc/5WDW-HFPB] (quoting the executive order). The order enables the Trump Administration to “move quickly to cut off funds and leave cities with serious shortfalls in their programs,” which severely undermines less wealthy cities’ autonomy if they wish to maintain their sanctuary-city statuses. *Id.* (quoting law professor Jonathan Turley); see also Jessica Bakeman, *As Race to the Top Ends, Controversy Continues*, POLITICO (July 15, 2015, 5:45 AM), <http://www.politico.com/states/new-york/albany/story/2015/07/as-race-to-the-top-ends-controversy-continues-023795> [perma.cc/U39B-PMWA] (describing how “the federal government took advantage of states’ devastating fiscal circumstances,” which led to many problems in the New York education system).

and local governments have limited means of expanding their budgets without increasing tax rates or requesting a larger allocation of federal tax revenue. There are some measures, such as the Internal Revenue Code's tax exemption of interest from state and municipal bonds, which incentivize individuals to lend money to states and municipalities.<sup>5</sup> However, while such mechanisms can help increase local government budgets, none of these measures directly help local businesses or provide governments with much potential for self-sufficiency.

Japan has developed a solution that has succeeded not only in raising funds for state<sup>6</sup> and local governments, but also in creating a long-term potential for greater financial independence by stimulating local businesses. Under the Japanese Hometown Tax system, a taxpayer that makes a charitable contribution to a local government receives a double-benefit: (i) the taxpayer receives a tax deduction and credit amounting to almost the entire value of the charitable contribution<sup>7</sup> and (ii) the taxpayer can, at almost no extra cost, select a gift of thanks (hereinafter, a "Return Gift"), typically produced by a local business in the region, to be delivered to the taxpayer's doorstep. Return Gifts vary by municipality and prefecture, ranging from luxury food items such as lobster, beef, and high quality fruit to cultural items such as handmade swords,<sup>8</sup> hand-carved Buddhist statues,<sup>9</sup>

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<sup>5</sup> I.R.C. § 103 (2012).

<sup>6</sup> The Japanese word for state-like political subdivisions is "prefecture," which will be used throughout this Note. Mentions of the word "prefecture" should be thought of as interchangeable with the word "state" for purposes of this Note.

<sup>7</sup> There is a fixed ¥2000 transaction fee per donation. *Furusato nōzei to wa*, FURUSATO CHOICE BY TRUSTBANK [hereinafter *What Is Furusato Nōzei*] <https://www.furusato-tax.jp/about.html> [perma.cc/WKJ7-XURM].

<sup>8</sup> Master Blaster, *City in Gifu Offering Authentic Handcrafted Swords in Exchange for Tax Payments*, JAPAN TODAY (Oct. 6, 2016, 5:52 AM), <https://www.japantoday.com/category/arts-culture/view/city-in-gifu-offering-authentic-handcrafted-swords-in-exchange-for-tax-payments> [perma.cc/9JVQ-SXM3].

<sup>9</sup> Editorial, *Hometown Tax Scheme Seems to Be Taking Off*, JAPAN TODAY (Apr. 14, 2015, 6:02 AM),

and gold ninja throwing-knives.<sup>10</sup> Other municipalities offer experiences, from hot spring vacations and paragliding on local sand dunes to being “team president” of a professional soccer team for one day.<sup>11</sup> The double benefit taxpayers receive under this system has caused the Hometown Tax to be hugely successful and has diverted a significant amount of tax revenue from affluent urban governments to struggling rural governments, thereby revitalizing many rural economies and increasing the financial independence of their local governments.<sup>12</sup>

This Note argues that given its success in stimulating local businesses and revitalizing languishing economies in the Japanese countryside, a Hometown Tax system could be a way to improve the financial state facing many local governments in the United States.

In Part II, this Note describes the origin of Japan’s Hometown Tax system, how it works, and why it has been successful. Part III addresses arguments for and against instituting a Hometown Tax system. Part IV discusses the implementation of a Hometown Tax system in the United States. In doing so, this Note recognizes the incompatibility between the expectation of Return Gifts that motivates many Japanese Hometown Tax taxpayers to participate and the U.S. law governing tax deductions for charitable contributions. Under U.S. law, donations made with the expectation of a personal benefit<sup>13</sup> are categorized as “quid pro

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<https://www.japantoday.com/category/kuchikomi/view/hometown-tax-scheme-seems-to-be-taking-off> [perma.cc/BU3W-N4U2].

<sup>10</sup> *Japan’s Rural Regions: Hometown Dues*, ECONOMIST (Apr. 18, 2015), <http://www.economist.com/news/asia/21648703-struggling-parts-countryside-have-found-novel-way-attract-money-hometown-dues> [perma.cc/L284-AB6L].

<sup>11</sup> Editorial, *supra* note 9. See *infra* Section II.C. for more examples.

<sup>12</sup> In 2016 alone, Japan’s Hometown Tax system resulted in ¥284.4 billion (approx. \$2.6 billion) in revenue to municipal and prefectural governments arising from the 7,260,000 donations made by taxpayers. See *infra* Section II.E.

<sup>13</sup> For a further discussion of the standards used to determine whether an individual has sufficient charitable intent, see the cases in Section IV.A.1, *infra*.

quo contributions,” which preclude donors from receiving a tax deduction for the donation’s full value.<sup>14</sup> Part IV also suggests some potential modifications for a U.S.-tailored Hometown Tax.

This Note concludes that, on the whole, a Hometown Tax system’s potential to remedy the underfunding of local governments and increase the financial independence of political subdivisions in the United States is significant enough that the United States should strongly consider instituting some variation of a Hometown Tax system.

## II. JAPAN’S HOMETOWN TAX

### A. Origin of the Hometown Tax

In the last twenty years, almost half of Japan’s municipal districts have vanished.<sup>15</sup> While urban municipalities with large populations have flourished, the population flow from rural to urban areas has made it difficult for rural

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<sup>14</sup> This depends on the amount and type of the donation in question. Donations made to local governments’ disaster relief funds would not result in any Return Gifts and would therefore be eligible for a full deduction (except for a fixed payment, *e.g.* \$18, per donation that cannot be deducted). On the other hand, if a taxpayer receives Return Gifts valued at either \$105 or more, or 2% or more of the taxpayer’s donation amount, the taxpayer will be required to subtract the value of the Return Gift from the total amount of the donation claimable for a tax deduction. Given that most Return Gifts are typically luxury goods that amount to much more than 2% of the total donation amount, most donors would not receive a full deduction for their donations if a Hometown Tax were to be transplanted into the United States with no modification of U.S. law. Part IV addresses this issue in more detail.

<sup>15</sup> According to a report submitted to the government, nine hundred population centers will disappear within a generation as the nation ages. As the number of residents has dwindled, almost half of Japan’s municipal districts have already vanished through mergers to cut administrative costs of running their governments. Keiko Ujikane & Kyoko Shimodoi, *Dying Japanese Towns Ply Beer in Drive for Tax Donations*, BLOOMBERG (Aug. 14, 2014, 9:33 PM), <https://www.bloomberg.com/news/articles/2014-08-14/dying-japan-towns-ply-free-beer-to-urbanites-in-tax-drive>.

municipalities to retain their residents and collect sufficient tax revenue to sustain necessary functions and services.<sup>16</sup>

Given the vast disparity in revenue sources among local governments throughout the country, Japan's central government administers Local Allocation Tax ("LAT") grants, under which portions of national taxes are transferred to local governments that lack sufficient tax revenue to keep running.<sup>17</sup> LAT grants fill the financial gap, or revenue shortfall, between the tax revenue collected and the cost of the public activities that local governments carry out.<sup>18</sup> Local governments are currently guaranteed LAT grants to the extent necessary for them to provide a baseline level of administrative services.<sup>19</sup> However, some argue that the availability of LAT grants has become a disincentive for rural governments to take measures to raise tax revenue and has essentially dissuaded rural economies from making good-faith efforts to improve regional economic growth, causing them to further deteriorate in terms of economic viability.<sup>20</sup> The LAT grants have been characterized as "poverty traps" because

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<sup>16</sup> Naoko Niitsu, *Innovative 'Hometown Tax' Donation Program Supports Municipalities*, JAPAN FOR SUSTAINABILITY (Aug. 2016), [http://www.japanfs.org/en/news/archives/news\\_id035641.html](http://www.japanfs.org/en/news/archives/news_id035641.html) [perma.cc/28GP-BPKY].

<sup>17</sup> Takero Doi, *Poverty Traps with Local Allocation Tax Grants in Japan 2* (Keio/Kyoto Global COE Discussion Paper No. DP2010-002, 2010), [http://ies.keio.ac.jp/old\\_project/old/gcoe-econbus/pdf/dp/DP2010-002.pdf](http://ies.keio.ac.jp/old_project/old/gcoe-econbus/pdf/dp/DP2010-002.pdf) [perma.cc/6CCT-7HE2].

<sup>18</sup> The rationale for LAT grants is that they aim to "equalize" the nation and prevent differences in the financial conditions of local governments from being reflected in the public services they provide to their residents. *Id.* at 3.

<sup>19</sup> Given that the central government already runs on a deficit, LAT grants have further drawn criticism for being a potentially unnecessary source of government spending. See NOBUYUKI UDA, MINISTRY OF FIN., JAPAN, JAPAN: FISCAL DISCIPLINE OF LOCAL GOVERNMENTS 15 (2015), [www.mof.go.jp/pri/research/seminar/fy2015/tff2015\\_s5\\_03.pdf](http://www.mof.go.jp/pri/research/seminar/fy2015/tff2015_s5_03.pdf) [perma.cc/KHA2-U2KP].

<sup>20</sup> *Id.* at 25; Motohiro Sato, *Unit 05 Kickoff Paper: Good and Bad Fiscal Decentralization*, NIPPON INST. FOR RESEARCH & ADVANCEMENT, <http://www.spacenira.com/en/columns/1844.html> [perma.cc/MF24-F5YF].



they help local governments on a year-to-year basis but do not provide a long-term remedy to rural economic development.<sup>21</sup>

In 2008, the Japanese central government launched an alternate solution to narrow the disparity between urban and rural communities: *Furusato Nōzei*, the hometown tax system (“Hometown Tax”), which allows citizens to direct up to twenty percent of their inhabitant taxes<sup>22</sup> to a municipality of their choice.<sup>23</sup> Unlike the LAT grants, the Hometown Tax does not pose the risk of permitting rural economies to lock themselves into poverty traps.<sup>24</sup> What makes the Hometown Tax unique (and worthy of potentially implementing in the United States) is that, in addition to providing a source of financial support for rural governments with revenue shortfalls, the Hometown Tax also stimulates local businesses in the rural areas and has spurred local governments to raise revenue from sources beyond their constituents.

## B. Hometown Tax Income Tax Deduction and Inhabitant Tax Credit Rules

Under the Japanese Hometown Tax system, taxpayers that make a donation to a prefecture or municipality of their choosing receive, in the amount of the donation less a ¥2000 (approx. \$18)<sup>25</sup> payment, (i) an income tax deduction, which the taxpayer will receive from the National Tax Agency in the

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<sup>21</sup> Doi, *supra* note 17, at 2.

<sup>22</sup> “Inhabitant tax” is the collective term for prefectural tax and municipal tax on individual income. The tax rates are fixed (not progressive); the prefectural tax rate is 4% and municipal tax is 6%. Individuals that are domiciled in Japan as of January 1 each year are subject to these taxes. *Laws & Regulations on Setting Up Business in Japan*, JETRO, [https://www.jetro.go.jp/en/invest/setting\\_up/laws/section3/page7.html](https://www.jetro.go.jp/en/invest/setting_up/laws/section3/page7.html) [perma.cc/W86Z-NLFT].

<sup>23</sup> *Furusato nōzei no gaiyō*, MINISTRY OF INTERNAL AFFAIRS & COMMC’NS, [Overview of Furusato Nōzei] [http://www.soumu.go.jp/main\\_sosiki/jichi\\_zeisei/czaisei/czaisei\\_seido/furusato/mechanism/about.html](http://www.soumu.go.jp/main_sosiki/jichi_zeisei/czaisei/czaisei_seido/furusato/mechanism/about.html) [perma.cc/23JG-AYX7].

<sup>24</sup> The Hometown Tax system exists in addition to the LAT grant system—it has *not* completely eliminated the necessity for LAT grants and likely will not any time soon. Sato, *supra* note 20.

<sup>25</sup> An exchange rate of \$1 to ¥110 will be used throughout the Note.

form of a refund for a portion of the income taxes paid that year; and (ii) a tax credit for the inhabitant tax<sup>26</sup> the taxpayer will pay to their residential local and prefectural governments the following year. To illustrate, a taxpayer earning an income of ¥3 million (approx. \$27,000) who is in the 10% income tax bracket<sup>27</sup> and donates ¥30,000 yen through the Hometown Tax will receive a corresponding ¥28,000 tax benefit (¥30,000 minus the fixed ¥2000 payment).<sup>28</sup> Once the taxpayer makes the donation, the recipient local government will provide a verification form, which the taxpayer will submit to the National Tax Agency with their tax return to receive the following: (1) a ¥28,000 income tax deduction, which the taxpayer will receive from the National Tax Agency in the form of a ¥2800 income tax refund,<sup>29</sup> and (2) an inhabitant tax credit for the remaining ¥25,200, which is credited toward the taxpayer's inhabitant tax liability for the following year.<sup>30</sup> The process was made even easier in 2015, as taxpayers that donate to five or fewer local governments no longer need to

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<sup>26</sup> KPMG TAX CORP., TAXATION IN JAPAN 2016, at 78 (2016), <https://asset.s.kpmg.com/content/dam/kpmg/jp/pdf/jp-en-taxation-in-japan-201612.pdf> [perma.cc/JX2J-3S3X].

<sup>27</sup> *Laws & Regulations on Setting Up Business in Japan*, *supra* note 22.

<sup>28</sup> *What Is Furusato Nōzei*, *supra* note 7.

