The EU-Japan Business Dialogue Roundtable

Working Group One (WG1)

CREATING AN OPEN ENVIRONMENT FOR TRADE AND INVESTMENT

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Contents

I. Summary

1. Preamble…..…….…… 4
2. Joint recommendations……..…… 5

II. Reviewing progress in Japan from a European perspective

1. Introduction …….. 8
2. Note's on this year's specific recommendations…..…… 8
3. Progress report
1. Regulatory transparency…..…….……..……..….. 11
2. Regulatory supervision…….……....13
3. Product approval liberalisation……..…..……14
4. Product approval harmonization..……..……..….. 17
5. Regulatory reform to facilitate economic activity...……..……..….. 19
6. Regulating dominant positions……...……21
7. Cross-border share-for-share transfers……..……....23
8. Provision of legal services..……..……....24
9. Visas and work permits…..……..……..... 26

III. Reviewing progress in Europe from a Japanese perspective

1. Introduction …….. 28
2. Facilitating EU-Wide business development…….……28
2-1 Societas Europaes (SE)..……..……..…….. 29
2-3 Merger Directive and harmonization of national corporate tax bases……..……..…….. 31
3. Facilitating the free flow of management resources…….…….. 33
3-1 Double payment of social security costs and double taxation….. 34
3-2 Visas and work permits……...…….…….. 35
3-3 Tariffs …… 36

I. Summary

1. Preamble:

The creation of a truly open environment for trade and investment is important to the future prosperity of both the EU and Japan for the following reasons:

- Companies benefit from increased access to the markets and resources of the global economy.

- Individual economies benefit from the economic stimulus of increased competition, productivity, and innovation.

- Consumers benefit from increased access to innovative products and services at competitive prices

Creating an open environment for trade and investment implies much more, however, than simply improving market access for foreign goods and services and removing discriminatory restrictions on foreign investment.

An open environment for trade and investment also implies the existence of a competitive internal market and the necessary economic infrastructure to do business efficiently. This is of concern to all businesses, regardless of national origin.

We are pleased to report that progress is being made in creating an open environment for trade and investment in both the EU and Japan. The EU is continuing to strengthen the economic institutions underpinning the internal market while Japan is pursuing an ongoing program of structural reform.

However, much remains to be done. Market access barriers still exist, and the development of appropriate regulatory, tax and legal infrastructure has not kept pace with the development of business links between the EU and Japan.

This report summarizes the issues that the members of Working Group 1 (WG1) continue to identify as the most damaging to the growth and development of businesses in the EU and Japan. Our joint recommendations are provided below.

This is followed by a detailed assessment of the Japanese and European trade and investment environments and an update of specific proposals tabled during last year's EUJBDRT held in Brussels.

2. Joint recommendations:

1. Improving the business environment between the EU and Japan

Facilitating the free flow of goods and services:

a) All remaining explicit barriers to trade and investment such as tariffs, quotas and other quantitative restrictions should be eliminated.

b) Standards and conformance assessment techniques should be further harmonized (e.g. through an expansion of the Mutual Recognition Agreement) in order to eliminate the unnecessary duplication of product testing and approvals.

Facilitating the efficient allocation of human resources:

c) The visa and work-permit system should be re-evaluated so that firms are better able to allocate human resources between their European and Japanese operations.

d) Double payments of tax and social security costs should be eliminated.

Facilitating increased flows of mutual direct investment:

e) The tax and legal systems should be strengthened to facilitate cross-border corporate restructuring and tax-neutral M&A activity.

2. Improving the business environment in Japan

Regulatory reform:

a) Regulatory transparency should be further strengthened to make it easier for companies to predict the consequences of business decisions, plan for regulatory developments, and efficiently allocate resources to comply with regulatory requirements.

b) The product approval process should be improved to facilitate the introduction of innovative new products at competitive prices.

c) Further de-regulation and re-regulation is needed to promote a truly competitive market environment.

Legal and tax reform:

d) The legal and tax systems should be modernized to promote corporate activity and facilitate further investment in an era of increasing globalization.

3. Improving the business environment in the EU

Facilitating EU-wide business development:

a) Rules and regulations governing economic activity within the EU should be further harmonized to reduce the burden companies face doing business in the single European market.

b) The legal framework governing corporate structures in EU member states should be extended to allow for a EU-wide company structure (*Societas Europaes*) for both stock and limited liability corporations.

c) A EU-wide consolidated tax system should be introduced to reflect the expansion of EU-wide business activities and the introduction of a EU-wide company structure.

II. Reviewing progress in Japan from a European perspective

1. Introduction

European firms doing businesses in Japan are increasingly finding that the issues they face are no different from those of their Japanese counterparts – how to cope with stagnant economic growth, how to improve operating efficiency in an increasingly competitive market environment, and how to take advantage of the new opportunities that have surfaced as a result of changes to the structure of the Japanese economy.

On a macro level, problems such as the persistence of non-performing loans in the financial sector continue to weigh heavily on the minds of European firms looking to invest in the Japanese market. Persistent frustration with the micro business climate also continues to discourage firms that are already established in Japan from expanding their operations.

