The EU-Japan Business Dialogue Round Table
Working Party 1

"Creating an open environment for trade and investment"

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Recommendations to the EU and Japan

1-EJ-1 Joint declaration on direction to enhance foreign direct investment between the heads of the governments of the EU and Japan

(Joint recommendation)

<Summary of the recommendation>

1. The heads of governments of the EU and Japan should make a joint declaration on the principles and general directions that would form a framework for policy to promote direct investment between the EU and Japan.

2. Such a joint declaration should explicitly refer to the following four priorities: the optimisation of the returns on investment; supporting timely development of business; supporting timely and smooth business reorganisation; and promotion of regulatory reforms.

<Background>

An increase in mutual foreign direct investment would help contribute to the development of knowledge-based economy in the EU and Japan. In order to make this goal a reality, it is important that the promotion of direct investment be implemented in concrete policy terms.

At last year's BDRT, Working Party 1 recommended that the EU and Japan sign an FDI Enhancement Agreement establishing a framework for mutual efforts to promote and facilitate an increase in foreign direct investment. The main purpose of this recommendation was to encourage the governments of the EU and Japan to go beyond the commitments agreed in the 2003 EU Japan Summit, which focused primarily on increasing investment promotion efforts, to address the many ideological and structural barriers inhibiting foreign direct investment between the EU and Japan in areas such as taxation, corporate reorganization, human resource management and the regulation of commercial activity.

Both governments have pointed out difficulties in concluding such an agreement at an early stage. We understand numerous political and practical difficulties involved in developing a formal agreement and ask this year that as a first step the heads of both governments commit themselves to the principles and general directions of a framework for a policy to promote direct investment.

Such a joint declaration should explicitly refer to the priorities in policy making that were raised by the BDRT last year, namely optimising returns on investment, supporting the timely development of business, supporting timely and smooth business reorganisation, and promotion of regulatory reforms.

<Relation with the progress reports>

It is unlikely that our previous recommendation, a 'framework agreement between the EU and Japan to enhance foreign direct investment', will be realised. However, both sides recognise the importance of the promotion of direct investment between the two

regions and have organised investment seminars and press tours for inward investment (the Japanese report), and carried out internal studies and discussion at the EU-Japan regulatory reform dialogue (both reports). Although the impact of such efforts has been limited, these efforts should nevertheless be welcome as a move towards promotion of direct investment.

However, concerning the removal of tax obstacles, which is one of the four priorities, both sides do not show any progress. The Japanese report states that appropriate requests would be taken as suggestions to improve business environment. The EU report states that because such issues belong to the competence of the Member States follow-up is to be carefully considered.

1-EJ-2 The optimisation of returns on investment

(Joint recommendation)

1. Avoidance of double taxation

<Summary of recommendation>

The two governments should exempt dividend payments from subsidiaries to parent companies and royalty and interest payments between related companies from withholding taxes.

<Background>

To optimise the return on investment and to reduce the possibility of double taxation, and thus enhancing direct investment between the EU and Japan, the two governments should agree that withholding taxes should be exempted on dividends from subsidiaries to its parent company, and on royalty and interest payments between related companies.

It will be necessary to modify the double taxation treaties between each EU Member State and Japan and reduce withholding taxes on dividends from subsidiaries to its parent company, and on royalty and interest payments between related companies to zero per cent.

Japan and the Netherlands have just started negotiations to revise their double taxation treaty, which may result in the reduction or exemption from withholding taxes of dividend, royalty and/or interest payments received by parent companies. The working party welcomes this initiative. The governments of Japan and the EU should make further efforts to start negotiations on treaty changes between Japan and Member States other than the Netherlands as soon as possible. We ask that the European Commission encourage Member States to address this issue in an expedient manner.

The working party notes that the new US-Japan tax treaty will provide a number of benefits to investment flows between the US and Japan through the reduction and/or

elimination of withholding taxes on dividends, royalty and interest payments. It is important that such benefits are made available to investment flows between the EU and Japan.