<sup>29</sup> The tax benefit from the income tax deduction is calculated as follows: (Donation – ¥2000 payment) x (Taxpayer's income tax rate). For the above example, it would be (¥28,000 x 10%) = ¥2800. Thus, the taxpayer will receive a ¥2800 refund for the income taxes paid that year. See *Furusato nōzei no shikumi: zeikin no kōjo ni tsuite*, MINISTRY OF INTERNAL AFFAIRS & COMMC'NS, [hereinafter *How Furusato Nōzei Works*] [http://www.soumu.go.jp/main\\_sosiki/jichi\\_zeisei/czaisei/czaisei\\_seido/furusato/mechanism/deduction.html](http://www.soumu.go.jp/main_sosiki/jichi_zeisei/czaisei/czaisei_seido/furusato/mechanism/deduction.html) [perma.cc/2U8Y-HHBF] (providing the calculation formulas).

<sup>30</sup> *What Is Furusato Nōzei*, *supra* note 7; see also *How Furusato Nōzei Works*, *supra* note 29 (providing the following two formulas for the inhabitant tax credit: (a) the basic inhabitant tax credit formula: (Donation – ¥2000 payment) x 10%; and (b) the special inhabitant tax credit formula, provided it does not exceed 20% of the taxpayer's inhabitant tax liability: (Donation – ¥2000 payment) x [100% – (10% basic credit rate) – (taxpayer's income tax rate)]).

submit *any* verification forms.<sup>31</sup> As a result, in 2016 alone, the Hometown Tax amassed over ¥284 billion (approx. \$2.6 billion) in donations.<sup>32</sup>

The name *Furusato* (Hometown) reflects the Hometown Tax's original purpose, which was to encourage people who had moved to urban areas to direct a portion of their inhabitant taxes to the rural towns in which they were raised.<sup>33</sup> The purpose of the Hometown Tax has since broadened to allow *all* local governments to benefit from the voluntary transfer of tax revenue; taxpayers do not need to have *any* connection to the local governments to which they donate—in fact, many Hometown Tax donors have never even been to the regions to which they donate.<sup>34</sup> For example, the

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<sup>31</sup> See *infra* note 200 (describing Japan's "One Stop" exception). It is also important to note, as T. R. Reid explains, Japan uses a tax system known as "precision withholding," under which Kokuzeichō (the official tax collecting agency of Japan, hereinafter "the National Tax Agency") sends every citizen a postcard in early March that sets forth "how much you earned, how much tax you owe, how much tax you've already paid through withholding . . . . If the figures on the postcard from Kokuzeichō look about right, the taxpayer does nothing. The tax has been computed and paid already . . . . As a result, paying income tax is a totally automatic process for about 80% of Japanese households, requiring no more work than reading a postcard once a year." T. R. REID, A FINE MESS: A GLOBAL QUEST FOR A SIMPLER, FAIRER, AND MORE EFFICIENT TAX SYSTEM 220 (2017).

<sup>32</sup> *Donations Under Hometown Tax Payment Program Hit Record ¥284 Billion in 2016*, JAPAN TIMES (July 4, 2017), <https://www.japantimes.co.jp/news/2017/07/04/business/donations-hometown-tax-payment-program-hit-record-¥284-billion-2016/#.WdhGvDOZPBI> [perma.cc/MR2A-BMHH].

<sup>33</sup> Governor Hirai of Tottori Prefecture, where the concept of sending Return Gifts to donors originated, explains the Tottori government's concern about the vicious cycle in which people raised in the countryside benefit from education and medical care funded with local government funds, but then move to cities to work, so the countryside governments never receive any tax revenue once those people start paying taxes. TOSHIKAZU TAKAMATSU, FURUSATO NŌZEI TO CHĪKI KEIEI [FURUSATO NŌZEI AND REGIONAL MANAGEMENT] 167 (2016).

<sup>34</sup> In comments on Satofuru, the online portal for Hometown Tax donations, donors have written "I found out about [town name] for the first time as I was searching for potential Return Gifts to choose. I am now going to start supporting [town name]." *Id.* at 119 (describing the online page of Abira-chō, a small town on Japan's northern island of Hokkaidō).

town of Miyakonojō in Miyazaki attracted ¥4.2 billion (approx. \$38 million), the greatest amount of Hometown Tax donations to a municipal government in 2016, but over 90% of its donors have no connection to Miyakonojō.<sup>35</sup> Taxpayers are free and encouraged to make their donations to any of the 1788 local governments throughout the country.<sup>36</sup>

The word *Nōzei* (Tax Payment) is a reference to the income tax deductions and inhabitant tax credits for which the donors qualify by making the voluntary donations.<sup>37</sup> Any donation a taxpayer makes is a one-time (non-recurring) donation to the municipality. The only cap is that the inhabitant tax credits the taxpayer earns cannot exceed twenty percent of the value of the taxpayer's own inhabitant tax bill.<sup>38</sup>

The donations have had a significant impact on the recipient localities—functioning, in some municipalities, as a main source of government income, and enabling local governments to provide government services funded on their own, rather than by LAT grants. For instance, the Hokkaidō city of Nemuro received close to one-third of its tax revenue

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<sup>35</sup> Yoshiaki Nohara, *Japan's Rural Towns Are Luring Tax from Tokyo with Beef and Beer*, BLOOMBERG (Jan. 9, 2017, 4:00 PM), <https://www.bloomberg.com/news/articles/2017-01-09/japan-s-rural-towns-are-luring-tax-from-tokyo-with-beef-and-beer> [perma.cc/J6BJ-PCNX] (explaining that, according to a 2015 survey, ninety percent of donors have no connection to Miyakonojō).

<sup>36</sup> *Nikkei Woman "Woman of the Year 2016" Happyō: Taishō wa Nihon ni kifubunka wo hirometa "Furusato Nōzei Boom" no tateyakusha ni* [*The Nikkei Woman "Woman of the Year 2016" Announcement: Grand Prize is a Leading Figure of "Furusato Tax Payment Boom" that Spreads Culture to Japan*], NIKKEI BUS. PUBL'N, INC. (Dec. 7, 2015), [corporate.nikkeibp.co.jp/information/newsrelease/20151207.shtml](http://corporate.nikkeibp.co.jp/information/newsrelease/20151207.shtml) [perma.cc/3A68-2C6N].

<sup>37</sup> 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/#.WdKp7jOZPBI> [perma.cc/SBU5-JRK8].

<sup>38</sup> Jonathan Soble, *In Japan, You Get a Tax Break and a Side of Lobster and Beef*, N.Y. TIMES (May 30, 2015), <http://www.nytimes.com/2015/05/31/business/international/in-japan-you-get-a-tax-break-and-a-side-of-lobster-and-beef.html> [perma.cc/J9V8-66CY].

through Hometown Tax donations in 2015.<sup>39</sup> Moreover, the revenue raised by Miyakonojō through the Hometown Tax has created local jobs and allowed the city to fund dental checkups, children's centers, and other community programs.<sup>40</sup>

### C. Return Gifts

Most recipient local governments send donors local specialty products as Return Gifts to both incentivize and thank them for their donations. Online portals—including Satofuru and Furusato Choice—function like Amazon or other shopping websites and allow taxpayers to select which municipality to donate to based on the Return Gift they will receive. The taxpayer can simply search by the type of Return Gift and browse all of the municipalities that will send that particular Return Gift to the taxpayer's home in return for the requisite donation amount.<sup>41</sup> The recipient municipality uses the donation funds to pay a local business to supply and ship the Return Gift to the donor, and keeps as revenue the remainder of the donation. The minimum donation amounts required to receive Return Gifts vary based on the value of the Return Gifts themselves.<sup>42</sup>

The following are examples of Return Gifts and their minimum required donation amounts. For a donation of ¥20,000 (approx. \$181) to the coastal town of Onjukumachi in Chiba Prefecture, a taxpayer can receive two *live* lobsters

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<sup>39</sup> *Hokkaidō City Repays 'Hometown Tax' Donors with Crab and Other Seafood, Sees Donations Soar*, JAPAN TIMES (Feb. 5, 2016), <http://www.japantimes.co.jp/news/2016/02/05/national/hokkaido-city-repays-hometown-tax-donors-crab-seafood-sees-donations-soar/> [perma.cc/VY5G-3BGA].

<sup>40</sup> Nohara, *supra* note 35 (quoting Shuichi Nomiyama, an official who runs Miyakonojō's tax program).

<sup>41</sup> See, e.g., *Satofuru: Furusato Nōzei Site*, SATOFURU, <http://www.satofull.jp> [perma.cc/YJU2-TWQM] (established in 2014) and *Furusato Choice*, FURUSATO CHOICE BY TRUSTBANK, <http://furusato-tax.jp> [perma.cc/WWH4-CDK5] (established in 2016).

<sup>42</sup> See *Furusato Choice*, *supra* note 41.

straight from the ocean.<sup>43</sup> For a ¥30,000 (approx. \$273) donation to the town of Kōmi in Nagano Prefecture, a taxpayer can receive a voucher for a one-day ski lift ticket at a mountain in Kōmi, as well as one night at a local inn “including two meals.”<sup>44</sup> For an ¥80,000 (approx. \$727) donation to the town of Kasai in Hyōgo Prefecture, a taxpayer whose ancestors are buried in a cemetery in Kasai can have a local cemetery professional clean the grave (and send the taxpayer a picture of it) three times throughout the year so that the taxpayer does not have to make the trips to do so.<sup>45</sup> For a ¥200,000 (approx. \$1818) donation to the city of Yanagawa in Fukuoka Prefecture, a taxpayer can receive a custom-designed wooden dining table built locally in Yanagawa (home delivery and assembly service are included).<sup>46</sup> Further, for donations to Seki city in Gifu Prefecture, a taxpayer can receive a 72-centimeter-long sword that will be handmade with a desired inscription in 2017 for ¥5,000,000 (approx. \$45,454) or ¥3,000,000 (approx. \$27,272), depending on whether the taxpayer would like the sword to be made by a master swordsmith or an “up-and-coming” swordsmith.<sup>47</sup>

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<sup>43</sup> *Iki Ise Ebi [Live Lobster] A*, FURUSATO CHOICE BY TRUSTBANK, [https://www.furusato-tax.jp/japan/prefecture/item\\_detail/12443/69664](https://www.furusato-tax.jp/japan/prefecture/item_detail/12443/69664) [perma.cc/7DKQ-QGS2].

<sup>44</sup> *Rizōto In Tachibanaya sukī-pakku (Otona ippaku nishoku-tsuki rifuto ichinichiken-tsuki) [Resort Inn Tachibanaya Ski Pack (For Adult, One Night, Two Meals and a One-Day Lift Pass)]*, FURUSATO CHOICE BY TRUSTBANK, [https://www.furusato-tax.jp/japan/prefecture/item\\_detail/20303/150261](https://www.furusato-tax.jp/japan/prefecture/item_detail/20303/150261) [perma.cc/WLU3-RZ5W].

<sup>45</sup> *Ohaka sōji anshin daikō sabisu (nen sankai kōsu) [Reassuring Grave-Cleaning Service (Three Times-per-Year Package)]*, FURUSATO CHOICE BY TRUSTBANK, [https://www.furusato-tax.jp/japan/prefecture/item\\_detail/28220/332337](https://www.furusato-tax.jp/japan/prefecture/item_detail/28220/332337) [perma.cc/DRP8-GG4J].

<sup>46</sup> *Furusato nōzei de tēburu ga moraeru ninki jichitai to kangen-ritsu matome*, FURUSATO NŌZEI NABI (Nov. 16, 2017), <https://minatoku-time.com/furusato-tax-recommend-goods/table/> [perma.cc/9LFV-7SAP].

<sup>47</sup> Takuji Yoshizumi, *City's Sword Gift Cuts the Mustard with Eager Hometown Tax Donors*, ASAHI SHIMBUN (Oct. 5, 2016, 4:25 PM), <http://www.asahi.com/sp/ajw/articles/AJ201610050047.html> [perma.cc/484R-WFTU].

The use of Return Gifts as a primary method to attract taxpayer participation in the Hometown Tax system has caused fierce inter-government competition and has given rise to potential problems, which are addressed in Part III.

#### D. Natural Disaster Relief: No Return Gifts

While the Return Gifts are the main incentive for taxpayers to donate to municipalities with which they have no connection, the Hometown Tax has a further benefit: Its online portals are extremely successful as donation portals in times of emergency. The surge in donations to earthquake-affected areas that offer no Return Gifts shows that in some cases, taxpayers do not require a Return Gift incentive to donate to local governments in need.<sup>48</sup>

For instance, within twenty-four hours of the Kumamoto Earthquake on April 16, 2016, Satofuru (the online portal) created a website called “Kumamoto Earthquake Disaster Emergency Donation Fund” and began accepting donations for Kumamoto Prefecture at midnight on April 17, 2016. In two days, Satofuru collected ¥2.8 million (approx. \$25,454) on behalf of the city of Kikuchi in Kumamoto Prefecture.<sup>49</sup> In the four days following the earthquake, Satofuru accepted pledges from 5477 individuals to give a total of over ¥81 million (approx. \$736,363) in donations to Kumamoto Prefecture.<sup>50</sup> By the end of the year, Kumamoto Prefecture ended up receiving eighty-six times the total donations it received in 2015, making Kumamoto Prefecture the recipient of the sixth highest sum in Yen of donations in 2016.<sup>51</sup>

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<sup>48</sup> Tomoko Otake, *Hometown Donation System Emerges as Effective Way to Help Quake Victims*, JAPAN TIMES (Apr. 21, 2016), <https://www.japantimes.co.jp/news/2016/04/21/national/hometown-donation-system-emerges-effective-way-help-quake-victims/> [perma.cc/M9JS-BTEZ].

<sup>49</sup> *Id.* See *infra* Part III for a discussion of why relief can be more effective when donated to local governments.

<sup>50</sup> Otake, *supra* note 48.