Despite these challenges, we are beginning to see signs of a positive shift in attitude towards the role of foreign trade and investment in Japan. Japanese customers are increasingly seeking out innovative European products; local and national government agencies are actively promoting European investment; and Japanese companies are adopting new attitudes towards doing business with their European counterparts. We are encouraged by these developments and will continue to promote further European involvement in the Japanese economy.

In order to help fulfill this goal, we urge the Government of Japan to follow through on its promise of meaningful reform – not only concerning macro-issues such as the disposal of bad loans, but also micro-issues such as the regulation of economic activity.

2. Notes on this year's specific recommendations

As in previous years, our specific recommendations continue to focus on the following priority issue areas:

1. Increasing **transparency and clarity in the regulatory environment** to make it easier for companies to predict the consequences of business decisions, plan for regulatory developments, and efficiently allocate resources to comply with regulatory requirements.

2. Increasing **efficiency in the product approval process** to make it easier for companies to introduce innovative products at competitive prices.

3. Increasing the scope and quality of **regulatory reform to promote competition and innovation** in the Japanese market.

4. **Modernizing the legal and tax systems** to support corporate activity and facilitate further investment in an era of increasing globalization.

5. Reviewing labor and immigration laws to **facilitate the efficient allocation of human resources**, both within and across national boundaries.

We are please to report that progress has been made in a number of these areas:

- A new "No-Action Letter" system has been introduced designed to increase clarity in the regulatory environment.

- There have been notable improvements in the product approval process for insurance and in-vitro diagnostic products.

- The competitive environment has been strengthened in the telecommunications sector.

- A DC pension scheme has been introduced.

- Legislation introducing a consolidated tax system has been passed by the Diet.

- The Commercial Code has been revised to allow for new types of corporate governance structures, including an outside director system.

These are all positive developments, but unfortunately are often overshadowed by the numerous challenges that remain:

- The new "No-Action Letter" system, while very welcomed in principle, does not provide legally binding precedent and in fact overshadows more fundamental issues concerning regulatory transparency in Japan.

- The quality of regulatory supervision (including employment levels of experts such as economists, financial officers and anti-trust lawyers) remains far below that in other advanced economies.

- The product approval process has yet to fully embrace internationally accepted methods of best practice in many important sectors of the Japanese economy.

- The regulatory framework continues to impede competition and innovation in the market, even in areas such as telecommunications where there have been positive developments.

- Restrictions placed on the new DC pension system have greatly diluted the value of corporate pension reform.

- The planned consolidated tax system is unlikely to be embraced by the corporate community in Japan due to provisions designed to secure tax revenues.

- Recent reforms to the legal and tax systems have in many cases ignored the increasingly global nature of economic transactions – it is still impossible, for example, for a European firm to acquire a Japanese firm using stock from the parent company.

These and other issues are discussed in detail in the progress report that follows.

3. Progress report

1. Regulatory transparency

Previous recommendations:

- A formal rulings process should be established whereby companies would be able to receive written, binding clarification regarding a planned business transaction or a particular regulatory situation. These rulings should then be made available in an anonymous format on a regular basis to establish a written body of precedent in order to help companies navigate the regulatory process.
- Each ministry and agency should develop and implement guidelines for an advanced clearance process based on the March 27, 2001 Cabinet Decision as soon as possible.
- Guidelines should also be developed for areas such as taxation, which are not explicitly mentioned in the Cabinet Decision.
- All replies should be legally binding.
- The implementation of this reform should be closely monitored.

Current status:

- On March 27, 2001, a Cabinet Decision was issued committing the Government of Japan (GOJ) to the establishment of a formal rulings process on a limited scale, with special emphasis on the financial services and IT sectors. Each individual national government ministry and agency has developed guidelines based on this Cabinet Decision and so far 3 "no-action letters" have been issued. These replies are not considered legally binding.

Commentary:

- A lack of transparency and clarity in the Japanese regulatory regime is one of the factors most frequently cited by European businesses as inhibiting the development of a truly open environment for trade and investment in Japan. A lack of transparency creates uncertainty, and this makes business planning difficult.
- The GOJ has implicitly acknowledged this problem with the introduction of the Japanese "No-Action Letter" system. The "No-Action Letter" system is a welcome development, but has suffered from the following constraints: a) replies are not considered legally binding, b) oral replies are in some cases still allowed, and c) very little use has been made of the system since its implementation (only 3 no-action letters have been issued).
- More disturbing, however, is the general attitude of the regulatory authorities towards transparency and clarity in their respective regulatory jurisdictions. Regulators should be proactively seeking out areas that need clarification, and this is still not happening in Japan.
- As a matter of standard practice, regulators should reply in writing to all requests for clarification from private firms, be it within the framework of the Japanese NAL, or not. Despite numerous policy initiatives designed to eliminate the practice, oral replies remain the norm in Japan.
- This has created somewhat of a double standard, especially in the financial services sector: on the one hand, the regulator requires firms to maintain a clear written relationship with their clients (in the interest of consumer protection), while on the other, they do not afford this

same courtesy to the firms that they regulate.

Questions:

- Does the GOJ have any plans to strengthen the current NAL system?
- Does the GOJ have any other plans to improve regulatory clarity and transparency besides through the use of the NAL system?