<Relation with the progress reports>

In general, reference to taxation in the progress reports is made in the abstract. The Japanese report states that appropriate requests would be taken as suggestions to improve the business environment and that negotiation for the modification of the existing double taxation treaties or new ones with European countries would be pursued as necessary. The EU report states that because such issues belong to the competence of the Member States follow-up is to be carefully considered.

The EU progress report states that a tax package including common system of taxation that exempts withholding tax on interest and royalty payments made between associated companies of different Member States was adopted in June 2003 and implemented from 1 January 2004.

2. Reducing compliance costs associated with transfer pricing

<Summary of recommendation>

A reduction of compliance costs of transfer pricing through simplification and rationalisation of transfer pricing regimes internationally would increase international competitiveness of businesses in the EU and Japan. The two governments should create a joint work group in order to realise the following:

(1) Harmonise and simplify interpretation and documentary requirements between the EU and Japan and among the EU Member States in order to reduce the costs of compliance to various transfer pricing taxation regimes.
(2) In order to reduce the costs of preparing for and obtaining APAs (advance price agreements), guidelines on unilateral, bilateral and multilateral APAs between the EU and Japan should be established, which would enable harmonised rules and operation of APA regimes between Japan and all the EU Member States.

<Background>

For transfer pricing taxation, while there is a convergence of policies among major countries according to the OECD Guidelines, companies find it costly and complicated to comply with the transfer pricing requirements of various countries.

For example, APAs are increasingly adopted by the EU Member States, but the conditions differ by country, and companies have to vary their approaches according to the local rules. As a result, compliance costs associated with the transfer pricing taxation requirements are high. In Japan APAs have been utilised effectively for some time, but inconsistencies remain between the methodologies used in APAs (where company-level profitability of public companies is

commonly used) and audit assessments (which relies heavily on secret comparables).

Under the circumstances, the governments of the EU and Japan should establish a joint work group in order to draw up guidelines at an early stage.

(1) Harmonisation and simplification of interpretation and documentary requirements

The guidelines should aim to harmonise and simplify interpretation and documentary requirements between the EU and Japan by establishing best practice. Best practice could then be applied by Japan and each Member State, which could reduce the costs of compliance to various transfer pricing taxation regimes.

We note that a Transfer Pricing Documentation Package has been developed recently by the Pacific Association of Tax Administrators (PATA) and suggest that this work be used as a basis for the establishment of best practice in this area between the EU and Japan.

(2) Guidelines on APAs

APAs (advance price agreements) are spreading rapidly to cover transactions between the EU Member States and Japan. However, the cost of obtaining such an agreement is not insignificant for businesses. Although it is desirable to obtain several bilateral APAs or a multi-lateral APA when several Member States are involved, the costs involved are often prohibitive partly due to varied requirements of the countries involved. In order to reduce the costs of obtaining APAs, guidelines should be established on unilateral, bilateral and multilateral APAs between the EU and Japan. Such guidelines, when applied by all the Member States and Japan, would enable a harmonised application of APAs between Japan and all the EU Member States.

< Relation with the progress reports >

The Japanese report states that the government understands that taxpayers are facing costly duplication of administrative requirements but did not go any further than requesting more efforts by businesses. The Japanese report has reiterated the principles on documentation agreed in the PATA that multinational enterprises should make sufficient efforts by complying with the rules determined by the taxation authorities and that they should submit documents promptly as the taxation authorities require.

The EU report recognises the high compliance costs of transfer pricing as an issue in its communication 'Towards an Internal Market without tax obstacles – A strategy for providing companies with a consolidated corporate tax base for their EU-wide activities' COM (2001) 582 in October 2001 and has set up a Joint Forum on Transfer Pricing. It has stated, however, that the forum will not discuss

the EU-Japan issues and that they should be solved through the modification of double taxation treaties between the EU Member States and Japan.

Concerning the establishment of APAs, the EU report states that it is recommending to the Member States to promote APAs. The Japanese report states that it is appropriate to form a consensus on APAs, among other issues, among Japan, the EU and its Member States through discussion at the OECD.