<sup>51</sup> *Furusato nōzei, jishuku keizoku de wareru jichitai* [Municipalities Face Split over Self-Restraint and Perseverance], NIKKEI SHIMBUN (July 4, 2017),

The online portals give donors an efficient way to send money directly to disaster-affected communities and to leave public messages of support.<sup>52</sup> Following the Kumamoto Earthquake, donations to Minamiaso Village in Kumamoto Prefecture were accompanied with messages from the donors encouraging victims to “stay strong” or “take care” amidst the hard circumstances.<sup>53</sup> Many donors also stipulated that their donations be used specifically for the restoration of Kumamoto Castle.<sup>54</sup> The convenience and accessibility of the trusted and accountable Hometown Tax online portals are likely to convince taxpayers at the margin to donate in times of emergency—especially those who want to contribute but are typically deterred from donating, since finding a reliable disaster relief organization can be cumbersome.<sup>55</sup>

Given that Hometown Taxpayers now know they can go straight to the online portals to make tax credit-eligible donations that will reach the disaster-affected communities, the Hometown Tax goes beyond enabling local governments to obtain needed tax revenue and stimulating local businesses with a new source of demand: It provides a convenient mechanism for donations in times of urgency and need. The tendency of donors to look to the Hometown Tax as a mechanism for disaster relief occurred not just in relation to the Kumamoto Earthquake, but also in the wake of the Great East Japan Earthquake in March 2011, after which the severely affected Iwate and Fukushima Prefectures experienced a surge in donations.<sup>56</sup> Japan’s Hometown Tax

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[https://www.nikkei.com/article/DGXLASFS04H64\\_U7A700C1EA2000/\[perma.cc/RD5K-EYM7\]](https://www.nikkei.com/article/DGXLASFS04H64_U7A700C1EA2000/[perma.cc/RD5K-EYM7]).

<sup>52</sup> TAKAMATSU, *supra* note 33, at 140–41.

<sup>53</sup> *Id.*

<sup>54</sup> *Municipalities Face Split over Self-Restraint and Perseverance, supra* note 51.

<sup>55</sup> TAKAMATSU, *supra* note 33, at 141 (noting that donors have said “donating [through the Satofuru site] was easier than I thought” and “I was able to donate in under five minutes”).

<sup>56</sup> Anthony Rausch, *Japan’s Furusato Nozei Tax System*, ELECTRONIC J. CONTEMP. JAPANESE STUD., Apr. 2017, <http://www.japanesestudies.org.uk/ejcs/vol17/iss1/rausch.html> [perma.cc/VZQ4-S9SS ] (explaining that between 2010 and 2011, the



online portal currently includes a “disaster support” section, which lists twelve “recent projects,” consisting of seven earthquake relief projects, four typhoon relief projects, and one project for the Itoigawa Fire, which destroyed 150 buildings in Niigata prefecture in 2016.<sup>57</sup> The Hometown Tax has also spurred municipalities to set aside competition for donation revenue and support each other in times of need by putting disaster relief donation buttons on their own online pages to collect money for affected regions.<sup>58</sup>

### E. Participation in the Hometown Tax

Since its establishment in 2008, the Hometown Tax system has skyrocketed from 30,000 donors in fiscal year 2009, contributing a total of ¥7.3 billion (approx. \$66.3 million), to 7,260,000 donors in fiscal year 2015, contributing a total of ¥165 billion (approx. \$1.5 billion).<sup>59</sup> In fiscal year 2016, contributions rose to ¥284.4 billion (approx. \$2.6 billion).<sup>60</sup> The high participation rate is largely attributable to four factors: (i) publicity that the Hometown Tax system is a “great deal” because it affords taxpayers the ability to obtain Return Gifts at almost no extra cost to them, except for the fixed

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Hometown Tax-generated tax revenue directed to Iwate rose by sixteen times and the number of donations rose by ten times; and further, that the Hometown Tax-generated revenue directed to Fukushima in 2011 was eight times that of 2010, and the number of donations rose by seven times).

<sup>57</sup> Anthony Rausch, *A Paradox of Japanese Taxation: Analyzing the Furusato Nozei Tax System*, ASIA-PACIFIC J., June 2017, at 7, <http://apjff.org/2017/11/Rausch.html> [perma.cc/S4GE-9UDX].

<sup>58</sup> To fundraise for the municipalities affected by the Kumamoto Earthquake, four municipalities from all ends of Japan (in Yamaguchi Prefecture, Shizuoka Prefecture, Kanagawa Prefecture, and Osaka Prefecture) engaged in this support. *Id.*

<sup>59</sup> *Local Govts Battle over ‘Hometown Tax’ Rewards*, DAILY YOMIURI (May 16, 2015), <https://www.questia.com/read/1P3-3685452291/local-govts-battle-over-hometown-tax-rewards> [perma.cc/X38Q-LZ2H] (providing 2009 statistics); see also TAKAMATSU, *supra* note 33, at 11 (providing 2015 statistics).

<sup>60</sup> *Donations Under Hometown Tax Payment Program Hit Record ¥284 Billion in 2016*, *supra* note 32.

¥2000 payment;<sup>61</sup> (ii) the procedure for making donations and applying for Return Gifts became much easier with the online portal sites; (iii) the maximum amount receivable in inhabitant tax credits was increased from ten to twenty percent in 2015; and (iv) local governments have become more aggressive in marketing their Return Gifts.<sup>62</sup>

The resulting surge in Hometown Tax donations has provided depopulated towns with increased revenue and created demand for their local products. For example, between 2014 and 2015, the town of Hirado in Nagasaki Prefecture had the highest earnings from Hometown Tax donations of any local government.<sup>63</sup> Donors to Hirado —36,000 in one year— outnumber residents.<sup>64</sup> As Hirado's population has dropped by half since the 1950s, the Hometown Tax has had a significant impact on its financial viability.<sup>65</sup> The ¥1.46 billion (approx. \$13.2 million) that Hirado received in Hometown Tax donations in fiscal year 2014 amounted to seven percent of its annual budget.<sup>66</sup>

Beyond increasing Hirado's local government revenue, the Hometown Tax has also stimulated Hirado's local businesses. Hirado offers a wide variety of Return Gifts for donors to choose from: shipments of fresh seafood (slipper lobsters, spiral-shelled mollusks, oysters), a monthly vegetable delivery or a wedding photo shoot in Hirado.<sup>67</sup> The donation amounts vary for each Return Gift, but it takes a donation of

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<sup>61</sup> So long as their total donation amounts do not exceed the limit of 20% of their income and inhabitant tax amounts, beyond the fixed required payment of ¥2000, taxpayers can receive each of the Return Gifts they apply for at *no extra cost* because they would have been paying the rest of their donation amounts as taxes to their *own* local governments (receiving no Return Gifts), were they not to donate them to the municipalities through the Hometown Tax system. Soble, *supra* note 38.

<sup>62</sup> TAKAMATSU, *supra* note 33, at 11.

<sup>63</sup> Soble, *supra* note 38.

<sup>64</sup> *Id.*

<sup>65</sup> *See id.*

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

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

only ¥10,000 (approx. \$91) to obtain the luxurious seafood delivery.<sup>68</sup>

The existence of Return Gifts creates demand for local products and has helped the local businesses that produce them. For example, an asparagus farmer in Hirado says he now earns thirty percent of his total income from Return Gift requests, whereas he received no Return Gift-related income before the Hometown Tax was created.<sup>69</sup>

The Hometown Tax system creates a win-win situation for under-funded governments, local businesses, and taxpayers. Under-funded governments gain access to a source of public finance, and the local businesses involved in providing Return Gifts to the taxpayers enjoy new avenues of demand for their products and a wider customer base. Further, taxpayers receive local products—often fresh from the countryside—at almost no extra cost while also feeling good about the fact that they are able to help revitalize the rural economy.

### III. THE NEED FOR A HOMETOWN TAX

#### A. Justifications for a Hometown Tax System

##### 1. Stimulates Local Businesses and Communities

A compelling justification for instituting a Hometown Tax—and what distinguishes it from the already-existing measures for raising local government revenue in municipalities with dwindling populations or low-income levels—is that the system creates a new source of demand for products made by local businesses and enables them to obtain repeat customers who would not otherwise have learned about their products.

When a local government selects a regional or local specialty good to offer as a Return Gift,<sup>70</sup> the government

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<sup>68</sup> *Id.*

<sup>69</sup> *Id.*

<sup>70</sup> For municipalities or regions that are not famous for any local specialty goods, choosing what to offer as Return Gifts may be difficult. Municipalities have addressed this selection task in creative ways. For instance, in 2015, the city of Hashima in Gifu Prefecture tasked a project

must select a local producer to supply the good.<sup>71</sup> Local businesses that are selected often enjoy unprecedented surges in demand and receive orders from customers who have never heard of them before. For instance, when the town of Miyakonojō in Miyazaki Prefecture began offering roast beef supplied by a local meat producer as a Return Gift, the local meat producer increased its sales five-fold.<sup>72</sup> Oftentimes, the increase in demand is long-lasting, creating a new and stable source of buyers for the local suppliers' products.<sup>73</sup> For example, before the town of Ōsaki in Kagoshima Prefecture began participating in the Hometown Tax system, a local grilled-eel business in the town of Ōsaki received fifty percent of its annual eel orders in the days leading up to and immediately following the traditional eel-eating day in July.<sup>74</sup> After Ōsaki began offering grilled eel as a Return Gift for Hometown Tax donors, the local business enjoyed steady demand for grilled eel in the winter for the first time.<sup>75</sup>

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team including twenty female officials in their twenties to select the Return Gifts Hashima should offer to taxpayers living elsewhere who donate to the city under the Hometown Tax system. The Hashima government felt that “the viewpoints of young women would help rediscover local specialties that had faded into obscurity.” *Rural Governments Taking Unique Tacks to Engage Women in Workforce*, JAPAN TIMES (Aug. 24, 2016), <https://web.archive.org/web/20160831025619/http://www.japantimes.co.jp/news/2016/08/24/national/rural-governments-taking-unique-tacks-engage-women-workforce/#.Wb1bb9OGNE4> [perma.cc/44N4-7AT5].

<sup>71</sup> Ideally, the municipality will rely fully on local producers. According to a survey conducted on the Satofuru online portal, 95.7% of respondents answered that they use producers in their townships. However, in some cases, such as when donations exceed the expected amount of donations, and thus the amount of Return Gifts to send exceed the selected producer's production capacity, a municipality may order the good from a supplier in a differing municipality. 20.3% of respondents answered that they would turn to other townships to supplement a deficiency in supplying Return Gifts if doing so was necessary. TAKAMATSU, *supra* note 33, at 42.

<sup>72</sup> *Furusato nōzei, tokusanhin ni aratana kokyaku* [*Furusato nōzei, New Customers for Specialty Goods*], NIKKEI SHIMBUN (Dec. 10, 2016), [http://www.nikkei.com/article/DGXLASDJ01H1L\\_Q6A211C1MM0000/](http://www.nikkei.com/article/DGXLASDJ01H1L_Q6A211C1MM0000/) [perma.cc/5L7R-WWKV].

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

<sup>74</sup> *Id.*

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

The newly increased, stabilized demand for local businesses' products has also led to those businesses being *discovered* by national distributors, who then decide to distribute their goods. National distributors can greatly help local businesses by providing year-long demand, which also helps local businesses that may have an over-supply of products. For instance, the town of Anami in Tokushima Prefecture was not known nationally before the Hometown Tax, but when its farm products became popular as Hometown Tax Return Gifts,<sup>76</sup> national distribution giant AEON took notice and now distributes Anami's products through a subsidiary it created in April 2016 called AEON Tokushima Awa Farms.<sup>77</sup> In times of over-supply, AEON's national distribution helps keep the prices of Anami farms' products from falling.<sup>78</sup> Anami's farms were unlikely to have been discovered by—or considered as suppliers for—AEON were it not for the Hometown Tax, which gave the businesses a new avenue to demonstrate the popularity of their products.

The price municipalities pay local businesses for their production of the Return Gifts is important to consider in examining the advantages that local businesses enjoy as a result of the Hometown Tax. Typically, the local government pays the local business the fair market value of the Return Gifts.<sup>79</sup> But some municipalities (11%) pay less than the fair market value for the specialty goods they buy and send to donors.<sup>80</sup> At first glance, this may seem to refute the argument that the Hometown Tax always stimulates local businesses. However, the approach being taken in this portion of municipalities is in fact often driven by the local businesses. For many small, regional businesses, the Hometown Tax is an optimal advertising opportunity: listing their products on the online portals gives the businesses instant access to potential

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<sup>76</sup> TAKAMATSU, *supra* note 33, at 66.

<sup>77</sup> *Id.*

<sup>78</sup> *Id.*

<sup>79</sup> According to a survey conducted by Satofuru, 82.6% of municipalities pay the fair market value for the specialty goods they buy and send to donors. *Id.* at 43.

<sup>80</sup> *Id.*

donors throughout the country. From the perspective of such businesses, the Hometown Tax is an opportunity to make their products known to many people, as donors may ultimately become customers.<sup>81</sup> As the “audience” browsing the Hometown Tax online portals is already likely to make a donation and order a Return Gift, the Hometown Tax gives businesses prime access to potential customers who are arguably more likely to buy their products through selecting them as gifts for their Hometown Tax donations than are the general audiences that the businesses could reach via television or print advertising.

Hometown Tax donors that like the Return Gift will either become repeat donors, or even direct customers of the local business, independent of the Hometown Tax system. For example, the municipal government of the town of Sakaiminato in Tottori Prefecture used the strategy of paying local businesses less than fair market value for Return Gifts to draw attention to its municipality and maximize the quantity of its donations by giving donors a good deal.<sup>82</sup>

Further, a supplier fishery contractor agreed to forego being fully compensated for the fried crab sent to donors as Return Gifts because it saw the potential for such donors to become repeat customers in the future.<sup>83</sup> Sure enough, many of the donors subsequently placed crab orders directly from the fishery, independent of the Hometown Tax donations, and became repeat customers.<sup>84</sup> Thus, a Hometown Tax is also justifiable on the grounds that it can help local businesses in the long term, providing them with access to repeat customers that they would not otherwise have been able to reach through the advertising efforts typically within their budgets.

Beyond stimulating local businesses, the Hometown Tax system has also invigorated communities and improved the level of municipality-funded public services. Due to the tax revenue that it received through the Hometown Tax

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<sup>81</sup> *Id.* at 155.

<sup>82</sup> *Id.* at 169.