New recommendations:

- Japanese regulators should take a pro-active stance in promoting regulatory transparency and clarity. Requests for clarification should be dealt with swiftly and the findings quickly made public.
- The current "No-Action Letter" system should be strengthened to make it legally binding and more widely used by regulators in Japan.
- As a *matter of standard practice*, all requests for clarification should be answered *in writing*.
- The scope of reform should be expanded for tax-related issues to include not only requests for clarification, but also explicit prior-clearance for specific transactions, including corporate restructuring.

2. Regulatory supervision

Previous recommendations:

- An independent regulator with a pro-competitive mandate should be established to supervise the telecommunications, energy and transportation sectors in Japan.

Current status:

- Increasing regulatory independence in these three sectors is not currently being considered.

Commentary:

- We are disappointed that the GOJ does not recognize the value of regulatory independence as a means with which to promote fairness, neutrality and competitive principles in these three sectors.
- Regulatory independence would make it easier to hire specialist staff (such as economists and anti-trust lawyers), which in turn would improve the quality of regulation in these sectors.
- European experience clearly shows that independence has contributed to increased competition, market access opportunities for non-incumbent firms, and ultimately a better deal for consumers.
- It is also interesting to note that while the GOJ does not feel an independent regulator would be appropriate for the three sectors mentioned above, there is already precedent for independence in the financial services sector (FSA) and talk of creating an independent regulator for food safety as well.

New recommendations:

- An independent regulator with a pro-competitive mandate should be established to supervise the telecommunications, energy and transportation sectors in Japan.
- Japan should strive to increase the quality of its regulatory supervision, for example by hiring more staff with specialist knowledge of the sectors that they are regulating (e.g. financial experts for product approvals in the financial sector; economists and anti-trust lawyers to enforce competition policy; and qualified scientists for product approvals in the health science sector.)

3. Product approval liberalization

Previous recommendations:

Insurance:

- All remaining requirements for prior product approval and pricing involvement by the FSA should be abolished.

Animal Health:

- Minor modifications to already-approved products should be allowed on a notification basis, without the need to navigate the time and energy consuming partial amendment procedure.
- The acute toxicity study employing animals for mycelial (feed grade) products, a test unique to Japan, required for each batch to detect toxic substances should be eliminated.
- The current mandatory assay for biological products should be replaced with a non-compulsory official batch release, as is common practice in Europe. For in-vitro diagnostic products this requirement should be eliminated all together.
- Reports prepared for New Animal Drug Application should be accepted in their original language with a summary in Japanese, as is currently the practice for pharmaceutical products intended for human use.
- Maximum Residue Levels and required withdrawal period should be established at the time of New Animal Drug Application, with all residue studies based on accepted international MRL standards, instead of the current zero-tolerance stance the GOJ takes regarding these products.

In-vitro diagnostics:

- The GOJ should develop a clear and detailed strategy for meeting its own goal of processing approvals for in-vitro diagnostic products within six months. This strategy should include provisions for the following:
    1. Allocation of sufficient human resources to deal with new product approval applications
    2. Elimination (or refocusing) all application requirements that are unique to Japan and/or have no basis in science, such as the 3 lot/ 3 time test data requirement.
    3. The quick establishment of a product approval process based on risk classification, with lower risk products subject to a simple notification procedure.

Current status:

Insurance:

- The product approval process, especially for non-life products, is gradually being liberalized and the notification system has now been expanded to cover most products. The Financial Council is currently debating the introduction of a “file-and-use” system for certain non-life commercial product lines. A notification-in-principle system for personal lines is being studied, but the GOJ remains concerned about preserving consumer safety.

Animal health:

- No change. Most MAFF efforts have focused recently on the BSE scandal.

In vitro diagnostics (IVDs):

- The MHLW issued a notification in 2001 clarifying the function of "Iyakuhin-Kikou" and "Shinsa-center", and this has reduced the time needed to have class 2 IVD products approved for sale to about the 3-4 month range. The GOJ is also currently in the process of revising the Pharmaceutical Affairs Law (PAL), which, amongst other things, would introduce a notification system based on risk classifications.

Commentary:

Insurance:

- We very much welcome the efforts the GOJ has made to deregulate the product approval process in the insurance sector over the past five years. The situation has improved remarkably, and the GOJ should be applauded for its efforts. We also welcome the Financial Council's current initiative to introduce a "file and use" system for commercial non-life products. Having said this, we still feel that there is really no need for the regulator to be involved at all in the approval of new products, as this only serves to stifle the introduction of innovative insurance products at competitive prices. Regulation should focus instead on the macro-level supervision of solvency margins and capital adequacy ratio in line with international best practice. There is also some concern with the competence of FSA staff charged with approving products for sale in Japan, especially in the Life sector.

Animal health:

- The product approval system for animal health products in Japan still lags well behind current international standards of best practice in this sector. The EBC appreciates, however, the good working relationship it has developed with MAFF, and hopes that mutual understanding will lead to improvements in the near future.

In-vitro diagnostics:

- We applaud the GOJ's efforts to improve the product approval process for IVDs over the past year. Clarification notifications released by the MHLW have led to noticeable improvements in the time needed to have class 2 IVD products approved for sale in Japan. We are also very excited about proposed changes to the PAL that would introduce a notification system based on risk classifications. The diagnostics community in Japan looks forward to working with the MHLW to make sure that these reforms are developed and implemented in a meaningful manner.