3. Participation exemption

<Summary of recommendation>

The governments of the EU, the EU Member States and Japan should, as a medium to long-term objective, consider the introduction and/or expansion of participation exemption regimes in order to promote direct investment between the EU and Japan.

<Background>

Participation exemption, by which dividends and capital gains received from business investment are exempted from further corporate taxation, is one measure to encourage mutual direct investment.

Participation exemption is also effective in encouraging direct investment in other countries from Japan and the EU, for example investment in wider Asia through Japan.

Participation exemption regimes are becoming more and more common in European tax jurisdictions. This working party recommends that the governments of the EU, each Member State and Japan consider the introduction and/or expansion of participation exemption as a medium- to long-term objective. Such exemption could be granted to capital investment that qualifies certain conditions such as the minimum holding rate and period.

<Relation with the progress reports>

New item.

1-EJ-3 Supporting timely development of business (smoother and swifter transfer of personnel)

(Joint recommendation)

<Summary of recommendation>

1. The two governments should declare that social security treaties between all the Member States of the EU and Japan should be concluded as soon as possible.

2. The two governments should simplify and accelerate the procedure to obtain a work and residence permit – or a residence permit for self-employed statutory directors – for intra-corporate transferees between the EU and Japan. The procedure should include a possibility to submit an application for a work-residence permit or a residence permit for self-employed after entering the assigned country. Furthermore, spouses should be granted the same rights as the holder of the permit, such as a work-resident permit and a residence permit for self-employed.

<Background>

1. Double payments of social security contributions by and for their personnel dispatched between the EU and Japan discourage investment by businesses.

   When a company sends its employee to an overseas assignment for a limited period – a few years, for example – it is often the case that the employee concerned keeps on contributing to the social security system, particularly pension funds, of the sending country. If contribution to the social security of the hosting country is obligatory, contributions will be paid in both countries. This double payment is heavy and an unnecessary burden for a company and/or its employee. A social security treaty solves this problem by typically exempting intra-corporate transferees from contributing to the social security system of the hosting country for a limited period. So far the United Kingdom and Germany have concluded bilateral social security treaties with Japan and they have been put into effect. France and Belgium are negotiating similar treaties with Japan.

   It takes a few years at least to negotiate, conclude and ratify a social security treaty. With an additional 10 Member States from May this year, it is clear that it will take more than 30 years to conclude such treaties between 25 EU Member States and Japan. It is clear that this bilateral treaty process is too slow.

   The heads of the governments of the EU and Japan should agree upon and declare the aim to conclude social security treaties between all the Member States of the EU and Japan as soon as possible. Following an agreement, both parties should jointly look for ways to accelerate the conclusion of social security treaties between all the Member States of the EU and Japan.

2. For the smooth and efficient running of international businesses, it is essential that companies are able to dispatch key personnel including directors. Such transfers do not have any negative impact on the labour market in the host country. On the contrary, it will expand employment in the host country through the development of business. The requirement to obtain a work and residence permit – or a residency permit for self-employed statutory directors – for intra-corporate transferees between the EU Member States and Japan is usually a formality and it is rare that the application of intra-corporate transferees is questioned with substantial reasons. However, the burden on companies as well as employees and their families is substantial, and does constitute an obstacle to swift development of business.

It should be agreed, therefore, that the procedure to obtain a work and residence permit or a residence permit for self-employed for intra-corporate transferees between the EU and Japan should be simplified and accelerated and include a possibility to submit an application for a work-resident permit or a residence permit for self-employed after entering the assigned country. We note that in Japan, this is already possible.

Furthermore, to facilitate swift deployment of personnel, spouses should be allowed to engage in economic activities in the host country. They should be granted the same rights as the holder of the permit, such as a work and residence permit, and a residence permit for self-employed.