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

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

donations, the town of Miyakonojō has successfully increased the amount of local jobs and “fund[ed] dental checkups, children’s centers and other community programs.”<sup>85</sup>

## 2. Creates a Population Inflow by Attracting New Permanent Residents

The Hometown Tax system also has the long-term aim of raising awareness of rural municipalities to try to entice urban residents to move (back) to them. Return Gifts involving coupons to stay at local hotels or visit local hot springs directly serve this purpose; if a town can get a taxpayer to visit in person, the taxpayer will not only spend money in the town while visiting, but also experience the town’s charm and have the opportunity to envision living there. In a 2016 survey, 70% of donors answered that they would like to visit the town to which they made Hometown Tax donations.<sup>86</sup>

In addition, the stimulation of the local economy itself, created by the demand for Return Gifts, may motivate retired residents to reenter the workforce. For instance, when the town of Anan in Nagano Prefecture began offering twenty-kilogram bags of prized local rice as Return Gifts for tax donations, it received such an enthusiastic response that elderly residents who had given up farming their rice paddies began cultivating them again.<sup>87</sup>

Yet, in the worst case, it is possible that municipalities that do not have desirable local specialty goods to offer as Return Gifts, or are unable to hire an effective marketing staff, will not actually be successful in stimulating local business. In

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<sup>85</sup> Yoshiaki Nohara, *Rural ‘Furusato Nozei’ Beer, Beef Thank-yous Costing Urban Japan Much-Needed Revenues*, JAPAN TIMES (Jan. 13, 2017), <https://www.japantimes.co.jp/news/2017/01/13/national/rural-furusato-nozei-beer-beef-thank-yous-costing-urban-japan-much-needed-revenues/#.WcSawTOZPBI> [perma.cc/JG7W-CVKJ].

<sup>86</sup> Takaaki Yasuda, *Kōka-dai daga jakuniku kyoushoku [The Hometown Tax Is Effective, but Cutthroat]*, MAINICHI SHIMBUN (Sept. 7, 2016), <http://mainichi.jp/articles/20160907/ddm/004/070/002000c> [perma.cc/4BXZ-LST5].

<sup>87</sup> *Japan’s Rural Regions: Hometown Dues*, *supra* note 10.

such cases, the Hometown Tax would not provide financial benefits, and would fail at both (i) raising local government revenue and (ii) stimulating local businesses. Nevertheless, the Hometown Tax may yield non-pecuniary benefits, such as making non-resident taxpayers aware that certain towns even exist. Discussing his town's involvement in the Hometown Tax system, Noriharu Yoshihara, a financial planning official in the town of Higashikawa in the northern island of Hokkaidō, explains, "We did not start this program for financial benefits and are instead focusing on increasing the nonresident population . . . . The system is effective in making people in big cities more interested in the countryside."<sup>88</sup> According to municipality data, the number of visitors to Higashikawa rose to more than one million in the 2013 fiscal year, up 18% from five years earlier.<sup>89</sup> Moreover, the population increased by 3.3% in five years, from approximately 7800 residents to 8092 residents as some visitors moved permanently to the town.<sup>90</sup>

By offering a way to spread awareness of small, rural towns and implanting the prospect of moving to the towns in donors' minds, the Hometown Tax may also provide a way to counteract the population flow from rural to urban areas.

### 3. Donor Satisfaction from Giving

In order to determine whether implementing a system akin to the Japanese Hometown Tax would garner taxpayer participation in the United States, it is helpful to consider whether U.S. taxpayers, on an individual level, would be interested in participating in it.

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<sup>88</sup> *Japan's Ailing Rural Towns Push Free Beer, Other Perks to Urbanites in Tax-sharing Drive*, JAPAN TIMES (Aug. 15, 2014), <http://www.japantimes.co.jp/news/2014/08/15/national/social-issues/japans-ailing-rural-towns-push-free-beer-perks-urbanites-tax-sharing-drive/#.WHkUmjvpVAY> [perma.cc/5C8T-ZY9A].

<sup>89</sup> *Id.*

<sup>90</sup> *Higashikawa-chō no gaiyō* [Overview of Higashikawa Town], HIGASHIKAWA TOWN BOARD OF EDUC., <http://higashikawa-edu.jp/assets/日本一の「子育て・教育の町づくり」.pdf> [perma.cc/WCW6-F7Z2].



Empirical studies have shown that people value control over the use of their taxes.<sup>91</sup> A study in which American taxpayers were allowed to allocate ten percent of their income taxes to any portion of the federal budget shows that permitting taxpayers to allocate their income tax to programs of their choice generates significant increases in taxpayer satisfaction.<sup>92</sup> Moreover, Professors Yair Listokin and David Schizer argue that “warm glow,” which is another “powerful motivation for charitable giving,” could arise for *mandatory* tax payments if the individuals know and choose the municipalities to which they donate.<sup>93</sup> If the knowledge that one gave money to an underpopulated rural municipality generates warm glow, many taxpayers may participate in an American Hometown Tax. Assuming people experience a “warm glow” from supplying public goods as such, and not necessarily public goods for their own use, an American Hometown Tax may yield the further benefit of lowering the number of people that evade taxes.<sup>94</sup>

#### 4. Taxpayer Autonomy

Comprehensive online portals like Satofuru and Furusato Choice allow taxpayers to search and sort the recipient governments to which they want to donate by any or all of the following criteria: (i) the Return Gift the taxpayer will receive; (ii) the geographic location of the recipient government; (iii)

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<sup>91</sup> Yair Listokin & David M. Schizer, *I Like to Pay Taxes: Taxpayer Support for Government Spending and the Efficiency of the Tax System*, 66 TAX L. REV. 179, 184 (2013).

<sup>92</sup> Cait Lamberton, *Your Money, Your Choice*, DEMOCRACY, Spring 2011, at 46, [http://www.democracyjournal.org/20/your-money-your-choice/\[perma.cc/7EGJ-Z3T3\]](http://www.democracyjournal.org/20/your-money-your-choice/[perma.cc/7EGJ-Z3T3]).

<sup>93</sup> “Warm glow” is a type of prosocial behavior in which individuals give to charity—not only because they value a particular public good—but also because they want to be the one *providing* it. Listokin & Schizer, *supra* note 91, at 189–90.

<sup>94</sup> Donors may be happy to be “the source” of the contribution in the sense that it happened because of their choice, regardless of whether they directly reap the public benefit or not. David M. Schizer, *Subsidizing Charitable Contributions: Incentives, Information, and the Private Pursuit of Public Goals*, 62 TAX L. REV. 221, 231 (2009).

the donation amount; and (iv) the specific project or cause for which the donation money will be used.<sup>95</sup> Taxpayers can narrow their searches for recipient governments by filtering for any of the following causes: nature conservation, preservation of cultural traditions, non-profit support, education, regional cultural festivals, tourism, medical care and welfare, agriculture, forestry, fisheries, tourism, landscape, music, international exchanges, and disaster relief.<sup>96</sup> Currently, 1623 local governments (over ninety percent of Hometown Tax-participating governments) afford taxpayers the ability to choose the policies and projects to which to direct their donation money.<sup>97</sup> For example, the town of Tokamachi in Niigata Prefecture allows taxpayers to choose any of the following policies and projects: creating a more elderly-friendly society, boosting efforts to preserve nature, and/or promoting sports and arts-related activities.<sup>98</sup> Once a taxpayer has located a recipient government that meets criteria suitable to him or her, the taxpayer can then order Return Gift(s) by donating the requisite amount of money to the local governments via the online portal.<sup>99</sup>

In an American Hometown Tax system, if municipalities similarly offer taxpayers the autonomy to decide where to allocate a portion of their tax money (via the charitable contribution followed by the tax credit), the Hometown Tax is likely to provide American taxpayers with autonomy in a part of their lives that has until now afforded almost no agency or freedom.<sup>100</sup> Given that many Americans deeply value autonomy, creating an opportunity for choice where it previously did not exist is likely to be attractive to many people.<sup>101</sup>

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<sup>95</sup> *Furusato Choice*, *supra* note 41.

<sup>96</sup> *Id.*

<sup>97</sup> TAKAAKI HŌDA, *FURUSATO NŌZEI NO RIRON TO JISSEN [THE THEORY AND PRACTICE OF FURUSATO NŌZEI]* 63 (2017).

<sup>98</sup> Osaki, *supra* note 37.

<sup>99</sup> *Id.*

<sup>100</sup> Lamberton, *supra* note 92, at 2.

<sup>101</sup> *Id.*

## 5. Efficiency and Administrability

A Hometown Tax can also increase efficiency. The prospect of receiving money from donors forces local governments to evaluate their municipality and region and reflect on what goods may be marketable to people around the country.

A Hometown Tax may also increase efficiency in the administration of tax collection by creating a legal way for taxpayers to divert a portion of their inhabitant tax money to causes that they care about. Giving taxpayers an opportunity to actively choose where their tax money goes gives them a sense of ownership over their tax obligations, which, in turn, is likely to raise the level of taxpaying compliance and lower the amount of tax evasion.<sup>102</sup> According to a study conducted by James Alm, Betty Jackson, and Michael McKee in 1993, “[G]overnment can generate greater compliance by ensuring that individuals feel that they have a say in the manner in which their taxes are spent . . . and that taxes are spent in ways consistent with [their] preferences.”<sup>103</sup> Recent research shows that “taxpayers will even give *voluntarily* to the government if they support the way their money will be used.”<sup>104</sup>

In some cases, however, the Hometown Tax system’s additional costs and uncertainty may not render it more efficient than applying for government grants. Obtaining donations does not come without cost: Many municipalities have created new marketing positions to oversee the municipalities’ participation in the Hometown Tax system.<sup>105</sup>

Further, the Hometown Tax does not guarantee that the Return Gifts a municipality offers will be desirable to taxpayers; given the large number of municipalities offering

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<sup>102</sup> Listokin & Schizer, *supra* note 91, at 183–84.

<sup>103</sup> James Alm, Betty R. Jackson & Michael McKee, *Fiscal Exchange, Collective Decision Institutions, and Tax Compliance*, 22 J. ECON. BEHAV. & ORG. 285, 301–02 (1993).

<sup>104</sup> See Listokin & Schizer, *supra* note 91 (describing the study in Tara Larson Brown et al., *Giving to Government: Voluntary Taxation in the Lab*, 95 J. PUB. ECON. 1190, 1190–91 (2011)).

<sup>105</sup> See TAKAMATSU, *supra* note 33.

many different kinds of goods, even the most popular online portals—like Satofuru and Furusato Choice—can make selecting a Return Gift time-consuming. For example, even if a taxpayer decides they would like to donate to a municipality that will send them a Return Gift of beef, they must still decide which of the 7046 choices of beef to request.<sup>106</sup>

Ultimately, Japan's Hometown Tax offers taxpayers the ability to allocate up to twenty percent of their inhabitant tax bill and is thus an example of an allocation of mandatory payments, as opposed to an allocation of voluntary payments, to uses that the taxpayers support. Giving taxpayers twenty percent of the control over where and how their inhabitant taxes are spent has the potential to “help generate warm glow for the portion they allocate and, possibly, for the rest as well.”<sup>107</sup> In the Hometown Tax context, Professor Shigeki Uno argues that, through the act of making a Hometown Tax donation, a taxpayer not only participates in policy-making that will shape the future of the local area, but also “becomes a part of that place's history and ongoing story.”<sup>108</sup> Research shows that if taxpayers perceive that their preferences are adequately represented and the taxpayers are supplied with public goods, their identification with the state, and thus their willingness to pay taxes, increases.<sup>109</sup>

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<sup>106</sup> The reason the choices available for beef exceed the total number of municipalities participating in the Hometown Tax system is that many municipalities offer multiple types of beef, varying in quality and level of luxuriousness, as well as the part of the cow the meat is from. See *Recommended Special Beef Based on Monetary Amount*, FURUSATO CHOICE BY TRUSTBANK, [https://www.furusato-tax.jp/feature/a/series\\_beaf](https://www.furusato-tax.jp/feature/a/series_beaf) [perma.cc/4RQZ-WVV2].

<sup>107</sup> See Listokin & Schizer, *supra* note 91, at 212–15 (discussing the difference between allocating mandatory vs. voluntary tax payments, and several ways to constrain taxpayer choice—the second under which the Hometown Tax system fits most closely).

<sup>108</sup> Rausch, *supra* note 56 (referencing Interview by NHK with Shigeto Uno, Professor, Univer. of Tokyo (Jan. 26, 2015), <http://www.nhk.or.jp/gendai/articles/3605/1.html> [perma.cc/U46W-SHW5]).

<sup>109</sup> See Listokin & Schizer, *supra* note 91, at 183–86 (discussing three studies analyzing whether people are more likely to pay taxes when taxes are spent in ways consistent with their preferences).

If taxpayers who support the way that their tax dollars are spent are indeed more likely to voluntarily comply with their tax obligations and are less likely to change their behavior to avoid paying taxes, then the Hometown Tax system offers a potential mechanism to deter tax evasion. Lower tax evasion would lower the amount of administrative expenditures on enforcing tax compliance, which could partly offset any increased efforts to administer the Hometown Tax.

## 6. Opportunities for Regional Collaboration

While a Hometown Tax creates fierce competition among municipalities to attract the greatest amount of donations possible, it has also given municipalities the opportunity and incentive to collaborate. When natural disasters occur, unaffected municipalities have successfully used their Hometown Tax donation pages to collect donations to give to the disaster-affected municipalities.<sup>110</sup> Moreover, even without natural disasters as the instigators, the Hometown Tax has spurred regional collaboration among municipalities that want to coordinate marketing efforts to attract donors.<sup>111</sup>

### B. Arguments Against a Hometown Tax

Through its creation of demand for Return Gifts, Japan's Hometown Tax has created an outlet for the products of local businesses and the potential for rural economies to flourish. However, there are reasons to be skeptical of implementing the system as it currently exists, which this Section will address.

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<sup>110</sup> See *supra* Section II.D. (describing how other municipalities and regions collected a huge amount of donations for the towns affected by the Kumamoto Earthquake in April 2016).

<sup>111</sup> 18.8% of responders to the Satofuru survey mentioned in TAKAMATSU answered that they sometimes collaborate in sending Return Gifts with other municipalities to which they have a "connection." TAKAMATSU, *supra* note 33, at 41.