Questions:

Insurance:

- We ask that the EUJBDRT be kept informed of developments in Financial Council deliberations concerning the introduction of a file-and-use procedure for commercial non-life products.

In vitro diagnostics (IVDs):

- We ask that the EUJBDRT be kept informed of developments concerning reforms to the PAL.

New recommendations:

Insurance:

- All remaining requirements for prior product approval and pricing involvement by FSA should be abolished.

Animal Health:

- Minor modifications to already-approved products should be allowed on a notification basis, without the need to navigate the time and energy consuming partial amendment procedure.
- The acute toxicity study employing animals for mycelial (feed grade) products, a test unique to Japan, required for each batch to detect toxic substances should be eliminated.
- The current mandatory assay for biological products should be replaced with a non-compulsory official batch release, as is common practice in Europe. For in-vitro diagnostic products this requirement should be eliminated all together.
- Reports prepared for New Animal Drug Application should be accepted in their original language with a summary in Japanese, as is currently the practice for pharmaceutical products intended for human use.
- Maximum Residue Levels and required withdrawal period should be established at the time of New Animal Drug Application, with all residue studies based on accepted international MRL standards, instead of the current zero-tolerance stance the GOJ takes regarding these products.

In-vitro diagnostics:

- An effective product approval process for IVDs based on risk classification (whereby lower risk products would be subject to a simple notification procedure) should be implemented as soon as possible following appropriate changes to the Pharmaceutical Affairs Law currently being deliberated in the Diet.

4. Product approval harmonization

Previous recommendations:

- The GOJ should, in cooperation with regulatory authorities around the world, work towards an approval process that does not require per country approval.
- The MRA should be ratified and implemented as soon as possible. The EU and Japan should monitor this agreement to make sure it is implemented effectively. Work should begin on expanding the scope of this agreement to include sectors such as medical devices, professional services, organic food certification, cosmetics and eco-labelling.
- The GOJ should be vigilant in unilaterally reducing the time and energy needed for companies to bring their products to market by applying regulatory practices already accepted by the international community, such as maximum residue limits developed by the CODEX Alimentarius Commission and risk-based assessment of harmful and non-harmful organisms in the importation of phytosanitary products.

Current status:

- MRA came into effect on January 1st, 2002 and is currently being implemented.
- There has been no change to the GOJ position regarding MRLs and SPS guidelines.

Commentary:

- We are very pleased that the MRA has now come into effect. We hope that this will be the beginning of further efforts to increase standards and conformance assessment between the EU and Japan in the future.
- We would like to note that vigilance must be maintained in order that this agreement is implemented effectively. As such, we very much welcome an extension of plans to hold conformity assessment seminars for regulators and industry.
- We also look forward to the eventual expansion of this agreement into areas such as medical devices, professional services, organic food certification, cosmetics and eco-labels.
- Eventually the mutual recognition of product standards and manufacturing processes should extend to mutual recognition of the approvals themselves, so that products need only receive approval once, regardless of where they are being sold, as per our original recommendation.
- We are disappointed that there has been little progress in harmonizing Japanese regulations with international best practice with regards to maximum residue limits and the risk-based assessment of harmful and non-harmful organisms in the importation of phytosanitary products. As a result, costs attributable to regulatory burden remain higher in Japan than in the rest of the world. This continues to be a major disincentive to trade and investment in Japan.

Questions:

- The EBC asks that the EUJBDRT be kept informed on the implementation status of the current MRA.

New recommendations:

- The GOJ should, in cooperation with regulatory authorities around the world, continue working towards an approval process that does not require per country approval.
- The EU and Japan should continue monitoring the MRA to make sure it is implemented effectively. Work should begin on expanding the scope of this agreement to include sectors such as medical devices, professional services, organic food certification, cosmetics and eco-labelling.
- The GOJ should be vigilant in unilaterally reducing the time and energy needed for companies to bring their products to market by applying regulatory practices already accepted by the international community, such as maximum residue limits developed by the CODEX Alimentarius Commission and risk-based assessment of harmful and non-harmful organisms in the importation of phytosanitary products.

5. Regulatory reform to facilitate economic activity

Previous recommendations:

- The scope of deregulation needs to be increased in order to counter the inefficiency of managed competition in sectors such as shipping, civil aviation and construction.

Current status:

Port operations:

- The Port Transportation Business Law was amended effective Nov.1, 2000. The licensing/approval system for port services has been partially liberalized and various adjustment controls have been eliminated.

Civil aviation:

- The domestic air travel market was partially liberalized in 2000 allowing companies to sell at self-determined rates. Major barriers still prevent the same for international air travel.

Construction:

- The Building Standards Law (BSL) was revised in 1998 to allow for the first time product approval on a performance (instead of prescription) basis. The Ministry of Land, Infrastructure and Transport (MLIT) is currently in the process of implementing these reforms, including, for the first time, accrediting third-party testing agencies. An act "Promoting Proper Tendering and Contracting for Public Works" came into effect April 1st, 2001, which the GOJ hopes will increase transparency and accountability in the bidding process.