<Relation with the progress reports>

1. The EU report states: *'Community provisions in the field of social security, in particular Regulation (EEC) 1408/71 co-ordinate, but do not harmonise arrangements for people who exercise their right to free movement within the European Union. Member States continue to be responsible for the funding and organisation of their social security systems. They are therefore free to determine details of their own social security systems, including which benefits shall be provided, the conditions for eligibility and the value of these benefits, as long as they adhere to the basic principle of equality of treatment and non-discrimination as laid down in the Regulation. It is also the exclusive competency of Member States to conclude social security treaties with third countries.'*

   The EU report also states that the above regulation has been amended and that its provisions have been extended since June 2003 to third-country nationals who live in a Member State legally.

   The Japanese report states that treaty negotiations with France and Belgium are carried out with strenuous efforts for early conclusion but that a decision on which countries to enter into negotiations with next will be made after taking into account requests from businesses among other elements.

2. The Japanese report states that an intra-corporate transferee can already apply for a permit even if he or she has entered Japan for other purposes and that such an application is treated swiftly. The EU report did not refer to this item.

1-EJ-4 Supporting timely and smooth business reorganisation from legal and tax points of view

(Joint recommendation)

<Summary of recommendation>

1. Respective company laws should be improved in order to facilitate cross-border reorganisations between the EU and Japan that involve exchange of shares and transfer of assets.

2. Tax law should be improved in order to expand the scope of tax deferral on unrealised profits resulting from business reorganisations including those involving exchange of shares and transfer of assets.

<Background>

1. Company Law

   For companies with global business, timely reorganisation of group business across national borders is essential in order to cope with rapidly changing markets and business environment.

   Japanese company law and tax law have improved considerably over the past five years and now enable companies to carry out a wide range of business reorganisations on tax neutral basis. However, cross-border reorganisations are not always within the scope of these laws. For example, cross-border exchange of shares is still not possible. We are pleased that many of these issues will be addressed in planned changes to the Commercial Code, which will introduce a wider variety of modern restructuring methods, including those involving foreign firms.

   In the EU, although the European Company Statute will enable cross-border mergers from October 2004, companies that are not in the form of public companies will have to wait for the adoption of the 10th Company Law Directed proposed in November 2003.

   The two governments should improve respective company laws and related provisions swiftly in order to facilitate cross-border business reorganisations.

2. Taxation

   In a cross-border merger, when the merging company issues shares in exchange for shares in the merged company, the recipient of new shares may be taxed for unrealised gains. In order to facilitate cross-border business reorganisation, it is necessary to modernise tax laws and enable tax-neutral cross-border exchange of shares.

   In Japan, tax deferral is currently only available for share exchanges involving Japanese-only companies, and only then in qualifying circumstances.

   When a company carries out cross-border reorganisation in the EU that does not qualify within the scope of Merger Directive, unrealised gains may be taxed. Taxation on unrealised gains at a time of reorganisation could be a considerable amount and could deter companies from reorganisation, which would reduce the international competitiveness of the company and consequently the international competitiveness of the EU economy.

The two governments should improve respective tax laws in order to widen the scope of tax-neutral reorganisation.

<Relation with the progress reports>

The Japanese report states that in April 2003 the Industry Revival Special Law was amended to introduce flexibility in the types of consideration used for mergers and that modern reorganisation methods are being discussed in the Company Law Group of the Legal Council with a view to amending the Commercial Code in 2005. In October 2003 a draft text was published for public comments, and included proposals such as increasing flexibility for types of consideration, such as triangular mergers and cash mergers, and short-form mergers. Concerning the taxation side of supporting reorganisation, the report states that appropriate requests would be taken as suggestions to improve business environment.

The EU report states that the Commission is not satisfied with the current limited scope and practical implementation of Directive 90/434/EEC on Mergers and that, with the view of addressing this issue by, for example, extending the application of tax deferrals to a new business re-organisation, the split-off, and of extending the applicability of the Directive to companies formed under the European Company Statute, the Commission presented a proposal in October 2003.

The EU report states that with regard more specifically to tax deferral on real property transactions and transfer of other intangible assets, after consulting the Member States, the Commission decided to limit its proposals. Furthermore, the report states that Member States would be most unlikely to agree to extending the scope of the Merger Directive to Japan-based companies, considering that such matters should fall within the scope of their individual bilateral tax treaties with Japan.

