Announcement

The Tax Issue Committee,
Japanese Association for Business Recovery
July 25, 2008

Announcement of Requests for 2009 Tax Reform Concerning Business Recovery

The Tax Issue Committee of the Japanese Association for Business Recovery has summarized requests for 2009 tax reform to help bring about a swift and sustainable business recovery in Japan.

For a long time, we have requested "tax deferment of income arising from debt exemption" for enterprises under reorganization. Major tax reform implemented in fiscal 2005 substantially dealt with this issue by clarifying the treatment of certain valuation losses or losses carried over. However, requests have been made regarding aspects that have still not been remedied or points to which the revised law cannot be easily applied. The main points of the requests for revisions include:

1. More flexible tax treatment of debtors
2. Practical treatment of bad-debt loss in bankruptcy and related issues
3. Clarification of the tax system for funds and investors

The Tax Issue Committee, a panel of professional business people and academics concerned with finding business recovery solutions, seeks early implementation of these and other requested revisions, which have been compiled based on the results of a recent questionnaire survey of JABR members.

Inquires should be made to:

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Requested Matters	Rev. of law	Rev. of Circu-lar
I. For debtors		
1. Flexible treatment of Reasonable Debt Treatment Plan	*	
2. Expansion of assets under CTL Article 33	*	*
3. Clarification of credit evaluation in DES arrangement		*
4. Disguised accounting 1 – Clarification of pertinent requirements in disguised accounting	*	
Disguised accounting 2 – Switch from a tax credit system to a refund system	*	
Disguised accounting 3 – Extension of correction period in disguised accounting	*	
5. Tax deferment of income arising from debt exemption	*	
6. Expansion of application of overdue losses	*	
II. For creditors		
7. Approval of bad-debt loss by fair appraisal	*	*
8.Clarification of requirements for bad debt in a private arrangement	*	*
9. Statute of limitation and requirements for bad-debt loss	*	*
10.Calculation method for collectible amounts under a personal guarantee	*	*
11. Timing and method for bad-debt loss in bankruptcy	*	*
12. Increase in the transfer ratio for bad-debt allowance under formal standard	*	
III. For funds and investors		
13. Clarification of treatment of collected receivables bought at discount		*
14. Income tax on gains under DES arrangement	*	
15. Lower taxation standards for corporate per capita residential tax	*	
16. Permanent arrangements for special-treatment measures in scale-of-capital tax standards for the Factor Based Tax	*	

See details for the above in a separate document, "Requests for 2009 Tax Reform Concerning Business Recovery".

Requests for 2009 Tax Reform Concerning Business Recovery (Summary)

I. For Debtors

1. Flexible treatment of Reasonable Debt Treatment Plan (Revision of law)

1) Flexibility of the existing requirements
The Reasonable Debt Treatment Plan (RDTP) stipulated in Article 24-2, Para. 1, of the Government Order (GO) under the Corporate Tax Law (CTL) permits the application of Para. 3 of CTL Article 33 (valuation losses) to non-legal proceedings or to a private arrangement. The application of overdue losses before valid "blue losses" also requires the same conditions for DTP, according to CTL Article 59, Para. 2, Item (3). However, it is difficult to satisfy the requirements of RDTP stipulated in Article 24-2, Para. 1, of GO under CTL because small- and medium-sized enterprises often use only one financial institution, or it is impossible for more than two specialists to be involved in their business reorganization.

The above requirements have become increasingly important, as they are also the requirements to relax application of usage restrictions on losses carried over in business reorganization. We therefore request flexible requirements for RDTP in order to apply them to the reorganization of small- and medium-sized enterprises.

Specifically, we request a change in the number of disinterested specialists involved with business reorganization (Article 8-5 of Enforcement Regulations of CTL) from three or more to two or more in order to satisfy the debt-exemption requirements of a number of financial institutions (Article 24-2, Para. 1, Item (4) of GO under CTL) and thus facilitate the reorganization of small- and medium-sized companies.

2) Addition of new requirements
We seek to add cases where 90% or more of the capital construction is replaced in a "buyout type" or "sponsor type" as a new requirement of Article 24-2 of Enforcement Regulations of CTL to diversify business reorganization.