Commentary:

- The original purpose of this proposal was to stress the importance of regulatory reform in promoting a competitive market environment in Japan in order to (a) increase market access opportunities for non-incumbent firms, (b) promote product and service innovation and (c) reduce the cost of doing business.
- Recent policy documents released by the GOJ such as METI's structural reform "Action Plan" (December 1, 2000), the new 3-year Programme for Regulatory Reform (March 30, 2002), and the Economic and Fiscal Policy Council's blueprint for structural reform of the Japanese economy all contain positive references to increasing competition through regulatory reform. The challenge now is turning these goals into reality.
- Recent changes to the Port Transportation Law, Building Standards Law, Civil Aviation Law, the introduction of new laws relating to government procurement procedures, and the establishment of wider government programs such as the 3-year Regulatory Reform Program are all welcome developments (and the EBC acknowledges that there have been a number of noticeable improvements in all of these areas), but often fall short of complete liberalization and adequate competition-based supervision the original recommendation entails.
- We are worried that a lack of effective implementation will seriously dilute the value of recent reforms, especially in the construction and shipping sectors.

New recommendations:

- The GOJ should continue to place high priority on regulatory reform measures designed to promote and facilitate economic activity in the Japanese market.

6. Regulating dominant positions

Previous recommendations:

- Dominant market positions in sectors such as telecommunications need to be adequately monitored and effectively regulated to prevent possible anti-competitive practices such as predatory pricing, cross subsidies from monopolies to market based activities, and misuse of customer information.

Current status:

- The GOJ amended the Telecommunications Business Law (TBL) introducing asymmetrical (dominant carrier) legislation in 2001. Other recent developments include: a) Telecommunications Competition Guidelines, written jointly with the JFTC, b) Guidelines for Permission to Expand the Scope of Operation of NTT East and NTT West, c) review of the Basic Regulatory Framework with intention to reform the Type I and Type II licensing distinction, d) review of NTT firewall provisions (with the goal of ensuring competitive safeguards of the NTT group are sufficient), e) consideration of new business models such as MVNOs and vertical integration of telecommunication firms into content areas (including regulatory and competition-policy issues that may arise), f) establishment of the Dispute Resolution Commission, which opened its doors on November 30, 2001 and to date has taken 7 cases.

Commentary:

- While we appreciate the efforts Japan has made to introduce a competition policy regime for the telecommunications sector, there remain a number of areas of concern. For example:
- The application of asymmetrical regulations is still not based on specific economic criteria.
- The move to tariff notifications is not consistent with a move to asymmetric regulation. Dominant carriers' rates should be approved and strictly enforced by the regulator, for example through a published Reference Interconnect Offer (RIO). While LRIC is likely to be applied to the fixed line business, NTT DoCoMo, the dominant mobile carrier, will not have to have its interconnect rates approved. This is inconsistent.
- While there are guidelines for NTT business expansion, no specific criteria have been established to guide applications by NTT companies wanting to engage in telecom business currently prohibited by law. An important test case will likely concern NTT's intention to merge all of its ISPs across local and long distance lines. This should be cleared through the process established by the guidelines, which includes public comment. So far no public interaction on this matter has been invited, even though there are potential anti-competitive issues raised by such a move.
- There is a shortage of economic skills within the ministries and agencies (MPHPT and JFTC in particular) to perform true economic based analysis required to determine market power and its abuse.
- In sum, while we appreciate the strides Japan has made to improve the competitive environment in the Japanese telecommunications sector, we feel that more can be done in the area of oversight and enforcement. This includes strengthening competitive safeguards placed on the NTT group to prevent anti-competitive behaviour and strengthening the power of the regulator to deter such abuses.

New recommendations:

- We maintain our original recommendation.

7. Cross-border share-for-share transfers (and related tax implications)

Previous recommendations:

- Cross-border share-exchanges should be made possible in Japan.
- At the very least, some mechanism should be introduced where-by foreign firms would be able to take advantage of tax deferral incentives currently available to wholly Japanese corporate reorganizations.

Current status:

- No provision has been made available in recent commercial code revisions for foreign companies to make stock-for-stock acquisitions of Japanese firms, and therefore take advantage of tax-deferral advantages available to domestic share and asset transfers. The GOJ position is that global share swaps would raise shareholder protection concerns since shareholders of one company would be forced to become shareholders in a firm based outside the country.

Commentary:

- The inability of foreign firms to acquire Japanese firms through a share-for-share transaction and therefore take advantage of tax deferral mechanisms available to wholly domestic transactions is clearly discriminatory.
- This also has a serious adverse impact on the Japanese investment environment since M&A deals involving some sort of share transfer now account for over 60% of all M&A activity world wide.
- The international trend is definitely towards supporting global M&A activity by providing for tax deferrals involving share-for-share transfers, or like-transactions. It should be noted that measures exist in most major European tax jurisdictions for global share-for-share exchanges and subsequent tax deferral. In other words, it is possible (in most cases) for Japanese firms to engage in M&A activity with European firms on a tax neutral basis, but not the other way around.
- We also fail to understand the GOJ's concern about protecting Japanese shareholders against a foreign share-for-share acquisition. After all, nobody is "forcing" anybody to do anything: it is the shareholders themselves who make the decision whether or not to accept a foreign acquisition offer, which currently requires 2/3 support. Prohibiting global share-swaps simply denies Japanese shareholders of this choice.

New recommendations:

- We maintain our previous recommendations.