1-EJ-5 Promotion of regulatory reforms

(Joint recommendation)

<Summary of recommendation>

1. The EU and Japan should continue to cooperate with each other through their on-going regulatory reform dialogue with the goal of creating an open environment for trade and investment.

2. The EU and Japan should abolish unreasonable authorisation procedures related to products and services, and continue to pursue mutual recognition of product standards, certification and notification.

<Background>

We appreciate the commitment of the governments of the EU and Japan to regulatory reform, as demonstrated in the annual EU-Japan regulatory reform dialogue. Cumbersome regulatory requirements represent a large barrier to increased trade and

investment. Mutual recognition of divergent regulatory requirements and compliance procedures should be pursued as much as possible.

<Relation with the progress reports>

Both the EU and the Japanese reports refer to improvements in regulatory environment as a result of the two High Level Meetings on Regulatory Reform in November 2003 and February 2004.

Furthermore, the Japanese report states that, following the policy speech by Prime Minister Koizumi in January 2003, a programme of promoting inward investment in Japan that cover 5 areas and 74 items was agreed in an Invest in Japan meeting and that various measures have been implemented. In addition, the report refers to reforms in certification based on the re-amended 3-year plan to promote regulatory reforms.

Recommendations to Japan

1-J-1 Promoting economic growth through decisive reform

(Europe-side recommendation)

<Summary of recommendation>

It is important that the Japanese Government continue pursuing its structural reform agenda so that the current economic recovery can be maintained.

<Background>

Corporate sentiment has improved since last year. This improvement can be attributed to a number of factors, including the business community's ongoing efforts to restructure operations, an increase in consumer confidence, and efforts by the Japanese Government to secure Japan's financial system by injecting public funds where necessary and pressuring financial institutions to clean up their bad-loan portfolios.

Having said this, if Japan's economic recovery is to be maintained, structural reform efforts initiated by the Koizumi Cabinet in areas such as public finance, social security, decentralization, regulatory reform, privatisation, and financial system reform, must continue to be implemented in a timely and resolute manner.

1-J-2 Modernizing legal and tax systems to support foreign investment

(Europe-side recommendation)

<Summary of recommendation>

The commercial code and relevant corporate tax laws should be revised to allow for cross border share exchanges on a tax-neutral basis.

<Background>

Merger and acquisitions represent the largest portion of foreign investment into Japan. This form of investment would likely increase if corporate and tax laws made it easier for foreign companies to use their own shares as consideration in an acquisition on a tax-neutral basis.

Unlike in most tax jurisdictions in Europe, however, Japan does not allow for tax on unrealised capital gains to be deferred on share exchanges involving foreign firms.

We welcome proposals released for public comment on October 29, 2003 by the Ministry of Justice to introduce modern types of organizational restructuring methods into Japan's Commercial Code. This is an important follow-on to the introduction of a triangular merger structure through the Industrial Revitalization Law in April 2003, a reform that unfortunately has not been widely utilised by the business community.

Direct changes to the Commercial Code allowing for a wider variety of modern restructuring methods should be implemented as soon as possible. Japan's Corporate

Tax Law should be amended at the same time to allow for tax-neutral corporate restructurings, including restructurings involving foreign companies.

It is important to note that for cross-border share exchanges involving closely held Japanese firms, it is not necessary to change the Commercial Code in order to allow for tax-deferral on the exchange. This would only require changes to Japan's Corporate Tax Law, which can be implemented before the Commercial Code is reformed.

1-J-3 Championing business activity at the local level

(Europe-side recommendation)

<Summary of recommendation>

More private sector involvement in the delivery of public services should be encouraged through the use of PFI/PPP schemes. Local governments should also take a more proactive role in attracting investment beyond current promotion efforts; for example, by offering special tax and/or regulatory incentives to potential investors.

