

The Tax Issue Committee
Japanese Association for Business Recovery

3rd Floor, Kayabacho Broad Square, 9-10, Nihonbashi-Kayabacho,
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Announcement

The Tax Issue Committee,
The Japanese Association for Business Recovery
August 31, 2004

**Requests for Revision of Tax System
Concerning Business Recovery**

The Tax Issue Committee of the Japanese Association for Business Recovery (JABR) has summarized requests for tax-system revisions aimed at promoting a swift business recovery. Key points of the requested revisions include:

Deferring taxes on profit arising from debt exemption.

Distinguishing between the tax treatment of statutory arrangements (Corporate Reorganization Law, etc.) and that of private arrangements (Private Arrangement Guideline, etc.).

Widening the range of allowable creditor expenses for bad debt and valuation losses.

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 notice	Info to public
I Tax deferment on profit arising from debt exemption	O		
II For debtors			
1. Wider scope of valuation losses on assets, etc.		O	
2. Change in the order of items eligible for inclusion as expenses of losses carried forward, and extension of the eligibility-application list	O	O	
3. Lower valuation standards for the fixed property tax, with taxation based on the proportion of business size to capital	O		
4. Treatment of debt equity swaps (DES)			O
5. Reduction of the registration license tax when DES increases capital	O		
6. Exemption or reduction of the delinquency tax	O		
7. Switch to a refund system when overstatements are based on misleading accounting	O		
III For creditors			
1. Procedures for bad debt loss when security is doubtful		O	
2. Clarification of “effective” accounting standards for doubtful accounts		O	
3. Additions to “formal” accounting provisions for doubtful accounts	O		
4. Higher transfer rate under “formal” accounting provisions for doubtful accounts	O		
5. Treatment of debt debt swaps (DDS)			O

Contents of the above are detailed in a separate document, “Requests for Revision for Tax System Concerning Business Recovery” (to be distributed at the press conference).

Inquiries should be made to:

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(located within Shojihomu KK)**

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**Requests for Revision for Tax System Concerning
Business Recovery (Summary)**

I Tax deferment on profit arising from debt exemption

Profit accruing from at least the partial exemption of debt by a creditor, and profit arising from the provision of private funds by other persons, are considered part of corporate gross revenue. However, since the liabilities of debtors seeking business recovery, in effect, exceed assets, the debtors may be unable to pay corporation taxes etc. on the one-off profit arising from debt exemption.

Therefore, where a certain reasonability is recognized in the process of creating and agreeing to a reconstruction plan (an arrangement under the Commercial Code, a statutory arrangement under the Corporate Reorganization Law and Civil Rehabilitation Law, a private arrangement under the Law on Special Measures for Industrial Revitalization – hereinafter referred to as the Industrial Revitalization Law – the Private Arrangement Guideline, or the Small and Medium Enterprise Industrial Revitalization Corporation), we request a deferment measure for corporate taxation on profit arising from effective debt exemption for a certain period (two or three years). (See separate sheet.)

II For debtors

1. Wider scope of valuation losses on assets

At present, inclusion as expenses of an asset valuation loss is allowed only in cases of a legal decision to commence reorganization proceedings etc. in accordance with the Corporate Reorganization Law. It is not allowed in principle for a private arrangement. We therefore request relaxation of the requirements (events) so that inclusion as expenses of an asset valuation loss in a private arrangement, as in a legal arrangement, will be allowed “where there is no arbitrariness and reasonability is pledged.”

In addition, we also request that securities and deferred assets be included as assets subject to valuation losses. (See separate sheet.)

2. Change in the order of items eligible for inclusion as expenses of losses carried forward, and extension of the eligibility-application list

We request revision of the Corporation Tax Enforcement Ordinance and Notices law so that, where an agreed private fund provision is accompanied by an asset arrangement in a private business recovery plan and where security of reasonability and exclusion of arbitrariness are pledged, inclusion as expenses of

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losses carried forward past an expired time limit can be made, as in a legal arrangement, and that the order of such items eligible for inclusion as expenses give priority to losses, as in the Corporate Reorganization Law. (See separate sheet.)