2. Expansion of assets under CTL Article 33 (Revision of law and revision of Circular)

1) Addition of monetary claims
CTL Article 33, Para. 2, permits deduction of asset valuation losses from income where the reorganization plan is approved in accordance with the Company Reorganization Law or the law on special exemptions etc.,concerning reorganization proceedings for financial institutions (hereinafter referred to as the "Company Reorganization Law), and where it is necessary to carry out revaluation under these laws, or where other certain conditions apply. However, loan receivables, trade-account and other receivables are excluded from assets with accountable revaluation losses, as they are collectively categorized as "deposits and the like" in CTL. It is therefore requested that monetary claims such as trade-account and loan receivables, security deposits/caution money etc. be added to eligible assets for the purpose of revaluation losses.
2) Addition of small assets
We request that the application of CTL Article 24-2, Para. 4, Item (5), which is the provision defining "small assets," become an option for an entity where CTL Article 33, Para.3, for the calculation of valuation losses is applied.

3. Clarification of credit evaluation in DES arrangement (Revision of Circular)

We request clarification of the evaluation method for credits in a debt equity swap (DES) permitted for taxation purposes in the calculation of increased capital and the like for debtors in DES.

4-1. Disguised accounting 1 – Clarification of pertinent requirements in disguised accounting (Revision of law)

Under current law, once they are unrecognized, bad-debt loss and provisions for doubtful accounts that should have been deducted based on generally accepted accounting principles are not taken back retroactively as deductible expenses for the accrual period. However, to the extent that the management who participated in a window-dressing settlement takes responsibility in a subsequent business year and makes a concrete restatement or amendments for past accounts, we request clarification under tax law that unrecognized bad-debt loss and provisions for doubtful accounts be considered "misrepresentation by disguising a fact," as stated in CTL Article 70.

4-2 Disguised accounting 2 – Switch from a tax credit system to a refund system (Revision of law)

We request that the tax credit system currently in force be changed to a refund system concerning the corporation tax for overstatements based on disguised accounting.

4-3 Disguised accounting 3 – Extension of correction period in disguised accounting (Revision of law)

We request that the period of correction determined by the Director of the Tax Office be extended from the current five years to seven years in cases of overstatements based on disguised accounting.

5. Tax deferment of income arising from debt exemption (Revision of law)

Following the introduction of amendments to the tax system in fiscal 2005, prescriptions concerning taxation on income arising from debt exemption have been made in that 1) valuation losses of assets are also counted as deductible expenses in cases based on a civil rehabilitation plan and any other rehabilitation plan (RDTP) corresponding to this, and that 2) the so-called preferred usage of overdue losses are permitted in certain cases. However, in cases of civil rehabilitation and RDTP, the calculation of profit on valuation has to be made in a set. Additionally, there is an inherent negative risk in the tax office's calculation of profit on valuation.

It is considered difficult for creditors to relinquish credit at the level where debtors incur tax on income arising from debt exemption. The relinquishment ratio therefore is inversely calculated to the level at which tax on income arising from debt exemption is not incurred. As a result, it is necessary to have the total amount of debt correspond to assets with latent losses. In some cases, therefore, drastic credit relinquishment cannot be made, or only incomplete support is given or repayment installments are made for a long time.
The fundamental problem in this issue lies in that tax on income arising from debt exemption is temporarily incurred by debtors having no tax-bearing capacity.

Accordingly, we request measures for deferring substantial tax on income arising from debt exemption for a certain period (approximately three years), depending on the accounting of a corporation, where certain reasonability is recognized in the creation and agreement process of a rehabilitation plan (company reorganization law, civil rehabilitation law, Article 24-2, Para. 1, of GO under CTL (fact corresponding to a decision to authorize a rehabilitation plan), Article 117 of GO under CTL, CT Basic Circular No.12-3-1 (facts corresponding to a decision to commence rehabilitation proceedings))