<Background>

Europe firms are reporting increasingly proactive efforts by local authorities to attract foreign investment, including offering monetary incentives such as subsidies. This is a positive development and should be maintained. It is hoped that with further decentralization (especially the transfer of more taxation authority), local authorities will have even more tools at their disposal to help attract business from overseas. We also see much potential in the use of "special de-regulation zones" to help attract investment.

With regards to the use of PFI/PPP, we note a report published by JETRO in July 2003 entitled "The Survey on Actual Conditions Regarding Access to Japan – Partnership between Public and Private Sectors in Public Works and Services" which highlights the numerous barriers that exist for foreign firms trying to access Japan's public works market. The Cabinet Office's PFI Promotion Committee has also published an interim report (June 1, 2004) outlining barriers to the further development of the PFI market in Japan and suggestions to improve this situation. We ask that the Japanese Government implement concrete measures to ensure that private capital and expertise can contribute more to the development of public facilities and services in Japan.

1-J-4 Creating a strong competition regime

(Europe-side recommendation)

<Summary of recommendation>

It is important that Japan strengthen its competition regime to prevent anti-competitive behaviour. Reforms to the Anti-Monopoly Act proposed by the Japan Fair Trade Commission should be submitted to the Diet and implemented as soon as possible.

<Background>

The Japan Fair Trade Commission has proposed a number of changes to the Anti-Monopoly Act (AMA) that would, amongst other things, raise the amount levied on violations of the AMA and introduce a leniency system for companies that cooperation with JFTC investigations.

The development of a strong competition regime is essential to the development of a business environment conducive to the growth of trade and investment in Japan and we feel that the JFTC proposals represent a pragmatic first step in this direction.

The JFTC proposals are being met with considerable opposition from various elements of the Diet and the Japanese business community. In response to this opposition, we urge the Japanese Government not to forget the benefits of a strengthened competition regime. A strengthened competition regime would help attract new investment, support the establishment of new business, and contribute to a reinvigoration of the Japanese economy. This is essential not only in terms of the potential contribution to economic growth, but also in terms of Japan's appeal to the international community as a modern, open economy.

1-J-5 Privatisation of Japan Post

(Europe-side recommendation)

<Summary of recommendation>

The privatisation of Japan Post is an important element of the Japanese Government's ongoing structural reform efforts and, if implemented effectively, will contribute to the reinvigoration of the Japanese economy. It is imperative, however, that the framework for privatisation ensures a level playing field for private sector competitors in Japan Post's three core business lines: insurance, banking and delivery services.

<Background>

In principle, we support the privatisation of Japan Post and its three core businesses: postal services, savings, and insurance. The benefits of privatisation will only be realized, however, if the Government of Japan establishes a framework for privatisation that ensures a level playing field in the market. In the case of Japan Post, this will not be easy considering the sheer size of its current operations.

Strict limits should be placed on the ability of Japan Post to expand its business in insurance, banking and other areas until appropriate competitive safeguards are in place to prevent Japan Post from using its dominant position in existing markets to cross-subsidize loss-making business, as well as entry into new business areas. As such, we support the complete separation of Japan Post's insurance, savings and postal services business into at least three separate privatised entities.

With regards to Japan Post's *Kampo* insurance business, at a very minimum a privatised Japan Post should be subject to the same capital, solvency margin, tax and policy-holder protection funding requirements as other private insurers in order to create a level playing field in the life-insurance market. Since *Kampo* provides the same services as their private-sector competitors, all should be subject to the same legal and regulatory requirements. We support the Japan Life Insurance Association's call for an immediate freeze on expansion of Japan Post's insurance business.

With regards to Japan Post's savings business, at the very minimum a privatised Japan Post should be subject to the same regulations and supervision as private financial institutions and that all privileges accorded to the current entity as a governmental institution should be completely abolished. We support the Japan Bankers Association's call to limit Japan Post's business in this area to payment and settlement services.

The way in which Japan Post is privatised will have an enormous impact on the market in Japan for insurance, banking and postal services. We urge the Japanese Government to carefully consider the implications of unfettered privatisation on competition and take appropriate measures to create a level playing field in these markets.