## 1. Inefficiency

### i. Non-Locally Produced Return Gifts and Non-Gifts Produced Locally

A major criticism of Japan's Hometown Tax is that the fierce inter-governmental competition it fosters has caused some municipalities to cheat, thereby undermining the purpose of the system. Municipalities that do not have local specialty goods that they deem desirable enough to attract donors sometimes offer as Return Gifts goods that are not produced by local businesses (or even produced in Japan). Return Gifts of this sort have tended to be expensive, luxury products like Apple's iPad.<sup>112</sup> The problem with such Return Gifts is that they may accomplish the Hometown Tax's first aim to raise government revenue, but they will not accomplish its further aim to stimulate local businesses. A local government that chooses to pay Apple to supply iPads as Return Gifts does not help local businesses. It does not create a source of new demand or give them access to a wider customer base for them.

What a local government ought to do to regulate this issue depends on the precise motivation that policymakers have as their goal. If the goal is (i) to help local governments raise short-term tax revenue, providing iPads as Return Gifts may accomplish this goal and be justifiable. With this goal, some local governments could properly offer non-locally produced iPads as Return Gifts, so long as they received enough donations to at least break even. However, if the goal is (ii) to help local governments raise money while *also* stimulating local businesses, then offering iPads as Return Gifts is *not* justifiable.

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<sup>112</sup> See, e.g., *City Sales Apps*, ODAWARA CITY OFFICIAL WEBSITE, [http://www.city.odawara.kanagawa.jp/field/tax2/furusato/appli/\[perma.cc/46TC-2NKE\]](http://www.city.odawara.kanagawa.jp/field/tax2/furusato/appli/[perma.cc/46TC-2NKE]) (listing the "Strength of Odawara" photo gallery app with photos of Odawara City that "comes along with" one of nine different types of iPads that one can purchase via Hometown Tax donations ranging from ¥130,000 to ¥250,000 (approx. \$1182 to \$2273)).

Another example of Hometown Tax Return Gifts that policymakers should eliminate if they are seeking to accomplish goal (ii) is gift cards that a donor can redeem for cash from third parties online. Offering gift cards as Return Gifts basically invites donors that do not want to make a trip to the region to resell the gift cards online. However, a gift card for a local business should be more justifiable; even if sold online to a non-donor, it would still provide income for the local businesses where it can be redeemed. Depending on the non-donor that buys the gift card, even online resales could conceivably open the door for local businesses to have wider brand recognition and repeat customers.<sup>113</sup>

In 2015, the Japanese government offered guidance on these issues, advising municipalities not to offer Return Gifts that would undermine the aims of the Hometown Tax. The government offered examples of such goods, including: (1) easily exchangeable prepaid (gift) cards; or (2) specialty goods for which the price comprises a high ratio of the donation amount.<sup>114</sup> In the same document, the Japanese government directed municipalities not to reveal to the donor the *percentage* of the required donation amount that the value of a Return Gift comprises (hereinafter, the “Return-Gift-Value-to-Donation Ratio”).<sup>115</sup> It is unclear how strictly these rules are enforced or if there is a penalty for municipalities that do not follow them.

Such government guidance had some influence, but not enough.<sup>116</sup> As of June 2016, seven municipalities cancelled their listings of certain Return Gifts, and thirty-three

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<sup>113</sup> See *Furusato Nōzei, New Customers for Specialty Goods*, *supra* note 72.

<sup>114</sup> See *Henreihin (Tokusanhin) sōfu e no taiō ni tsuite [Regarding Dealing with the Sending of Return Gifts (Specialty Goods)]*, MINISTRY OF INTERNAL AFFAIRS & COMM’NS, [http://www.soumu.go.jp/main\\_content/000351771.pdf](http://www.soumu.go.jp/main_content/000351771.pdf) [perma.cc/QV7V-QX92].

<sup>115</sup> See *id.*

<sup>116</sup> See, e.g., *Furusato nōzei, kifugaku no 4-wari ga henreihin keihi ni [40% of Furusato Nōzei Donation Amounts Used on Return Gift Expenses]*, NIKKEI SHIMBUN (June 18, 2016), [https://www.nikkei.com/article/DGXLASFS17H6H\\_Y6A610C1NN1000/](https://www.nikkei.com/article/DGXLASFS17H6H_Y6A610C1NN1000/) [perma.cc/G9Q2-7VKY].

municipalities altered their Return Gift descriptions to remove mention of the percentage of the donation the value of the Return Gift comprises.<sup>117</sup> Yet, while most of the main online portals—such as Furusato Choice—quickly prohibited local governments from listing iPads and other non-locally produced electronics, other online portals—such as Yahoo Japan or Rakuten—continued to sell them.<sup>118</sup> For example, through at least February 2017, Yahoo Japan and Rakuten sold a “photo gallery app” with pictures of Odawara City that “comes along with” an iPad mini of the Hometown Tax donor’s choice.<sup>119</sup>

On March 31, 2017, the Ministry of Internal Affairs and Communications gave stricter, clearer guidelines: Starting on April 1, 2017, (1) the value of any Return Gift must not exceed thirty percent of the value of the required donation and (2) municipalities should not offer as Return Gifts computers, tablets, consumer electronics, bicycles, jewelry, instruments, or other luxury items.<sup>120</sup> These guidelines seem to have had a

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<sup>117</sup> *Id.*

<sup>118</sup> 2017 *Furusato nōzei de ipadair ya pro taburetto ga moraeru jichitai to kangen-ritsu matome* [Compilation of Local Governments from Which You Can Receive iPad Air or Pro Tablets with Furusato Nōzei 2017], FURUSATO NAVI, <http://minatoku-time.com/furusato-tax-recommend-goods/ipad-yaizu-odawara-city/> [perma.cc/9RY2-PWPZ].

<sup>119</sup> As explained below, as of September 22, 2017, this photo gallery and iPad set are no longer available. The following footnotes include the links to the original listings, last accessed in February 2017. 0187 *iPad mini 4/32GB with GD for City Sales App Use*, Odawara City, Kanagawa Prefecture, Furusato Nōzei Item Details,” YAHOO JAPAN (2017), <http://furusatonozei.yahoo.co.jp/detail/16712>; [*Furusato Nōzei*] *City Sales App ‘Strength of Odawara’ 10-month Use Ticket (comes with iPad mini 4 Wi-Fi 32 GB – Gold)*, Odawara City, Kanagawa Prefecture, RAKUTEN MARKETPLACE (2017), <http://item.rakuten.co.jp/f142069-odawara/6704-30002502/>.

<sup>120</sup> *Furusato nōzei ni kakaru henreihin no sōfu nado ni tsuite*, MINISTRY OF INTERNAL AFFAIRS & COMMC’NS (Apr. 1, 2017), [http://www.soumu.go.jp/main\\_content/000476919.pdf](http://www.soumu.go.jp/main_content/000476919.pdf) [perma.cc/4RSP-QFP4]; *Furusato nōzei henrei, kaden mo jishuku yōsei Sōmushō “jōgen 3-wari” kijun* [Ministry of Affairs Specifies a “30% maximum” for Furusato Nōzei Return Gifts, and Requests No Consumer Electronics], NIKKEI SHIMBUN (Mar. 31, 2017),



greater impact in spurring local governments to comply. Of the two hundred prefectural or municipal governments that have received the highest amount of money from donations, almost ninety percent have stated they intend to alter their practices.<sup>121</sup> The town of Yaizu in Shizuoka Prefecture stated in May that it would eliminate cameras and watches as Return Gifts, and the town of Miyakonojō in Mizayaki Prefecture vowed to decrease its Return-gift-Value-to-Donation Ratio from fifty percent to thirty percent.<sup>122</sup> Further, Ina City in Nagano Prefecture vowed to stop offering televisions as Return Gifts, Yamagata City in Yamagata Prefecture vowed to stop offering furniture and golf putters, and other regions agreed to stop offering air conditioners by the end of September.<sup>123</sup> As of September 22, 2017, Odawara City's photo gallery app and iPad mini set also appears to have been discontinued.<sup>124</sup>

Individual prefectures' announcements of such changes, however, are distorting taxpayer behavior in a peculiar way. For example, since word spread that consumer electronics are likely to disappear as Return Gift options, there has been a surge of housewives in their 50s who made donations to Ibaraki Prefecture in order to receive cordless vacuums while they still yield a high Return-gift-Value-to-Donation Ratio.<sup>125</sup>

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[http://www.nikkei.com/article/DGXLASFS31H4W\\_R30C17A3EA4000/\[perma.cc/U3WG-X7F2\]](http://www.nikkei.com/article/DGXLASFS31H4W_R30C17A3EA4000/[perma.cc/U3WG-X7F2]).

<sup>121</sup> *Donations Under Hometown Tax Payment Program Hit Record ¥284 Billion in 2016*, *supra* note 32.

<sup>122</sup> *Furusato nōzei, jichitai 76% "minaooshi" kōgaku henrei no jishuku yōsei-uke [Municipalities Receive Request to Withhold High Value Return Gifts and 76% of Municipalities Review]*, NIKKEI SHIMBUN (May 8, 2017), [http://www.nikkei.com/article/DGXLASDC02H1P\\_Y7A500C1EA1000/\[perma.cc/Z6D7-9XJ8\]](http://www.nikkei.com/article/DGXLASDC02H1P_Y7A500C1EA1000/[perma.cc/Z6D7-9XJ8]).

<sup>123</sup> *Furusato nōzei, kako saikōno 2844-okuen 16-nendo 72% zō [28.44 Billion Yen, the Highest Amount, 72% Increase in 2016]*, NIKKEI SHIMBUN (July 4, 2017), [https://www.nikkei.com/article/DGXLASFS04H06\\_U7A700C1MM0000/\[perma.cc/EV7V-C688\]](https://www.nikkei.com/article/DGXLASFS04H06_U7A700C1MM0000/[perma.cc/EV7V-C688]).

<sup>124</sup> See *supra* note 119.

<sup>125</sup> See *Henreihin wa kyōdo-ai yori tsuyoshi [Return Gifts Are Stronger than Love for Hometowns]*, NIKKEI SHIMBUN (May 20, 2017), [https://www.nikkei.com/article/DGXMZO16600370Z10C17A5000000/\[perma.cc/M2TJ-R8GJ\]](https://www.nikkei.com/article/DGXMZO16600370Z10C17A5000000/[perma.cc/M2TJ-R8GJ]).

Such surges may strain local governments if they lack sufficient supply to fulfill the orders.

Further, some local governments feel wronged by the government guidelines. A local government from Western Japan claimed that the government regulation of the goods that could be offered as Return Gifts and the imposition of a maximum Return-Gift-Value-to-Donation Ratio had “suddenly kicked away the ladder,” presumably on which that local government could have climbed financially to the top.<sup>126</sup>

## ii. Inefficient Use of Tax Revenue

Given the fierce competition within the Hometown Tax system in Japan, some local governments have begun offering Return Gifts that comprise such a high percentage of the donation that, after incurring the costs of advertising, buying and delivering the Return Gifts, they are left with very little revenue to use for public purposes.

For instance, the town of Kamishihoro on the island of Hokkaidō, which is famous for hot air balloons, offered a hot air balloon ride as a Return Gift for any donor that contributed over ¥500,000 (approx. \$4545).<sup>127</sup> Kamishihoro also offered to give donors hot air balloon rides outside of Hokkaidō for contributions over ¥1,000,000. Giving donors this experience cost the town almost the entire amount of the donations it received, allowing it to retain barely any of the donation as tax revenue.<sup>128</sup> According to a town official, Kamishihoro offered the hot air balloon rides despite their high cost because “it’s important to let people know about Kamishihoro’s culture.”<sup>129</sup> Increasing awareness about Kamishihoro’s culture and enticing donors to visit and have an enjoyable experience in its precincts may lead donors to become future Kamishihoro residents themselves. As such, while it may be inefficient from a short-term revenue-collection standpoint, this practice is

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<sup>126</sup> *Id.*

<sup>127</sup> *‘Hometown Tax’ Gifts Grow More Attractive*, JAPAN TIMES, Sept. 19, 2014, at 3.

<sup>128</sup> *See id.*

<sup>129</sup> *Id.*

justifiable, and even endorsable, if it ends up furthering the long-term aim of attracting future residents or more visitors to the municipality in person. Whether such a strategy would be at odds with the 2017 guidelines on the Return-Gift-Value-to-Donation Ratio cap of thirty percent remains to be seen.

Of course, an inefficient ratio would not be justifiable if it neither (i) stimulates local businesses nor (ii) reinforces the culture or tradition of a municipality to attract visitors and new residents. A Return Gift system that results in a revenue shortfall but offers neither of these benefits would fail to even meet the prior aim of increasing the absolute monetary amount of local government revenue. The 2017 guidelines limiting the Return-Gift-Value-to-Donation Ratio decrease the potential for inefficient use of revenue.

### iii. Inefficient Use of Local Government Workers

A Hometown Tax system is costly, as it requires local government officials to spend a lot of time on advertising the local products to compete with other municipalities for taxpayers' donations. Arguably, the local government workers could better spend their time performing other tasks. In response to this concern, most local governments have been creating new marketing *positions* so that typical government officials do not have to take on the role of marketing Return Gifts to potential donors. If ultimately the Hometown Tax system yields positive net income for the local government, the use of local government workers' time to further the process is actually more efficient than the alternative of having the same government workers spend their time applying for federal funding of town projects.<sup>130</sup>

## 2. Democratic Concerns and Crowdfunding

Hometown Tax donations may also raise democratic concerns. The Hometown Tax system functions because

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<sup>130</sup> See *supra* Section II.B. (discussing how the Hometown Tax has reduced local government reliance on LAT grants).

donors pay tax money to municipalities and/or states in which they do not live. Donors thus cannot vote in local elections to ensure their money is used in ways they support. However, the Hometown Tax system effectively preempted this issue by allowing donors to search for local recipient governments based on the specific causes their donations will fund. In fact, the very act of selecting a cause to support allows taxpayers to vote with their wallet to further a cause they care about.

