

*The Tax Issue Committee*  
*Japanese Association for Business Recovery*

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Chuo-ku 2-chome, Tokyo 103-0025. Tel: 03-5614-6086 Fax: 03-3664-8845

**Announcement**

The Tax Issue Committee  
Japanese Association for Business Recovery  
August 14, 2006

**Announcement of Requests for 2007 Tax Reform  
Concerning Business Recovery**

To promote a swift business recovery in Japan, the Tax Issue Committee of the Japanese Association for Business Recovery (JABR) has summarized requests for 2007 tax reform as shown in the following matters.

We have requested “Tax deferment of income arising from debt exemption” for enterprises under reorganization for a long period. Major tax reform implemented in fiscal 2005 substantially dealt with this issue by clarifying 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 treatment of debtor taxation**
- 2. Higher transfer rate for doubtful debts under formal accounting standards**
- 3. Clarification of 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 were compiled based on the results of a recent questionnaire survey of JABR members.

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Requested Matters	Rev. of law	Rev. of Circular	Info open to public
<b>I . For debtors</b>			
1. Flexible treatment of Debt Treatment Plan	*		*
2. Revaluation of monetary claims added to assets under CTL Art. 33	*	*	
3. Accounting of negative goodwill at start of Corporate Reorganization Procedures	*		
4. Lower valuation standards for fixed property tax	*		
<b>II . For creditors</b>			
5. Higher transfer rate for doubtful debts under formal accounting standards	*		
<b>III . For recovery funds and P/E investors</b>			
6. Mitigation of income tax on the gains from under DES arrangement based on a reasonable reconstruction plan	*		
7. Permissible transfer of 50% of DDS to provisions for doubtful accounts in some cases	*	*	
8. Clarification of how to treat collected receivables bought at discount		*	

See details for the above in a separate document, “Requests for 2007 Tax Reform Concerning Business Recovery”.

Inquires should be made to:

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**Requests for 2007 Tax Reform  
Concerning Business Recovery  
(Summary)**

**I . For debtors**

**1. Flexible treatment of Debt Treatment Plan**

The Debt Treatment Plan (DTP) 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 (revaluation losses) to non-legal proceedings or to a private arrangement. On the other hand, the conditions for DTP are required to use the carry-over of overdue losses, before valid “blue losses,” when applying CTL Article 59, Para. 2, Item (3).

As a result, above requirements for a DTP, under the 2006 tax reform, especially involvement of 2 or more financial institutions and 3 or more independent specialists, become a significant hurdle when the use of losses carried over in business recovery is subject to limitations. We therefore request the relaxation of application requirements so that small- and medium-sized enterprises can take advantage of DTP.

It should be noted that there is another type of non-legal proceedings stipulated in Item 4 of Article 117 of GO under CTL that shall be arranged to use the overdue losses carried over after the blue losses. We request the requirements for that type of non-legal proceedings to be more clarified, for example as to whether above two conditions are not required under Item 4 of Article 117 of GO under CTL.

(See separate sheet)

**2. Revaluation of monetary claims added to assets under CTL Article 33**

Article.33, Paras. 2 and 3, of CTL permits the inclusion of asset valuation losses as expenses under certain conditions. However, loan receivables, trade-account and other receivables are excluded as “deposits and the like” from assets that may show a valuation loss.. It is requested that monetary claims such as trade-account and loan receivables, guaranteed deposits/caution money, etc. be added to assets for the purpose of valuation losses.

In addition, we request confirmation that the valuation method stipulated in the Special Circular (Kaho 2-14, Sacho 4-20) under CTL dated December 4, 1998, “Tax treatment of prices of credits calculated on the basis of appropriate valuation procedures and real estate securing bad debts” will be applied to the valuation of monetary claims in that instance.