8. Provision of legal services

Previous recommendations:

- Barriers within the legal profession, such as prohibitions on foreign-domestic partnerships and requirements for written advice for foreign lawyers advising on third country law should be removed to ensure access to comprehensive, integrated legal advice in Japan.

Current status:

- Domestic/foreign partnerships – The GOJ's current position is that the "Specific Joint Enterprise" system provides adequate means for foreign/domestic lawyers to work together and has no intention of allowing complete freedom of association between foreign/domestic lawyers in Japan.
- Advising on third country law – The GOJ current position is that requirement for foreign lawyers to receive written advice before advising on third country law is necessary to protect clients.

Commentary:

- The Judicial Reform Council (JRC) report approved by the Cabinet on June 15, 2001 contains many good recommendations for the complete overhaul of the Japanese legal system. If implemented properly, the proposals contained in this report such as increasing the number of lawyers in Japan, expanding the role of specialized attorneys, and improving the disclosure process in civil trials could greatly improve efficiency and accountability in the Japanese legal system, which is one of the main goals of this working group.
- The key now will be making judicial reform a reality. We support the establishment of the Judicial System Reform Promotion Headquarters and urge the GOJ to make judicial reform a top priority.
- While the Final Report clearly recognizes the need for firms doing business in the global economy to be able to procure comprehensive and integrated legal advice, it did not explicitly call for the complete elimination of barriers in the legal services profession between foreign and domestic lawyers. This is unfortunate as these restrictions are not only clearly discriminatory, but also represent a major barrier to the establishment of a truly global legal services sector in Japan, something that the business community desperately needs.
- It should be noted that business organizations and government representatives have been lobbying for complete freedom of association between foreign and domestic lawyers ever since the Foreign Lawyers Law went into effect in 1987.

Questions:

- We ask that the GOJ keep the EUJBDRT informed of concrete measures to implement the proposals contained in the JRC Final Report.

New recommendations:

- The GOJ should make the implementation judicial reform based on the Final Report of the

Judicial Reform Council a priority.

- In particular, barriers within the legal profession, such as prohibitions on the freedom of association between foreign and Japanese lawyers and requirements for written advice for foreign lawyers advising on third country law, should be removed to ensure access to comprehensive, integrated legal advice in Japan.

9. Visas and work permits

Previous recommendations:

- Japanese immigration law should make it easier for companies to efficiently allocate human resources on a global basis. Specific proposals include the following:
    1. The re-entry permit system should be abolished. Foreign workers should free to come and go as they please within the period specified by the original visa.
    2. Companies should be able to decide independently who is eligible as a transferee, and not be limited by time of employment.
    3. We urge the GOJ to take action on liberalizing requirements for specialist workers as soon as possible. The EBC recommends that the ten-years experience requirement for engineers, skilled labour, and humanities specialists should be cut in half.

Current status:

- Re-entry permit system – The maximum period during which re-entry is permitted has been extended from one to three years as of Feb.18, 2000. However, the GOJ has no intention of eliminating the re-entry permit system all together.
- Transferees – No change. Applicants must have worked a minimum of one year at head office in order to be eligible for this visa.
- Ten-years experience requirement – The GOJ is currently thinking about reviewing regulations regarding foreign specialists and engineers in areas where these skills are currently in demand, but has not drawn any conclusions yet.

Commentary:

- Re-entry permit system – While we appreciate the GOJ's efforts to extend the validity of re-entry permits, it is still not clear why a re-entry permit system is required.
- Transferees – While we understand the GOJ's desire to prevent the abuse of Japanese immigration laws, this requirement represents an unnecessary burden on European companies transferring employees to operations in Japan, especially for training purposes.
- Ten-years experience requirement – We are encouraged by current discussions surrounding specialist workers, especially in the IT sectors, and hope that the GOJ will reach a conclusion on this issue as soon as possible.

New recommendations:

- We maintain our previous recommendations.

III. Reviewing progress in Europe from a Japanese perspective

1. Introduction

Last year, we made recommendations focusing on the major problems that Japanese companies were facing in conducting business activities targeting the EU market. We would like to express our heartfelt gratitude to the European Commission for their detailed responses to our recommendations.

We have made the following new recommendations referring to the European Commission's responses to our previous recommendations. These are based on a review of subsequent progress made in the EU, and include recommendations on new problems arising from subsequent business activities.

We request that the European Commission promptly solve the problems listed below.

2. Facilitating EU-wide business development

As a result of EU market integration and the progress of the EMU, it is becoming of the utmost importance for Japanese companies to expand their business on an entire EU-wide basis. Unlike EU companies, which have already established their business bases in each of the EU member states, most Japanese companies have only recently started their business in Europe. They have no choice but to expand their business in the integrated EU market through unified and more efficient management.

Appropriate company laws and regulations and a proper taxation system covering the entire EU should be available for companies to conduct EU-wide business activities. For company laws and regulations, we urge the adoption and implementation of the European Company Statute to enable EU-wide unification of management and business restructuring.

For the taxation system, we request that companies be provided with a single common corporate tax base for their EU-wide activities as early as possible and that a consolidated tax system be introduced.