6. Expansion of application of overdue losses (Revision of law)

Where an entity owns real estate with latent assets but overdue losses comprise the majority of the total losses, a large profit on asset sales arising from the sale of such real estate comprises taxable income and thus incurs a heavy corporation tax. We therefore request that profits on asset sales carried out in accordance with a rehabilitation plan be counted as overdue losses -- as if it were income arising from debt exemption, where "there is no arbitrariness in the decision" of the rehabilitation plan such as under the company reorganization law, civil rehabilitation law, Article 24-2, Para. 1 of GO under CTL (corresponding to the authorization of a rehabilitation plan), Article 117 of GO under CTL, and CT Basic Circular No.12-3-1 (corresponding to the decision to commence rehabilitation proceedings) "as it is decided in negotiation by a number of creditors and to the extent that its contents are deemed to have reasonability."

II. For creditors

7. Approval of bad-debt loss by fair appraisal (Revision of law and revision of Circular)

Even where fairness in the appraisal of underlying collateral etc. is deemed to be maintainable, bad debt can be recognized only after the underlying collateral etc. is disposed of under current rules. We request revision as this treatment is not realistic.

8. Clarification of requirements for bad debt in a private arrangement (Revision of law and revision of Circular)

Either of the following two requirements must be satisfied before bad-debt loss of credit or the transfer of provisions for doubtful accounts can be recognized in a private arrangement under CTL:

1) Liability arrangement under reasonable standards
2) Creditors' meetings and negotiations between concerned parties through an arrangement by an administrative body, financial institution or other third party.

We request clarification that other third parties may include not only business partners, financial institutions etc. but also professional specialists (lawyers etc.) who are selected by them or in an independent position.

9. Statute of limitation and requirements for bad-debt loss (Revision of law and revision of Circular)

1) There are cases where bad-debt loss is not deductible -- even where credit collection becomes impossible due to the establishment of extinctive prescription -- because of the

lack of provisions for treating such credits. 2) We request clarification in CT Basic Circular and Enforcement Regulations of Consumption Tax Law that such cases may justify bad-debt loss with respect to general credits, excluding the small lot credits mentioned below, on condition that appropriate credit management is carried out, where a debtor's claim for prescription and extinctive prescription is therefore established. Considering that the emergence of Internet business etc. creates a huge number of small lot transactions together with fractional receivables on the books of general business people, we request that the establishment of extinctive prescription be appropriately included in bad-debt loss under CTL. In view of the actual state that debtors rarely claim for prescription, we request revision of the CT Basic Circular and Enforcement Regulations of Consumption Tax Law to permit these fractional receivables as bad-debt loss where a period of prescription has expired.

10. Calculation method for collectible amounts under a personal guarantee (Revision of law and revision of Circular)

We request a new Circular and revision of law on the provisions of deemed collection for calculating the collectible amount pertaining to the personal guarantee deductible from bad-debt loss when the total amount becomes uncollectible due to the asset condition, solvency etc. of the debtor as well as to deductions from the provisions for doubtful accounts.

Specifically, we request that the new Circular and revision of Circular articulate an income-based allowance up to the annual income of the guarantor multiplied by five years as deemed collection, and that the payer may ignore a collectible amount exceeding that sum.

11. Timing and method of bad-debt loss in bankruptcy (Revision of law and revision of Circular)

Bankruptcy is a judicial proceeding for liquidating the asset relationship and satisfying creditors in a fair manner when a debtor (individual or corporation) becomes economically insolvent. At present, approximately 80-90% of the cases where bankruptcy proceedings were petitioned are abrogated (simultaneous abrogation) at the same time as, or later than (abrogation at a different time), the commencement of bankruptcy proceedings. In these cases, generally speaking, the actual situation is that debtors have virtually no assets and creditors are virtually unable to collect the receivables.

In the absence of clear laws, the regulations or Circulars on bad-debt loss from bankruptcy receivables under tax law, CT Basic Circular No. 9-6-2 (bad-debt loss on uncollectible monetary claims) can be applied. However, the requirements of this Circular seem too rigid for bankruptcy practice.