Local governments are also addressing this issue by taking other affirmative steps to disclose the use of funds, such as crowdfunding specific projects. Rather than waiting for donors to *fortuitously* filter their online searches for the particular causes or products that the local government happens to offer or the geographic area<sup>131</sup> that the municipality happens to be in, some local governments have started donation campaigns for specific projects. These “Government Crowdfunding” municipalities publish the total funding requested and impose a time limit, operating just like common crowdfunding websites in the United States. The Furusato Choice online portal has made this a viable mechanism for raising money and has an entire page devoted to Government Crowdfunding projects.<sup>132</sup> Donations to local government crowdfunding efforts qualify as Hometown Tax donations and are therefore eligible for income tax deductions and inhabitant tax

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<sup>131</sup> Satofuru and Furusato Choice (online portals) allow browsers to search for gifts by the eight greater regions within Japan ((i) the northern island of Hokkaidō; (ii) southern islands of Kyūshū/Okinawa; (iii) southwestern island of Shikoku; and the five regional segments of the main island of Honshū: (iv) the Tōhoku northeast region; (v) the Kantō east region; (vi) the Chūbu middle region; (vii) the Kinki southwestern region; and (viii) the Chūgoku far west region. Each region is comprised of one to nine Prefectures (similar to U.S. state regions, *e.g.* New England)). *Furusato nōzei o chīki kara sagasu* [Search Furusato Nōzei by the Region], SATOFURU, [https://www.satofull.jp/static/municipality\\_list.php](https://www.satofull.jp/static/municipality_list.php) [perma.cc/5DUR-ATCK]; *Furusato nōzei o chīki kara kensaku* [Search Furusato Nōzei Through the Region], FURUSATO CHOICE BY TRUSTBANK, <https://www.furusato-tax.jp/japan.html> [perma.cc/9JL9-62LD].

<sup>132</sup> *Gabamento-Kuraudofandingu to wa? Genzai uketsuke-chū* [What Is Government Crowdfunding? Current Registering Projects], FURUSATO CHOICE BY TRUSTBANK, <https://www.furusato-tax.jp/gcf?1> [perma.cc/5ZKV-W5EV].

credits.<sup>133</sup> Local governments participating in crowdfunding must reveal the exact budget breakdown for the costs that the requested donations will be used to cover in completing the project.<sup>134</sup>

The use of Government Crowdfunding has already demonstrated success. After the January 2017 death of the sole doctor in a hospital near the Fukushima Daiichi Nuclear Plant (where the 2011 nuclear disaster occurred), the Fukushima town of Hirano launched an online crowdfunding campaign to collect donations via the Hometown Tax.<sup>135</sup> With an aim to raise money to cover the costs of enabling a substitute doctor to visit the hospital every day, the town of Hirano set its goal to raise ¥2,500,000 (approx. \$22,727) in nine days.<sup>136</sup> The crowdfunding goal was reached in just one day.<sup>137</sup>

Given that donors receive the opportunity to choose where to donate and what cause or project to support,<sup>138</sup> the more

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<sup>133</sup> *Fukushima Hirano-chō Furusato nōzei de byōin shien inchō shikyo-uke* [Town of Hirano, Fukushima Supports Hospital Through Furusato Nōzei, After Death of Director], NIKKEI SHIMBUN (Jan. 11, 2017), [http://www.nikkei.com/article/DGXLASDG10HC8\\_R10C17A1CR0000/](http://www.nikkei.com/article/DGXLASDG10HC8_R10C17A1CR0000/) [perma.cc/W8CH-2RWN].

<sup>134</sup> See, e.g., *Kodomotachi ni chūsha de wa naku “naoru mirai” o todoketai* [We Want Children to Have a Future of Being Cured, Not Shots], FURUSATO CHOICE BY TRUSTBANK, <https://www.furusato-tax.jp/gcf/77> [perma.cc/QJ5Q-MBS4] (demonstrating Saga Prefecture’s crowdfunding effort to further test a potential cure for Type 1 Diabetes and providing a specific breakdown of how the target maximum donation amount will be spent).

<sup>135</sup> *Town of Hirano, Fukushima Supports Hospital Through Furusato Nōzei, After Death of Director*, *supra* note 133.

<sup>136</sup> *Id.*

<sup>137</sup> *Id.*

<sup>138</sup> It is also noteworthy that not every municipality offers donors the opportunity to select the causes their donations are used towards—in fact, 134 municipalities (7.5%) do not give donors this option. However, given that over 92% of municipalities *do* offer donors the ability to select the causes their donations are used for, if a donor has democratic concerns about the use of their tax money, they should just choose to make a donation to one of the 1,649 municipalities that allows them to choose the cause. Local Tax Bureau, *Furusato nōzei ni kansuru genkyō chōsa kekka* [Results from Survey Regarding Current Conditions of Furusato Nōzei], MINISTRY OF

serious issue is accountability and the ability to determine whether the money that the donor directed to a cause or project was appropriately *used* and whether the cause or project was completed.

Yet, this issue arises in relation to *every* donation anyone makes to any charity. Once a taxpayer donates to a charity, newsletters or other public communications are often the only means of confirming that the money is actually used for the specific cause anticipated by the donor. One solution for greater *ex post* transparency would be to require every local government to maintain an online transparency portal that tracks the progress of donation-funded causes and projects. Portals of this sort already exist: The state of Indiana operates a regularly updated “Transparency Portal” website that allows taxpayers to examine local government budgets and actual spending, as well as revenue and detailed indebtedness information for counties, cities and towns, and other political subdivisions.<sup>139</sup> Assuming such online progress trackers would be accurately updated, they are a solution to democratic concerns about a potential lack of local government accountability to non-resident taxpayers.

### 3. Vertical Equity

A stronger critique of the Hometown Tax is that it skews in favor of the wealthy, which raises the vertical equity concern that those in society with higher income have a greater capacity to benefit from the policy than do others. Because the maximum tax-deductible amount is a fixed percentage of income, higher-income taxpayers have the

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INTERNAL AFFAIRS & COMM’NS 7 (July 4, 2017), [http://www.soumu.go.jp/main\\_content/000493819.pdf](http://www.soumu.go.jp/main_content/000493819.pdf) [perma.cc/8DFB-DTJU].

<sup>139</sup> See *Indiana Transparency Portal*, IND. STATE GOV., <http://www.in.gov/itp/2341.htm> [perma.cc/3DNC-MWPL]; *Indiana Gateway for Government Units*, INFO. FOR IND., <https://gateway.ifionline.org> (last accessed Feb. 10, 2017) (including data viewable by district and provided by the following participating state agencies: Department of Local Government Finance, the State Board of Accounts, and the Indiana Education Employment Relations Board).

ability to receive greater tax credits and higher-value Return Gifts. Unsurprisingly, 70.5% of all Hometown Tax donations in 2014 were made by donors from Tokyo, Osaka, Nagoya, and their respective greater metropolitan areas.<sup>140</sup> However, these metropolises are also the most populated and highest-educated areas in Japan, so one cannot automatically infer that this statistic means the wealthy are benefiting from the system the most. As online portals make the donation process convenient and accessible, and taxpayers at nearly every income level must pay inhabitant taxes, the Hometown Tax does not, on its face, benefit the wealthy more than others. However, the ¥2000 (approx. \$18) payment required for every Hometown Tax donation may render the system less affordable for taxpayers at the margin. This would skew the participation rate towards higher-income taxpayers.

Here, it is helpful to take a step back and recognize that even if the wealthiest are in fact the greatest beneficiaries of the system, the goals the Hometown Tax aims to achieve are not necessarily incompatible with such questionable distribution consequences.

The main goals of implementing a Hometown Tax in the United States would be to give local governments a way to raise revenue and stimulate local businesses. It is true that the wealthy have the capacity to receive greater monetary value in tax credits and Return Gifts. However, because the ordering of Return Gifts is predicated on the taxpayers donating designated monetary amounts required to receive the Return Gifts, any wealthy donor is arguably paying their fair share of donations to the local government, and thereby raising that government's revenue. The source of the

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<sup>140</sup> *Furusato Nōzei, sandai toshiken kara 7-wari 14 nen sōgaku 2.4-bai ni* [70% of the Donations from the Three Great Metropolitan Areas; 2014's Total Donation Amount Rose by 2.4 Times], NIKKEI SHIMBUN (Apr. 9, 2016), [http://www.nikkei.com/article/DGXLASFS08H5O\\_Z00C16A4MM0000/](http://www.nikkei.com/article/DGXLASFS08H5O_Z00C16A4MM0000/) [perma.cc/VDV4-T24L]; See *Heisei 26-nenchū no furusato nōzei (kifu) ni yoru kifu-kin zeigaku kōjo no tekiyō jōkyō ni tsuite* [Donations and Tax Credits in 2014 (Heisei Year 26)], in “Related Documents [to *Furusato Nōzei*]”, MINISTRY OF INTERNAL AFFAIRS & COMM’NS, [http://www.soumu.go.jp/main\\_content/000404762.pdf](http://www.soumu.go.jp/main_content/000404762.pdf) [perma.cc/M3KM-WMPP] (providing statistics on all Prefecture residents’ donation amounts).

donations matters very little to languishing local business owners seeking to increase the demand for their products or residents of a rural municipality hoping for the local public school and nearby local hospital to stay open. Such residents and local business owners, who are the target beneficiaries of the Hometown Tax, are unlikely to be worried about vertical equity. Thus, even if vertical equity proponents are skeptical, the Hometown Tax merely diverts mandatory inhabitant taxes, rather than involving any type of government subsidy greater than that already existing.

Further, taxpayers who obtain Return Gifts through the Hometown Tax do not always keep the gifts for their own use. For example, the staff members of JBC CSR Fund, a scholarship-focused nonprofit organization (“NPO”) in Tokyo contributed ¥12 million (approx. \$109,090) of their tax money to a town in Saga Prefecture in order to obtain Return Gifts of beef.<sup>141</sup> The NPO staff members planned to deliver what amounted to 380 kilograms of beef from Saga to 223 scholarship recipients, many of whom were low-income high school students affected by the Kumamoto Earthquake.<sup>142</sup> Thus, the mere capacity of the wealthiest taxpayers to benefit the most from the Hometown Tax does not necessarily mean that they will reap significantly greater benefits than other taxpayers.

Therefore, although vertical equity concerns may remain, this Note concludes that they do not carry enough weight to tip the scales against the implementation of a Hometown Tax system.

#### 4. Potential Reliance by Businesses

Another concern with instituting a Hometown Tax system may be that, while a Hometown Tax may create a source of

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<sup>141</sup> Shinya Haraguchi, *NPO Members Donate 12 Million Yen in Taxes to Anti-Nuclear City*, ASAHI SHIMBUN (Jan. 8, 2017, 5:40 PM), <http://www.asahi.com/ajw/articles/AJ201701080018.html> [perma.cc/R6LJ-BEPF] (explaining that each of the 223 students would be able to enjoy 1.7 kilograms of beef).

<sup>142</sup> *Id.*



stable demand of Return Gift supply purchases by local governments, local businesses might rely on that demand and complacently stop making efforts to find customers independent of those placing Return Gift orders. Such changes in behavior would hurt local businesses in the long run if the local governments later decide to change Return Gift suppliers or if a radical political shift causes the nation to stop the Hometown Tax system altogether.<sup>143</sup>

However, there so far do not appear to be any instances of businesses that have irrationally stopped their efforts to find independent sources of revenue solely because they were chosen as Return Gift suppliers.<sup>144</sup> For instance, ten percent of the output from livestock raisers in the town of Miyakonojō is now dedicated to use as Hometown Tax Return Gifts; this is a significant amount of their annual revenue, but has not caused them to stop producing the other ninety percent of their output.<sup>145</sup> One concrete solution would be for local governments to select Return Gift suppliers using a fair procedure that gives all local businesses a chance at being selected, such as through requests for proposals (“RFPs”). Using such procedures would create competition among local businesses, which would also help to prevent the businesses and producers selected to be Return Gift suppliers from relying too heavily on government demand for their products.

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<sup>143</sup> It is hard to imagine a political shift drastic enough to halt the entire Hometown Tax system if it were to be implemented and be successful. A better example perhaps more suited to the United States could be a local beef-producing business that relies to a significant extent on its position as a Return Gift supplier for wealthy taxpayer donors, who some years down the road become vegetarians due to the increasing trend in some communities in the United States against consuming red meat.

<sup>144</sup> However, this may also be because articles about this issue have not been published in newspapers, or because the popularity of the Hometown Tax system is a recent phenomenon.

<sup>145</sup> *Furusato Nōzei, New Customers for Specialty Goods*, *supra* note 72.

## 5. Excessive Diversion of Revenue from Urban Governments

Arguably the biggest challenge to the Hometown Tax is that the diversion of tax revenue to local governments is a zero-sum game. Any tax revenue donated to a recipient government necessarily deprives the urban residents' own local governments of that tax revenue. This can harm urban governments if many donors in a particular municipality contribute the maximum amount (twenty percent of inhabitant taxes) to other local governments. In Setagaya Ward in Tokyo, which has nearly 900,000 residents, so many residents made Hometown Tax donations to other local governments that the Setagaya government lost ¥1.65 billion (approx. \$14 million) in tax revenue in 2016.<sup>146</sup> Setagaya could have used that tax revenue to build five nursery schools, especially given that it faces a childcare crisis (with over 1000 children on nursery-school waiting lists).<sup>147</sup> The Hometown Tax system's maximum inhabitant tax revenue diversion threshold of twenty percent technically enables Setagaya residents to deprive their own local government of money it could have used to better the Setagaya community's well-being.<sup>148</sup>

By redistributing tax revenue to other prefectures and municipalities that need the revenue, residents may prevent their own local governments from receiving the revenue they (also) need.

Other municipalities that face this problem have ended up with deficits for their Hometown Taxation budgets. Nagasaki, which has a population of 550,000 people, recorded a deficit of ¥89 million (approx. \$809,090) in its Hometown Tax budget

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<sup>146</sup> Nohara, *supra* note 35.