3. Lower valuation standards for the fixed property tax, with taxation based on the proportion of business size to capital

When the book value of real estate has been reduced due to legal proceedings, we request that such value be treated as the valuation standard for affixing the property tax, provided that a corporate reconstruction plan has been approved under the Corporate Reorganization Law or the Civil Rehabilitation Law.

In addition, we request that, when taxation standards are applied based on the proportion of business size to capital, the calculation of the capital surplus in an “ineligible” reorganization be the same as that for an “eligible” reorganization, and that, where losses are transferred due to an “eligible” reorganization, capital surplus corresponding to the losses be excluded from the taxation standards. (See separate sheet.)

4. Treatment of debt equity swaps (DES)

Treatment of creditors with respect to the acquisition value of equities in debt equity swaps (DES) is clarified in Corporation Tax Basic Notice 2-3-14 etc., but the treatment of debtors is not clarified. We therefore request that treatment of debtors (corporate issuers) be clarified. (See separate sheet.)

5. Reduction of the registration license tax when DES increases capital

We request that a DES capital gain accrued by a corporation seeking business recovery be separated from other capital increases and that the registration license tax rate be reduced. In addition, we request that, where DES results in capital gains, any capital reductions made to compensate for deficits be excluded from taxation standards (per capita rate) of the corporate inhabitant tax. (See separate sheet.)

6. Exemption or reduction of the delinquency tax

We request that, once proceedings for business recovery commence, the punitive delinquency tax rate for unpaid taxes and public charges be reduced or eliminated if tax payment funds have dried up. (See separate sheet.)

7. Switch to a refund system when overstatements are based on misleading accounting

With regard to the corporation tax, we request that the current tax-amount exemption system change over to a refund system tax when overstatements are based on misleading accounting. (See separate sheet.)

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III For creditors

1. Procedures for bad debt loss when security is doubtful

In the case of bad debt losses on secured money claims, where a material security was pledged in excess of its fair market value, where a human guarantor is missing, or where a debtor has multiple loans outstanding, it is understood that such material security or human guarantor need not be taken into consideration. However, we request clarification of this treatment. (See separate sheet.)

2. Clarification of “effective” accounting standards for doubtful accounts

Provision transfer for doubtful accounts is allowed under both “effective” and “formal” accounting standards, except where repayment has been legally shelved for a long time. However, since the calculation method for collectable amounts, other than by a material security or a human guarantee, is not clear with respect to “effective” standards and to the wide scope of application (reason for transfer and amount of transfer etc.), its application tends to be avoided. We therefore request that, in the case of “effective” standards, the method for calculating the collectable amount be clarified. This is also important from the viewpoint of promoting the disposal of nonperforming loans. (See separate sheet.)

3. Additions to “formal” accounting provisions for doubtful accounts

We request that accounting provision events for doubtful accounts under “formal” standards be balanced with statements of case proceedings for a legal arrangement, including the commencement proceedings from the Private Arrangement Guideline (corresponding to the Specified Mediation Law) and the application for the Industrial Revitalization Corporation, etc. (See separate sheet.)

4. Higher transfer rate under “formal” accounting provisions for doubtful accounts

The provision transfer rate for doubtful accounts under “formal” standards has remained at 50% since 1954 and the Credit Write-off Provisions System. This rate is too low from the perspective of various surveys. We therefore request that the transfer rate be raised to about 80% (or that the transfer rate be set up during proceedings for each reconstruction program). (See separate sheet.)

5. Treatment in debt debt swaps (DDS)

The provision transfer treatment for doubtful accounts by creditors when debt debt swaps (DDS) are carried out is not clear. We request clarification of this treatment.

End

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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 proposals aimed at a practical approach to 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. At present, JABR has 300 full members and 40 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 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 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 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

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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 a University of Tokyo professor) was set up to determine trends in business-recovery techniques centering on the 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," "Others" and "Taxation" -- 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 Katsuki Yamamoto of Kyoto University) was inaugurated following the across-the-board revision of the Bankruptcy Law. It has studied the future application of the Substantive Law on Bankruptcy, to which important revisions have been made. At the May 27 symposium mentioned above, the "Repudiation System" was discussed.

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