While collection is practically impossible, only a formal transfer (50%) of provisions for doubtful accounts can be made according to Article 96 (maximum transfer to provisions for doubtful accounts), Para. 1, Item (3-c), of GO under CTL. The remaining 50% of bad-debt loss is shelved until the fiscal year when the bankruptcy is completed (two/three years later). This means the creditor must live with tax overpayment for a considerable period. Such a situation is too harsh, especially for small- and medium-sized enterprises.

We therefore request that, where a debtor is cleared to commence bankruptcy

proceedings, bad-debt loss be immediately allowed and that the creditor not recognize income from recovery until receivables are collected later under a newly issued CT Basic Circular No.9-6-2 (2) that would deem such a case as substantially a state of bad-debt loss.

12. Increase in the transfer ratio for bad-debt allowance under formal standard (Revision of law)

The transfer ratio in provisions for doubtful accounts under the so-called formal standard has been 50% of the amount of monetary claims in the previous credit write-off special account system. We request a higher rate as it is too low in view of the current actual state. Specifically, we request that the current rate of 50% be raised to between 70% and 80%.

III. For funds and investors

13. Clarification of treatment of collected receivables bought at discount (Revision of Circular)

When monetary claims are bought during business recovery, they are acquired at lower than face value due to the credit risk ascribed to the debtor of such monetary claims. Collection based on such monetary claims will be made later. However, tax treatment of the amount collected is not clear. One method treats collection up to the amount bought as the principal part, and the part exceeding that amount as profit. Another method treats the amount of difference arising at the time of the purchase as adjustable according to either the interest method or the straight line method etc. The collection amount each time is divided into separate amounts deemed part of the principal and the interest.

We consider it reasonable to recognize profit from the time the amount collected exceeds the amount bought from the standpoint of the purchaser of the monetary claims bearing such risk., However, treatment under this method is unstable from the perspective of taxation because of the lack of provisions prescribing such treatment.

We request clarification that there would be no problem in applying the above treatment for tax purposes.

14. Income tax on gains under DES arrangement (Revision of law)

Following the enforcement of CTL under the revised tax law of fiscal 2006, the definition of “amount of capital etc.” was revised to “amount of capital and the like” (Article 2, Item (16) of CTL). Under the revised tax law, the amount of capital and the like that increases due to a share issue is defined as the amount of assets minus the amount of paid-in money and money granted. In other words, where assets other than money are invested in kind, they will be at market value. As a result, gains from debt extinguishment will accrue to a debtor in a DES arrangement where the market value of the credit does not reach face value, excluding cases under eligible investment in kind.

However, in a capital increase in a DES arrangement, redeemable preferred equity shares are normally issued. This is different from relinquishment of credits and does not mean that creditors relinquish all of the credit amount. It does not increase tax-bearing capacity, either. In many cases, charging income tax on gains from debt

extinguishment will have a major impact on reorganization.

We therefore request deferment of tax on gains from debt extinguishment in a DES arrangement for an unlisted corporation where requirements of a reasonable reconstruction plan under company reorganization law, civil rehabilitation law, reasonable private rehabilitation (corresponding to the decision to authorize a rehabilitation plan based on Article 24-2 of GO under CTL) and CT Basic Circular No. 9-4-2 are satisfied.

15. Lower taxation standards for corporate per capita residential tax (Revision of law)

Compensation for a loss represents a reduced scale of business activity.. We therefore request that amount-of-loss compensation be struck from taxation standards applicable to the per capita corporate residential tax.

16. Permanent arrangements for special treatment measures in scale-of-capital tax standards for the Factor Based Tax (Revision of law)

As for lower scale-of-capital taxation standards for the Factor Based Tax, where loss is compensated by reducing the amount of capital and the like or the amount of capital reserves for a business year during the period April 1, 2004, to March 31, 2010, the amount is deducted from the amount of capital and the like. We request that this transitional measure be made permanent.

The Tax Issue Committee
Japanese Association for Business Recovery

Requests for 2009 Tax Reform Concerning Business Recovery

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What is the Japanese Association for Business Recovery?