<sup>147</sup> *Id.*

<sup>148</sup> *Watashitachi no machi Setagaya-ku ni Furusato nōzei*, SETAGAYA CITY GEN. AFFAIRS DEPT. (2017), [http://www.city.setagaya.lg.jp/kurashi/107/158/764/771/d00018317\\_d/fil/furusatonouzeipanfu.pdf](http://www.city.setagaya.lg.jp/kurashi/107/158/764/771/d00018317_d/fil/furusatonouzeipanfu.pdf) [perma.cc/W39G-Q59V].

in 2015.<sup>149</sup> While the city received 1801 donations amounting to ¥72 million (approx. \$654,545), 2692 of Nagasaki's own citizens made Hometown Tax donations to other municipalities, which resulted in a ¥116 million (approx. \$1.05 million) decrease in the city's tax revenues, on top of ¥45 million (approx. \$409,090) of expenditures for Return Gifts and delivery costs.<sup>150</sup> Thus, the Hometown Tax has the potential to hurt, rather than help, municipalities in which Hometown Tax donors are concentrated: A one hundred percent participation rate by a municipality's residents could cause twenty percent of its tax revenue to be diverted elsewhere in the country.

## 6. Disproportionate Donations to Non-Urgent Causes

Implementing a Hometown Tax may also lead to an allocation of donations disproportionate to the urgency of the causes. For instance, if the local government relies on donations from idiosyncratic donors from outside of its region, it could receive a lot of donations designated for "sports," but none designated for the "local hospital." As Hōda suggests, municipalities that are in dire need of funding, that benefit most from Hometown Tax donations, probably have projects in need of financing—such as the maintenance of a municipal sewage system or the repair of a town bridge—that donors would not find interesting.<sup>151</sup> A system that gives taxpayers autonomy at the individual level to determine what causes to support may lead to a disproportionate and societally inefficient allocation of tax money.<sup>152</sup> However, the

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<sup>149</sup> Masato Ishii, *Gifts for Donations: Winners and Losers in "Hometown Tax" Program*, NIPPON (July 15, 2016), <http://www.nippon.com/en/genre/politics/100161/> [perma.cc/R4MP-3PMC].

<sup>150</sup> *Id.*

<sup>151</sup> HŌDA, *supra* note 97 at 76.

<sup>152</sup> See, e.g., Andrew Flowers, *A Checkbox on Your Tax Return Helped Kill Public Campaign Funding*, FIVETHIRTYEIGHT (Apr. 9, 2015), <https://fivethirtyeight.com/features/a-checkbox-on-your-tax-return-helped-kill-public-campaign-funding/> [perma.cc/T2RC-D5GJ] (showing that although individuals are given the option on their tax returns to choose

implementation of a Hometown Tax should not preclude the local government from crowdfunding or applying for federal funding for projects that do not receive sufficient donations.<sup>153</sup>

### 7. Counterargument: Subsidiarity and Financial Independence

While a Hometown Tax system poses the risk of an excessive diversion of tax revenue from highly populated municipalities, it offers two further benefits: increased subsidiarity and financial independence of local governments.

Subsidiarity is “the principle that public goods should be delivered and funded by the lowest feasible level of governance.”<sup>154</sup> Having goods delivered and funded by the lowest feasible level of government allows for greater oversight of public goods provision<sup>155</sup> and enables spending to be tailored to tastes.<sup>156</sup> As the Hometown Tax provides a mechanism for local governments to raise revenue to fund intra-state or local projects on their own, it gives local governments increased autonomy and financial independence. Empowering local governments to fund projects increases subsidiarity, and greater financial

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whether to allocate \$3 of their tax money to public funding for presidential campaigns, participation has declined over the last thirty years and that decline may have contributed to the current lack of public funding for elections; this indicates that allowing the source of funding for certain public causes to be subject to individual tax allocation decision-making can lead to shortfalls).

<sup>153</sup> Takurō Furukawa, *About Furusato Nōzei and Crowdfunding*, 4 INSTITUTE FOR TOKYO MUNICIPAL RESEARCH 22 (2014), <https://www.tama-100.or.jp/cmsfiles/contents/0000000/405/hurusatonouzei.pdf> [perma.cc/7FAF-6QK3] (explaining that in addition to the Hometown Tax, crowdfunding is a further method that municipalities can use to raise money).

<sup>154</sup> Listokin & Schizer, *supra* note 91, at 201.

<sup>155</sup> *Id.* at 201–02 (citing Paul Seabright, *Accountability and Decentralisation in Government: An Incomplete Contracts Model*, 40 EURO. ECON. REV. 61, 62–63, 67–68 (1996)).

<sup>156</sup> *Id.* (citing WALLACE OATES, *FISCAL FEDERALISM* 11–14, 126–28 (1972); Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416, 418–21 (1956)).

independence may protect states and municipalities from being subject to blanket federal government policies that make their constituents worse off.<sup>157</sup>

#### IV. IMPLEMENTING A HOMETOWN TAX IN THE UNITED STATES

The United States should consider instituting some variation of a Hometown Tax to give struggling local governments a method of tax revenue collection that does not involve raising taxes on their constituent taxpayers or relying on federal funding.

U.S. startups have already begun to bring the concept of “crowd-funding” to local government financing. In 2012, Kansas City, Missouri successfully raised over \$400,000 toward establishing a downtown bicycle-sharing program<sup>158</sup> through using a crowdfunding website called *Neighbor.ly*.<sup>159</sup> Denver, Colorado, Philadelphia, Pennsylvania, and Central Falls, Rhode Island have also used crowdfunding to fundraise for public projects.<sup>160</sup> States have even started passing crowdfunding laws for their local businesses (however, such

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<sup>157</sup> Calvert et al., *supra* note 4; *see also* Bakeman, *supra* note 4 (describing how “the federal government took advantage of states’ devastating fiscal circumstances,” that New York’s state financial crisis forced it to participate in and rely on the Race to the Top federal grant program out of “desperation,” and how implementing the program’s education reforms have led to controversy and boycotts).

<sup>158</sup> Charles Chieppo, *Crowdfunding: A New Way to Get Things Done in Government*, GOVERNING (Sept. 6, 2012), <http://www.governing.com/blogs/bfc/col-crowdfunding-kansas-city-google-broadband.html> [perma.cc/8EY9-S2LP].

<sup>159</sup> Neighbor.ly has since abandoned its three-year old crowdfunding approach, and now offers a “community investment program” which allows individuals to buy bonds in city projects. Drew Lindsay, *Local Governments and Nonprofits Test Crowdfunding for Civic Projects*, CHRON. OF PHILANTHROPY (Jan. 7, 2015), <https://www.philanthropy.com/article/Local-Governments-and/152005> [perma.cc/M229-LP6D?type=image].

<sup>160</sup> *Id.*

local businesses use crowdfunding for private projects, not public projects).<sup>161</sup>

There are two important differences between the U.S. crowdfunding efforts and a potential Hometown Tax. First, the existing U.S. crowdfunding efforts are aimed at obtaining donations from donors living *within* the municipalities, whereas the Japanese Hometown Tax focuses on raising revenue for municipalities through donations from *non-resident* donors.

Second, U.S. government crowdfunding efforts may be tax-deductible, but neither result in state or municipal tax credits nor offer Return Gifts, whereas the Japanese Hometown Tax allows participants all three benefits. The fact that the U.S. cities were able to raise money even without offering either of these benefits to donors indicates that a Hometown Tax in the United States has the potential for success.<sup>162</sup>

Would a “transplant” of the Hometown Tax in the United States work?<sup>163</sup> To maximize the potential for success, state and municipal departments of taxation would have to implement tax credits for Hometown Tax donations, and either the Return Gifts that donors receive must be treated as non-taxable gifts, or the current U.S. tax law on charitable and quid pro quo contributions would need to be modified. This Section will explain the legal hurdles facing the implementation of a Hometown Tax transplant: The U.S. law

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<sup>161</sup> Stacy Cowley, *Tired of Waiting for the U.S. to Act, States Pass Crowdfunding Laws and Rules*, N.Y. TIMES (June 3, 2015), <https://www.nytimes.com/2015/06/04/business/smallbusiness/states-pass-crowdfunding-laws-for-small-businesses.html> [perma.cc/HD89-M5HK].

<sup>162</sup> This is not a fully logical inference because the donors to the crowdfunding efforts in these cities were the future beneficiaries of the public good that would be provided if the crowdfunding monetary goal was reached. Therefore, these donors had an interest in donating to the cause. In contrast, taxpayers that will never benefit personally from a local government’s achievement of a crowdfunding goal may not find Return Gifts or tax credits to be ‘worth it’ to divert taxes away from their municipality of residence to a faraway region.

<sup>163</sup> There are reasons to be skeptical about legal transplants. See, e.g., Daniel Berkowitz, Katharina Pistor & Jean-Francois Richard, *The Transplant Effect*, 51 AM. J. COMP. L. 163, 171 (2003).

on charitable contributions and the disruption to the incentive structure that a Return Gift-reliant Hometown Tax would require. It will also discuss the benefits a Return Gift-free Hometown Tax could provide.

## A. Quid Pro Quo Contributions Under U.S. Law

### 1. Charitable Contributions Given with an Expectation of the Receipt of a Benefit

In the United States, under Internal Revenue Code (“IRC”) § 170, individuals can claim as an itemized deduction any charitable contribution payment that is made within the taxable year.<sup>164</sup> A “charitable contribution” is defined as a contribution or gift to or for the use of a list of eligible recipients, which includes the U.S. government, states and any of their political subdivisions, as well as organizations that are organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes.<sup>165</sup>

There are several limits to claiming deductions for charitable contributions: (i) charitable contribution deductions are limited to fifty percent of the taxpayer’s adjusted gross income (“AGI”);<sup>166</sup> (ii) a taxpayer who claims a charitable deduction for any form of contribution in excess of \$250 must be able to substantiate the deduction with a bank record (such as a cancelled check) or a written acknowledgment of the donation by the charity;<sup>167</sup> and (iii) the contribution or gift must be “made for exclusively public

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<sup>164</sup> I.R.C. § 170(a)(1) (2016). § 170 also addresses charitable contributions by corporations, but this Note will focus solely on individual charitable contributions.

<sup>165</sup> Also included are veterans organizations, fraternal lodge organizations (but only if the gift is to be used for charitable purposes), and cemetery companies. I.R.C. § 170(c) (2016).

<sup>166</sup> Charitable deductions are capped at thirty percent of a donor’s income when made to organizations that do not fall into the prior categories. See I.R.C. § 170(b)(i) (2017).

<sup>167</sup> *Written Record of Charitable Contribution*, INTERNAL REVENUE SERV. (last updated Oct. 28, 2016), <https://www.irs.gov/charities-non-profits/contributors/written-record-of-charitable-contribution> [perma.cc/Y636-JG39].

purposes.”<sup>168</sup> Courts have interpreted the requirement that the contribution or gift be made *exclusively* for public purposes to mean a deduction is not allowed where a taxpayer intends to obtain a direct or indirect benefit from the charitable contribution.<sup>169</sup>

Under *Singer Co. v. United States*, the receipt or expected receipt of a *substantial* benefit in return for a charitable contribution precludes a § 170 tax deduction.<sup>170</sup> In that case, Singer sold discounted sewing machines to charities and schools for the predominant purpose of increasing future sales.<sup>171</sup> Since Singer expected to receive a *substantial* benefit from the school discounts in the future, the court rejected Singer’s tax deduction for them.<sup>172</sup> On the other hand, Singer was allowed to deduct the discounts it gave to charities.<sup>173</sup> Under *Singer*, a charitable contribution made with the expectation of a *substantial* benefit disqualifies a taxpayer from obtaining a charitable deduction, but an *incidental* benefit does not.<sup>174</sup>

In *Ottawa Silica Co. v. United States*, the Federal Circuit held that a contribution made to a charity is not made for exclusively public purposes if the donor receives, or anticipates or expects the receipt of, a substantial benefit in return.<sup>175</sup> Ottawa Silica donated land to a local school board with the knowledge and expectation that the donation would result in roads being built that would increase public access

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<sup>168</sup> I.R.C. § 170(c)(1) (2016).

<sup>169</sup> STEPHANIE B. CASTEEL, *Charitable Planning Potpourri: Advanced Use of Basic Techniques*, ALI CLE ESTATE PLAN. COURSE MATERIALS J., Apr. 2014, at 5.

<sup>170</sup> *Singer Co. v. United States*, 449 F.2d 413, 424 (Ct. Cl. 1971); I.R.C. § 170 (2016).

<sup>171</sup> *Singer*, 449 F.2d at 423–24. The court reasoned that Singer’s purpose in discounting sewing machine sales to schools was to encourage the students to use the sewing machines so they were therefore more likely to purchase Singer Co. sewing machines in the future. *Id.*

<sup>172</sup> *Id.*

<sup>173</sup> *Id.* at 424.

<sup>174</sup> *Id.*

<sup>175</sup> *Ottawa Silica Co. v. United States*, 699 F.2d 1124, 1131 (Fed. Cir. 1983).



to separate land the company owned.<sup>176</sup> The court concluded that the expected receipt of benefits “at least partially” prompted Ottawa Silica to make a donation,<sup>177</sup> thereby precluding the possibility that the donation was made *exclusively* for “public purposes.”<sup>178</sup> Accordingly, the court denied a tax deduction for the value of the donated land.<sup>179</sup>

More recently, in *DuVal v. Commissioner*, the Tax Court held that whether a transfer is a charitable contribution for purposes of § 170(c) hinges on what the court determines to be the taxpayer’s “primary or dominant intent or purpose in making the transfer.”<sup>180</sup> In sum, for a charitable contribution to fully qualify for a tax deduction, “the donor may not expect a direct or indirect benefit from the donation.”<sup>181</sup>

## 2. Quid Pro Quo Contributions

Quid pro quo charitable contributions are payments a donor makes to a charity *both* (i) as a contribution and (ii) to receive goods or services in return. In the United States, only the portion of the payment’s value that is an *unreciprocated* charitable contribution—the total donation minus the value of good or service the donor has received as a quid pro quo for the contribution—is tax deductible. In 1993, Congress enacted § 6115 of the IRC, which provides that payments made partly as a contribution and partly as consideration for goods or services provided to the donor by the recipient organization are “quid pro quo contributions.”<sup>182</sup> Section 6115 requires that for any quid pro quo contribution over \$75, the recipient organization must provide the donor with a written statement that informs the donor that the contribution’s deductibility is limited to: the amount of the contribution *minus* the value of

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<sup>176</sup> *Id.* at 1135.