(See separate sheet)

**3. Accounting of negative goodwill at start of Corporate Reorganization Procedures**

After the amendment of accounting rule (Article 1, Para.3, of the Enforcement Regulations of the Corporate Reorganization Law), negative goodwill may be accounted for in the revaluation process under the Corporate Reorganization Law .We therefore request that the

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provision stipulated in Article 62-8 of CTL be revised so that it is applicable to the corporations under the above process.  
(See separate sheet).

**4. Lower valuation standards for fixed property tax**

We request that valuation losses incurred as a result of legal proceedings be added as a reduction-in-value event in fixed-property taxation standards so that the value adopted as a revised book value, such as a fair value in a real estate appraisal, may be treated as the value in fixed-property taxation standards with regard to corporations for which an agreement (decision and approval) on a reconstruction plan has been made under legal proceedings in accordance with the Corporate Reorganization law or the Civil Rehabilitation Law.  
(See separate sheet)

**II . For creditors**

**5. Higher transfer rate for doubtful debts under formal accounting standards**

The transfer rate in provisions for doubtful accounts under the so-called formal standards has remained at 50% of the subject amount of monetary claims since the inception of the Special Provisions for Credit Write-down in the former regime. We request an increase in the rate, as it has been estimated to be too low in light of actual results.  
(See separate sheet)

**III . For recovery funds and private equity investors**

**6. Mitigation of income tax on the gains from under DES arrangement based on a reasonable reconstruction plan**

Following the promulgation of the New Company Law, 2006 Tax Reform stipulates that an increased amount of capital and the like should equal the asset value received for the shares issued (Article 2, Item 16, of CTL). As a result of this change, the debtor company may have to recognize gains from forgiven debt, through a debt equity swap (DES) arrangement, in the amount of the difference between the fair value of the debt and its principal amount. However, it is still a matter of argument that the fair value of the debt to the debtor should be the same one with that between the third parties.

The debtor in DES arrangement will not be fully discharged from its original debt but still carrying responsibility to the new equity in exchange. Moreover, although DES gains apparently improve the LTV ratio of the debtor, they won't substantially improve financial strength. Therefore, income taxes on these gains, especially with regard to corporations in the reorganization process, could have a significant effect on that process. We request that gains from forgiven debt exempted under DES be offset against overdue losses carried over before valid blue losses when it is based on a reasonable reconstruction plan stipulated in CTL Basic

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Circular 9-4-2 in addition to the DTP stipulated in CTL GO Article 24-2, Para. 1 and the reorganization plan of legal proceedings.

(See separate sheet)

**7. Permissible transfer of 50% of DDS to provisions for doubtful accounts in some cases**  
**(revision of circular)**

Debt for Debt Swaps (DDS) should be arranged for the purpose of reducing the burden of debtors by replacing part of the excessive liabilities with a subordinated loan, since borrowings of working capital tend to be self-perpetuating for small- and medium-sized enterprises. In this instance, the possibility of having to collect on a subordinated loan following DDS, which is more like capital, will be much lower than for other general credits. We therefore request that 50% of the subordinated loan after DDS be transferable to provisions for doubtful debts under formal accounting standards under certain conditions as reorganization-support measures by financial institutions (and general business enterprises).

(See separate sheet)

**8. Clarification of how to treat collected receivables bought at discount**

With regard to receivables and claims in bankruptcy and rehabilitation etc. on which interest has not been paid for a considerable period, we request that the amount of such income not be recognized as a collected claim if the division between the interest and principal amounts is not clear, and that the collected amount be treated as the collection of the principal amount, i.e., by cost recovery method.

(See separate sheet)

End.

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## **What is the Japanese Association for Business Recovery?**

■ The Japanese Association for Business Recovery (known as Jigyo Saisei Kenkyu Kiko in Japanese) is a group of professional people dedicated to promoting studies in bankruptcy and business recovery, exchanging opinions and information between people practically involved in these fields, and fostering international cooperation on problems related to bankruptcy and business recovery. JABR was founded on March 16, 2002. Its representative directors are professor Makoto Itoh of Tokyo University and attorney Makoto Tahira.