■ The Japanese Association for Business Recovery (JABR), known as Jigyo Saisei Kenkyu Kiko in Japanese, was founded on March 16, 2002, to promote the study of practical proposals for a swift business recovery in Japan. The group includes business professionals and academics who exchange opinions and information among themselves and with experts overseas concerning bankruptcy, business-recovery methods and related processes. JABR's representative directors are professor Makoto Ito, of the University of Tokyo, and attorney Makoto Tahira.

■ JABR comprises full members (individuals) and supporting members (organizations) representing various professions. Full members include administrative and judicial authorities, attorneys, certified public accountants, licensed tax accountants and real estate appraisers, as well as managers of domestic and foreign financial institutions, business-recovery and PE funds, and consulting firms. Accounting firms, business corporations and financial institutions, which perform an active role in the first line of business recovery, participate as supporting members. As of July 2008, JABR had 230 full members and 15 supporting members.

■ JABR has a number of committees dealing with business recovery, in addition to the Tax Issue Committee:

(1) The Prepackage Examination Committee (chaired by attorney Hideaki Sudo) was set up to survey and analyze prepackage type business recovery cases in Japan. Comparisons have been made with cases in foreign countries including the United States, and information has been collected on relevant topics based on domestic and overseas surveys. Explanatory meetings for members were held in June and October 2003. At a Nov. 29, 2003, symposium titled "The Present Issue in the Prepackage Type Business Recovery," diverse viewpoints on materials under examination by the committee were discussed. This is summarized in the independently published book "Finance for Business Recovery" (Business Recovery Series 4).

(2) The Finance Committee (with the Bank of Japan Finance Market Bureau as secretariat) was set up to sort out the financial state involving a wide range of processes related to business recovery for both creditors and debtors. It has examined and discussed the framework under which remedies can be effected relatively easily, after conducting overseas surveys. Following a May 27, 2004, symposium titled "A New Viewpoint of Business Recovery" and the independent publication of the book "Finance for Business Recovery" (Business Recovery Study Series 5), the committee put out its final report in June. The summary of the report appears in NBL No.789 (July 15 issue).

(3) The Corporate Reorganization Case Study Committee (chaired by professor Junichi

Matsushita of Tokyo University) was set up to determine trends in business-recovery techniques centering on corporate reorganization plans of recent years, and to compile books that contribute to effective business-recovery practices beyond the scope of case studies. The committee has carried out detailed analyses -- identified as Reconstruction Techniques, Reorganization Security Right, Reorganization Credits and Others -- on about 300 reorganization cases nationwide that were approved on or after 1997. The results appear in the book, "Practice and Theory of Reorganization Plans" (Business Recovery Study Series 6) published in June.

(4) The Study Committee of Revised Substantive Law on Bankruptcy (chaired by professor Katsumi Yamamoto of Kyoto University) was inaugurated following the across-the-board revision of the Bankruptcy Law. It has studied future application of the Substantive Law on Bankruptcy, to which important revisions have been made. Since "New Perspective in Business Recovery" was discussed at a May 27, 2004, symposium, six explanatory meetings for members have been held to discuss Repudiation, Corporate Bond, Leasehold and other significant issues following the keynote report for each issue.

(5) The Modernization of Corporate Law and Business Recovery Committee (chaired by attorney Atsushi Toki) was set up in 2004 to sort out the possible impacts on business recovery and bankruptcy legislation of a completely amended Corporate Law before the new law takes effect. At a May 28, 2005, symposium titled "Modernization of Corporate Law and Business Recovery", Financing, Corporate Governance and other issues were discussed from practical viewpoints.

(6) The Trust and Business Recovery Committee (chaired by attorney Masaya Miyama) was set up to study possible impacts on business recovery of the first overall revision of the Trust Law proposed in 80 years. Significant issues selected in terms of business recovery have been reported and studied. Based on those results, the committee is preparing comments on the exposure draft of the new Trust Law.

(7) The M&A Examination Committee (tentatively named) was set up to survey and analyze the practical application of M&A techniques to the business recovery scene. Among the broad issues in this perspective, the committee started to discuss legal procedures, financial restructurings, business restructurings, etc. in order to report on aspects for a Nov. 29, 2005, symposium.

Inquiries should be made to:

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