<sup>177</sup> *Id.*

<sup>178</sup> *Id.* at 1131.

<sup>179</sup> *Id.* at 1140.

<sup>180</sup> *DuVal v. Commissioner*, 68 T.C.M. (CCH) 1375 (1994).

<sup>181</sup> CASTEEL, *supra* note 169, at 6.

<sup>182</sup> I.R.C. § 6115(b) (2016).

the goods or services provided by the recipient organization.<sup>183</sup> Further, the statement must provide the donor with a good faith estimate of the value of such goods and services.<sup>184</sup>

Quid pro quo contributions work as follows: If a donor gives Carnegie Hall \$100 and receives a concert ticket valued at \$40, the charitable contribution portion of the payment is \$60.<sup>185</sup> Even though the portion of the contribution available for the deduction is \$60 and therefore does not exceed \$75, the donor must file a disclosure statement because the quid pro contribution, \$100, exceeds \$75.<sup>186</sup>

There are two notable exceptions to the disclosure statement submission requirement that reduce reporting requirements for both charities and taxpayers: (i) the insubstantial benefit exception and (ii) the intangible benefit exception.

Under the insubstantial benefit exception, a donor can deduct the entire value of a quid pro quo contribution, provided that (a) the total cost of all gift items received by the donor does not exceed \$10.50; (b) the donor makes a contribution of \$52.50 or more and the benefit received is a low-cost item under \$10.50; or (c) the fair market value of all the gifts received by the donor in connection with the contribution do not exceed \$105 or two percent, whichever is less.<sup>187</sup>

Under the intangible benefit exception, a disclosure statement is not needed when a “quid pro quo” donor receives only an intangible religious benefit in return.<sup>188</sup> The IRS specifies that to be tax-deductible, the intangible religious benefit the donor receives must be provided to the donor by an

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<sup>183</sup> I.R.C. § 6115(a) (2016) (“the excess of the amount of any money and the value of any property other than money contributed by the donor over the value of the goods or services provided by the organization”).

<sup>184</sup> *Id.*

<sup>185</sup> *Substantiating Charitable Contributions*, INTERNAL REVENUE SERV. (Oct. 31, 2016), <https://www.irs.gov/charities-non-profits/substantiating-charitable-contributions> [perma.cc/6FR6-GW4N].

<sup>186</sup> *Id.*

<sup>187</sup> Rev. Proc. 2014–61, 2014–47 I.R.B. 860, 867 (2014).

<sup>188</sup> *Substantiating Charitable Contributions*, *supra* note 185.

organization organized exclusively for religious practices and the benefit must be of a type generally not sold in a commercial transaction outside the donative context.<sup>189</sup> Although it is not enumerated in the IRS guidelines, the intangible benefit exception also applies to nonreligious intangible benefits, referred to as “psychic benefits.” For instance, if an individual contributes money to a university in return for the university’s agreement to name a building after the individual, the contribution is fully deductible, despite the obvious psychic benefit of having one’s name on a building.<sup>190</sup>

The U.S. system makes sense from a theoretical perspective as an attempt to encourage and reward only the portion of a quid pro quo contribution made with “purely” charitable intent.

#### B. Divergence Between Japanese and U.S. Treatment of Return Gifts and Harmonizing a Hometown Tax with U.S. Law

Unlike the U.S. legal treatment of quid pro quo contributions for which a donor would not be able to deduct the value of a typical Return Gift, Japan’s National Tax Agency allows taxpayers to receive income tax deductions on the full amount<sup>191</sup> of their donations to state and local governments, even though most are quid pro quo contributions. This reveals a legal divergence between Japanese and U.S. law.<sup>192</sup> Unlike the U.S. requirement that, in order to be tax deductible, a charitable contribution must be made “exclusively” for public purposes, Hometown Tax Return Gifts do not lessen the deductibility of the donations.<sup>193</sup> In allowing the full income-tax deduction for the

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<sup>189</sup> *Id.*

<sup>190</sup> JOSEPH BANKMAN, DAVID N. SHAVIRO & KIRK J. STARK, FEDERAL INCOME TAXATION 365 (16th ed. 2012).

<sup>191</sup> Excluding the ¥2000 (approx. \$18) required payment.

<sup>192</sup> There are sure to be further hurdles (especially politically) to implementing a Hometown Tax system in the United States, but due to the scope of this project, this Note will cover only some of them.

<sup>193</sup> Niitsu, *supra* note 16.

donation, the Japanese Hometown Tax is, in effect, a fully tax-deductible quid pro quo donation system. Further, given that the Japanese Hometown Tax involves an *additional* inhabitant tax credit, the Japanese system allows donors to *divert* their donation amounts (except for the required ¥2000 payment) to the government(s) of their choice.<sup>194</sup>

### 1. Set a Maximum Return-Gift-Value-to-Donation Ratio

One way to implement a Hometown Tax system involving Return Gifts with the U.S. legal treatment of charitable contributions would be to set a percentage cap on the Return-Gift-Value-to-Donation Ratio. The United States could invoke the *DuVal* test for examining whether a donation qualifies for a charitable deduction—that a deduction is warranted if in making the donation, *charity* is the donor’s “primary or dominant intent or purpose.”<sup>195</sup> Policymakers could decide that, so long as the value of a given Return Gift does not exceed the designated Return-Gift-Value-to-Donation Ratio, even if a taxpayer expects a *substantial* benefit (the Return Gift) from the donation, the donation will still have been made for a primarily or dominantly *charitable* “intent or purpose.”<sup>196</sup>

For instance, the maximum Return-Gift-Value-to-Donation Ratio could be set to thirty percent.<sup>197</sup> Any donation made to receive a Return Gift valued at over thirty percent of the donation amount would result in quid pro quo tax treatment, meaning that the taxpayer would be unable to receive an income tax deduction for the full donation amount.<sup>198</sup> Any donation made to receive a Return Gift valued

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<sup>194</sup> See *supra* Section II.B.

<sup>195</sup> *DuVal v. Commissioner*, 68 T.C.M. (CCH) 1375, 1379 (1994).

<sup>196</sup> As discussed above, the reality is that in Japan the Return Gifts are the primary reason taxpayers make Hometown Tax donations.

<sup>197</sup> In March 2017, the Japanese government stipulated that a thirty percent cap threshold should be used for setting donation amounts required for Return Gifts. See *supra* Section III.B.1.a.

<sup>198</sup> This idea is basically giving a “cutoff” amount for the donations to be treated as *quid pro quo* contributions.

at less than thirty percent of the donation amount would be fully eligible for an income tax deduction (and state and municipal tax credit, if implemented).

## 2. Administrability

The next concern with implementing a Hometown Tax system in the United States is that requiring donors to submit an additional tax verification form seems cumbersome, for both donors and tax officials. It may seem questionable that individuals would even be willing or able to understand more paperwork than is already necessary to submit a tax return.

Admittedly, leaving the allocation of tax revenue to local governments in need to a federal governmental agency would avoid the potential administrative difficulty both taxpayers and government officials would face in dealing with donation-verification forms from local governments. Yet, the Internal Revenue Service already has a system in place for processing such verifications. § 6115 of the IRC requires a written statement from charitable organizations to which donations of over \$75 have been made.<sup>199</sup> Thus, Hometown Tax donations would not require any extra “steps” beyond those already in place for typical charitable donations. One important caveat for the existing U.S. donation process is that, unlike typical charitable contributions, Hometown Tax donations would need to be available for taxpayers who claim the standard deduction. Confining Hometown Tax donations only to those that use itemized deductions is likely to deter people at the margin from donating.

Additional strategies may maximize participation and minimize administrative costs. Japan recently passed the “One Stop Exception,” a new regulation under which taxpayers that donate to up to five local governments can do so without submitting any extra tax paperwork.<sup>200</sup> Further,

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<sup>199</sup> I.R.C. § 6115 (2016); INTERNAL REVENUE SERV., UPDATES ON DISCLOSURE AND SUBSTANTIATION RULES 67 (1997), <https://www.irs.gov/pub/irs-tege/eotopicg97.pdf> [perma.cc/5382-DSAK].

<sup>200</sup> The “One Stop Exception” has been cited widely as a significant factor that led to the surge in Hometown Tax donations in 2015. *Furusato*

as the success of the Japanese Hometown Tax demonstrates, an online website with easy-to-follow instructions can make charitable contributions to local governments a commonplace activity for individuals and households.

Even if the implementation of an American Hometown Tax were to end up adding an additional “step” to the tax filing process, the competing considerations of increasing local government revenue, revitalizing local businesses, and allowing states and local governments to obtain further financial independence from the federal government should outweigh any slight increase in the effort required for its administration.

### 3. Cultural Differences

Skepticism may arise about instituting a system that relies heavily on the sending of Return Gifts in the United States, which some argue has less of a gift-giving culture than does Japan. The success of the Japanese Hometown Tax may be attributable in part to a cultural appreciation for craftsmanship or locally made gifts. Moreover, even if donations, including the value of Return Gifts, were fully tax-deductible, an American Hometown Tax system simply may not “catch on” in society. However, empirical studies show American people value control over the use of their taxes,<sup>201</sup> and that the autonomy provided by the ability to choose how twenty percent of one’s local and state taxes are spent may be enough to garner participants.<sup>202</sup> Thus, the added autonomy

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*nōzeigaku 1.6-bai ni 16-nendo, Kanbō Chōkan ga mitōshi* [Cabinet Secretary Forecasts, the 2016 Furusato Nōzei Monetary Amount Will Be 1.6 Times], NIKKEI SHIMBUN (Nov. 18, 2016), [http://www.nikkei.com/article/DGXLASF518H6B\\_Y6A111C1000000/](http://www.nikkei.com/article/DGXLASF518H6B_Y6A111C1000000/) [perma.cc/R4ME-E5JR].

<sup>201</sup> A study in which American taxpayers were allowed to allocate ten percent of their income taxes to any portion of the federal budget shows that permitting taxpayers to allocate their income tax to programs of their choice generates significant increases in taxpayer satisfaction. Lambertson, *supra* note 92.

<sup>202</sup> Listokin & Schizer, *supra* note 91.

created by an American Hometown Tax could be popular among taxpayers even *without* any Return Gifts.

#### 4. Benefits of an American Hometown Tax Even Without Return Gifts

Even if it is impractical to modify the U.S. treatment of quid pro quo contributions to attract taxpayers to participate in the Hometown Tax with Return Gifts, the United States would still benefit from reliable, central online portals that transfer donations to local governments.

Political issues can lead to increases in donations independent of changes in Return Gifts. Following the Trump administration's executive order on immigration in 2017, for example, the American Civil Liberties Union raised seven times the amount it raised in prior-year online donations over one weekend.<sup>203</sup> Not only charitable organizations, but also local governments could benefit from donor behavior spurred by political issues. For instance, Japanese citizens opposing the relocation within and construction of additional U.S. military bases in Okinawa have significantly increased their donations to Nago City, Okinawa.<sup>204</sup> Donors have attached messages of support for the city's opposition to the U.S. military bases to their donations, such as "I support Mayor Susumu Inamine, who opposed relocation of an American military base" indicating their decisions to donate to Nago City were influenced by their political views, not solely by Nago City's Return Gifts.<sup>205</sup> Another indicator that many of the donations are politically-influenced is that some donors

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<sup>203</sup> Liam Stack, *Donations to the A.C.L.U. and Other Organizations Surge After Trump's Order*, N.Y. TIMES (Jan. 30, 2017), <https://www.nytimes.com/2017/01/30/us/aclu-fund-raising-trump-travel-ban.html> [perma.cc/49Y6-THSH].

<sup>204</sup> In 2015, Hometown Tax donations to Nago City amounted to ¥257.78 million (approx. \$2.3 million) altogether from 1188 taxpayers, which was twelve times the total amount in 2014. *Fiscal Year 2015 Furusato Taxes to Nago Reach 44,000,000 Yen Opposing Henoko Relocation*, RYUKYU SHIMPO (Mar. 10, 2016), <http://english.ryukyushimpo.jp/2016/03/20/24686/> [perma.cc/CL9T-BZUG].

<sup>205</sup> *Id.*

gave as little as ¥300 (approx. \$2.72), which does not qualify for Return Gifts.<sup>206</sup> Nominal donations are evidence that the donations were not Return Gift-driven.

Further, in times of emergency, donors at the margin are more likely to give if they have a trustworthy go-to portal through which to donate.<sup>207</sup> If, upon hearing about forest fires in a particular region, U.S. taxpayers knew exactly where to make online donations directly to the affected local government(s) (that are eligible for both income tax deductions and state and municipal tax credits), local government(s) in need would likely receive a larger quantity of donations from a wider geographic area than they currently receive.

## V. CONCLUSION

The Japanese Hometown Tax's success in enabling many local governments to increase their tax revenue and revitalizing rural economies makes it worthy of attention in the United States. Transplanting the Hometown Tax exactly as it is in Japan is impractical without modifying U.S. quid pro quo contribution law and implementing state and municipal tax credits. Nonetheless, given the many rural economies in need of revitalization, the United States would do well to consider adopting some variation of a Hometown Tax to improve the plight of such municipalities. Every stagnating municipality deserves the opportunity to access new sources of revenue and avenues of demand for the products made by its local businesses. An American Hometown Tax, with or without Return Gifts, could provide a method to counteract the typical population outflow from rural to urban areas, at least in some regions. Further, amidst a politically tumultuous time when many states and *urban*

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<sup>206</sup> *Nago-shi, Furusato Nōzei 12-bai han kichi shien, ken 4400-man'en* [*Nago City, Furusato Nōzei 12 times, Supporting Military Base Opposition, 44 million yen to the Prefecture*], RYUKYU SHIMPO (Mar. 10, 2016), <https://ryukyushimpo.jp/news/entry-236017.html> [perma.cc/7CJ3-G2NA].

<sup>207</sup> Regarding donations in times of emergency, see *supra* Section II.D (describing donors' generous donations after the Kumamoto Earthquake, regardless of municipalities offering no Return Gifts).



areas have views that are at odds with those of the individuals in charge of their federal funding, an American Hometown Tax may also lead to greater subsidiarity and financial independence, ultimately allowing greater autonomy for both the political subdivisions and individuals nationwide.