■ JABR consists of 300 individuals (full members) and 40 organizations (supporting members). Full members include a variety of professionals actively engaged in the business recovery field, including 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 funds and PE funds, consulting firms, etc. Supporting members include accounting firms, business corporations and financial institutions that perform an active role in the first stage of business recovery.

■ JABR has other committees dealing with various themes in the business recovery field, in addition to the Tax Issue Committee. The following are some recent activities: -

- (1) The Prepackage Examination Committee (chaired by attorney Hideaki Sudo) was set up to carry out surveys, analyses etc. of prepackage-type business recovery cases in Japan for comparison with cases in foreign countries beginning with the United States. It has compiled questionnaire survey information on prepackage-type business recovery, carried out overseas surveys and held explanatory meetings (in June and October 2003) for members. At the Nov. 29, 2003, symposium titled “The Present Issue in Prepackage-Type Business Recovery”), the examination contents of the Committee were considered from diverse viewpoints as materials for discussion. This is summarized in the independently published book titled “Prepackage-Type Business Recovery” (Business Recovery Study 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 and to create frameworks in which both creditors and debtors can carry out undertakings more easily. It has evolved amid continuous discussions and overseas surveys, etc. Following the aforementioned Nov. 29, 2003, symposium, a May 27, 2004, symposium titled “A New Viewpoint of Business Recovery,” and the independent publication of a book titled “Finance of Business Recovery” (Business Recovery Study Series 5), the Committee put out its final report in June 2004. The report summary appears in NBL No. 789 (July 15, 2004 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 reorganization plans in 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 of reconstruction techniques, reorganization security rights, reorganization credits, related issues and tax matters involving about 300 reorganization cases nationwide that were approved on or after 1997. The results appear in the book independently published in June 2004 titled “Practice and Theory of Reorganization Plans” (Business Recovery Study Series 6).

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- (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, to determine the revision trend with respect to the Substantive Law on Bankruptcy and to carry out discussions for developing future practices. At the aforementioned May 27, 2004, symposium, the Committee developed discussions on a repudiation system.
  
- (5) The Corporate Law Modernization and Business Recovery Committee (chaired by attorney Atsushi Toki) was set up in 2004 to examine the influence of corporate law on business-recovery and bankruptcy laws ahead of commercial code revisions aimed at modernizing legislation. The committee consists mainly of attorneys, scholars besides other practitioners involved with financial institutions and PE funds. During the first half of 2005, recovery aspects were examined from various points of view. A May 28, 2005, symposium titled “Corporate Law Modernization and Business Recovery” reported on practical considerations centering on financing, corporate governance, etc.
  
- (6) The Trust and Business Recovery Committee (chaired by attorney Masaya Fukuyama) was set up in 2005 to examine the influence of trust law, following its revision after 80 years, on business recovery. The committee consists of people in charge of banking legal affairs including scholars and attorneys. Along with reporting and examining 18 selected items related to business recovery, explanatory meetings with guest lecturers for members were conducted. Moreover, in response to public comment on the “Trust Law Revision Outline Draft”, the committee submitted recommendations to the Ministry of Justice at the end of August, and held an explanatory meeting for members regarding the tentative plan in December. Committee members served as lecturers.
  
- (7) The M&A and Business Recovery Committee (chaired by attorney Hideyuki Sakai) was set up to examine M&A effects on and application to business recovery in 2005. The committee has pursued discussions of legal, financial and business restructuring points related to the business-recovery form of M&A. In addition, at the Nov. 29, 2005, symposium titled “M&A — The Central Role of Funds (subtitle: The Functions of M&A and the Role Fulfilled by Funds and Professionals in M&A),” frank opinions of leading lecturers in the field and those of the panelists were announced ahead of the official publication of the committee results. The symposium attracted wide interest.

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