2-1 Societas Europaes (SE)

Recommendations made in July 2001:

- It is expected that the *Societas Europaes* related regulation and directive will be promptly established and put into effect.
- EU's Merger Directive will be applied to the formation of the SE by merger. According to the directive, however, formation by merger is available only to public limited companies. Why is it so decided? Most Japanese companies now operating in Europe are private limited companies, and private limited companies should also be allowed to create an SE by merger.
- The present *Societas Europaes* draft does not cover taxation. Without a privileged tax treatment, however, there would be fewer advantages in creating the SE. We desire that a directive that allows losses endured by branches operating within EU to be offset by the profits earned by the parent company, as well as a directive to harmonize the Member States' national systems concerning the carryover of losses, be promptly adopted and put into effect.

European Commission progress report of March 2002:

- The directive and the regulation governing the *Societas Europaes* will both enter into force in October 2004.
- The aforementioned directive and regulation do not govern the offset of profits and losses. The European Council has not yet adopted the European Commission's proposal for a directive on the offset of profits and losses with subsidiaries located in other EU Member States.

Evaluation:

- We appreciate that a time frame has been set for the implementation of the directive and regulation governing the planned SE, and will monitor the legislation process.
- Without a privileged tax treatment, there would be little merit in selecting the creation of the SE.

New recommendations:

- Private limited companies should also be allowed to create an SE by merger. For the "European Private Company" described in the consultative document prepared by company law experts titled "A Modern Regulatory Framework for Company Law in Europe," we could expect that such a new European legal form of company will cover those issues not covered by the European Company Statute. We therefore hope that further examinations will be made concerning a European Private Company. Both private companies and unlisted public companies should be allowed to establish European Private Companies through mergers or by converting their existing local corporations in EU Member States to such Companies.
- It should be made clear that the SE will enjoy privileged tax treatment. It is especially important that the tax system not prevent the offset of losses endured by branches and subsidiaries with profits earned by their parent companies or the restructuring of companies. Accordingly, the following two directives should be modified to cover the SE.
  - -The EU Parent-Subsidiary Directive, which stipulates that dividends between parent and subsidiary companies shall be exempted from withholding taxes

-The EU Merger Directive, which provides for the tax exemption of capital gains obtained in the merger, split, and transfer of assets by companies

- We urge the prompt establishment of a new directive substituting the yet-to-be adopted draft directive concerning the offset of losses.

2-2 Merger Directive and harmonization of national corporate tax bases

Recommendations made in July 2001:

- The scope of the Merger Directive should be expanded so that it can be applied to intra-group reorganizations such as changing a local corporation structure to a branch structure operating under a European headquarters.
- The national tax systems should be further harmonized, including capital gains taxation.

European Commission progress report of March 2002:

- The European Commission is currently discussing, with the Member States, how to extend and improve the scope of the Merger Directive.
  - The adoption of the *Societas Europaes* will help to tackle this problem. The list of companies to which the Merger Directive applies has to be modified to include the SE.
- As regards the restructuring of companies, the situation is becoming more complex, involving general transfer taxes and capital gains taxation.
  - The recent Commission Communication, "Towards an Internal Market without Tax Obstacles – A strategy for providing companies with a consolidated corporate tax base for their EU-wide activities" and the accompanying study report "Company Taxation in the Internal Market" show various ways in which the Directive could be extended and improved.

Evaluation:

- We highly appreciate that further examinations have been made for the removal of obstacles related to EU-wide corporate management, business restructuring and to taxation. We will monitor subsequent progress.
- In its Communication published under the title of "Towards an Internal Market without Tax Obstacles," the European Commission identifies many of the tax-related problems that need to be resolved for smoother Japan-EU business activities. We welcome this report and urge the Commission and the Member States to promptly deal with the issues discussed in the report, including the implementation of the measures proposed in our new recommendations, as detailed below.

New recommendations:

- To extend and improve the Merger Directive to remove obstacles related to EU-wide corporate management, to business restructuring and to taxation.
  - To include the SE in the scope of the directive
  - As pointed out in the Communication, the implementation rules of the Merger Directive greatly differ by member state, which reduces the effectiveness of the Directive. This causes various problems, especially for Japanese companies operating in the EU. To restructure their local corporations into branches, the Japanese companies transfer the assets of local corporations to their European headquarters according to the Merger Directive. There are, however, some member states that oblige these companies to

continue to maintain an “empty corporation,” whose assets have already been transferred, for a certain period. This incurs unjustified costs by the companies, both in terms of maintenance costs and of dividend withholding tax, and inhibits their group restructuring operations. To resolve this problem, it is necessary for this obligation imposed by the member states to be discontinued or for Japan and the EU to conclude a comprehensive agreement to allow the deferral of tax on such operations.
- As mentioned in the Communication, the Merger Directive does not provide for the deferral of transfer tax for cross-border restructuring operations. This seriously hinders companies from restructuring their businesses and the Merger Directive should be promptly revised to cover taxation on cross-border transfers.
- The harmonization of national corporate tax bases will provide a fundamental and systematic solution to the diverse tax problems that companies operating in two or more EU Member States are facing in conducting their business activities. We admire the European Commission’s initiatives for the harmonization of national corporate taxation systems, and express our strong hopes for the early achievement of this harmonization.

3. Facilitating the free flow of management resources between the EU and Japan

To promote business between Japan and the EU, it is important to ensure free and smooth movement of managerial resources (labor, goods and money).

The movement of labor refers to the "temporary movement of labor" under GATS. The smooth movement of labor has become of the utmost importance for Japanese companies operating in Europe. The following shows the specific issues that we are facing and suggested response.

Issues

- Smoother and more efficient allocation of managers and representatives within companies

- Promotion of the contract-based movement of human resources having advanced expertise

Suggested response

- To solve the double payment of pension costs

- To simplify, speed up and increase the transparency of immigration procedures, including those for the issuance of visas and work permits

- To promote the mutual recognition of qualifications (for lawyers, accountants, engineers, architects, IT professionals, etc.)

For goods, tariffs are the biggest hindrance to their cross-border movement. We think it necessary for all remaining tariffs and quotas between the EU and Japan to be removed.

For the movement of money, there has recently been the possibility that the EU's preferential taxation for foreign investment will be regulated, which might seriously hinder investment in Europe by foreign companies – including ourselves. Concerning harmful corporate tax competition, we believe that general tax competition should not be deterred. By taking into consideration the importance of facilitating investment in the EU economy, measures for facilitating investment which are now being restricted to foreign companies should become general measures, which apply to all domestic companies equally.

3-1 Double payment of pension costs and double taxation

Recommendations made in July 2001:

- In anticipation of the creation of a single EU social security system in the future, negotiations between Japan and EU Member States should in the meantime reduce the expenses resulting from double payment of pension costs.
- It is expected that the Council will prompt member states other than Germany and the UK to conclude social security agreements with Japan in order to solve the double payment problem.

European Commission progress report of March 2002:

- EC regulation in the field of social security coordinates, but does not harmonize, the Member States' national social security systems. The European Commission has therefore proposed to the Council to amend the regulation to cover nationals of third countries who legally reside and pay social security contributions under the legislation of a Member State.
- The Council drew up the basic principles for the modernization of the regulation and those principles will form the basis for future reform of the regulation.

Evaluation:

- In the Progress Report, the European Commission proposes to apply the basic pension aggregation rule to nationals of third countries, in addition to nationals of European countries. We welcome the proposal because it will promote the smooth movement of Japanese employees within the EU, and request that this proposal be promptly implemented.

New recommendations:

- Occupational pension-related problems still constitute an obstacle to the movement of labor within the EU. The harmonization of occupational pensions will provide a fundamental solution to these problems, which is, however, politically difficult. We therefore propose the following as more realistic solutions:
  1) Harmonization of taxation targets (impose tax on premiums and not on pensions received)
  2) Mutual recognition of tax qualification standards among Member States
- We urge the Japanese government and the governments of EU Member States to make further efforts for the conclusion of social security agreements between the Member States and Japan.

3-2 Visas and Work Permits

Recommendations made in July 2001:

- Many of the Member States are still implementing unclear, time-consuming and complex procedures for visas and work permits. The European Commission should encourage such Member States to improve their procedures to grant visas and working permits as soon as possible.

European Commission progress report of March 2002:

- It is stipulated that the decision to grant or to refuse the primary residence permit shall be made as soon as possible and in any event not later than six months from the date of application for the permit.
- It is also stipulated that the formalities for obtaining a residence permit shall not hinder the immediate beginning of employment under a contract concluded by the applicants.
- As regards third country nationals, the Member States currently, and for the foreseeable future, decide upon the rules and conditions of entry, residence and employment.

Evaluation:

- No progress has been made in relation to nationals of third countries. We hope that such progress will be promoted.

New recommendations:

- We urge the European Commission to encourage the Member States to improve the transparency, simplicity, and efficiency of their visa and work permit granting procedures.
- In Italy, the number of work permits that can be issued has been greatly reduced, which made it difficult for Japanese companies operating in the country to transfer their employees or to conduct business activities. Visas and work permits are the most basic conditions for the investment environment, and we urge the European Commission to instruct Member States to make improvements concerning this issue as soon as possible.
- The draft directive concerning the free movement of third-country nationals within the EU, which was proposed by the European Commission in July 2001, might conflict with the reciprocal visa exemption arrangements made between Japan and the Member States, and could prevent the free movement of Japanese businesspersons within the EU. We urge the Commission to deal with this issue carefully.

3-3 Tariffs

Recommendations made in July 2001:

- Tariffs on manufactured goods are very high in the EU, including consumer electronics products (14%) and passenger vehicles (10%). These high tariff rates should be lowered.
- The intentional and arbitrary changing of tariff classifications, which is often the case with digital products, should be avoided.
- All remaining tariffs and quotas between Europe and Japan should be removed.

European Commission progress report of March 2002:

- The aforementioned recommendations give a selective and imbalanced picture of the tariff situation.
- Prospects for implementation

  The launch of multilateral market access negotiations for non-agricultural products within the new Round will provide an opportunity for both the EU and Japan to reduce overall tariff levels and tariff peaks as well as to seek harmonized and simpler tariff structures for all WTO members.

  The evolution of technology and the convergence of industries have led to challenges in the classification of many products. Perhaps a modernization of the HS nomenclature will be required.

Evaluation:

- We agree with the "Prospects for implementation" as mentioned above.

New recommendations:

- We expect that the aforementioned recommendations made in July 2001 will be implemented.
- As mentioned in the "Evaluation" above, we would like to see our recommendations be implemented in the new WTO Round.