1-J-6 Facilitating business development through regulatory reform

(Europe-side recommendation)

<Summary of recommendation>

The Japanese Government's regulatory reform programme should be strengthened by giving the new Regulatory Reform and Privatisation Promotion Council extra powers to implement the Government's "3-year Regulatory Reform Programme" and by expanding the special deregulation zone initiative. Special attention should be paid to regulatory reform recommendations made in the context of the EU Japan bilateral regulatory reform dialogue and recommendations submitted by European business organisations such as the Council of the European Business Community in Japan.

<Background>

We welcome the current Government's ongoing commitment to regulatory reform, including the recent release of a new "3-Year Regulatory Reform Programme" and the creation of a new body under the Cabinet Office tasked with promoting regulatory reform. The proposals contained in the "3-Year Regulatory Reform Programme" should be implemented as soon as possible. A new mechanism should be established that would enable the new regulatory reform commission to force the various Ministries and Agencies responsible for sectoral regulation in Japan to implement these proposals in a timely and effective manner.

We note a number of positive developments in Japan's regulatory reform efforts, including in issue areas previously monitored by the BDRT, including the liberalisation of partnerships between Japanese and foreign lawyers and testing requirements for

animal health products. We are disappointed, however, that many regulatory issues of long standing concern to businesses in Japan continue to be ignored by the authorities and we ask that more effort is made to resolve these issues as soon as possible. Please refer to the “EBC Report on the Japanese Business Environment” for more details.

1-J-7 Ensuring transparency and consistency in the regulatory process

(Europe-side recommendation)

<Summary of recommendation>

Japanese regulators should make more efforts to improve the transparency and consistency of regulation, including for tax-related matters.

<Background>

A lack of transparency and consistency in the application of regulations continues to be 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, especially in areas with complex regulatory environments such as financial services and taxation.

It is still common for rule interpretation and enforcement to vary substantially depending on the officer in charge and the current political situation. It is difficult in many cases to challenge decisions of the regulator for fear of negative treatment from the authorities in the future. Judicial recourse is often not a realistic option, especially for tax-related matters, as the overwhelming majority of rulings favour the regulators. Moreover, disputes between taxpayers and Japanese tax authorities continue to be published regularly in the media, despite the supposed confidentiality of such matters.

A lack of transparency creates uncertainty, and this makes business planning difficult.

Having said this, we are encouraged that the public comment system and the no-action letter system will be reviewed under the Government’s new “3-Year Regulatory Reform Programme”. We also welcome the proposed introduction of a regulatory-impact assessment system into Japan’s regulatory system.

All too often, however, these positive policy initiatives do not filter down to front-line administrators and it is still common to hear replies to requests for clarification to the effect of “just try it and see what happens”.

1-J-8 Modernising Japan’s food additives list

(Europe-side recommendation)

<Summary of recommendation>

The 46 food additives submitted by the Ministry of Health, Labour and Welfare (MHLW) to the Food and Sanitation Control Council on December 19, 2002 should be reviewed and approved for use in Japan without delay.

<Background>

All of the food additives submitted by the MHLW to the Food and Sanitation Control Council on December 19, 2002 have been approved by the Joint FAO/WHO Expert Committee on Food Additives (JECFA) and are in wide use in both the US the EU. Despite the best efforts of the MHLW to review these additives and submit an application for approval to the Food Safety Commission, to date none of these additives have received approval for use in Japan.

The lack of conformity between Japan's food additive list and international standards remains a major barrier to the import of food into Japan. We ask that the Japanese Government expedite the approval process for additives that are in common use throughout the world.

1-J-9 Protecting test data in new drug applications

(Europe-side recommendation)

<Summary of recommendation>

Protection for data submitted as part of a new drug application should be made equivalent to the protection currently provided for in Europe. We support the Federation of Pharmaceutical Manufacturers' Association of Japan (FPMAJ) call for an eight-year protection period, noting that a similar period of protection was approved by the EU Council on March 11, 2004.

<Background>

The cost of developing innovative new drugs and obtaining regulatory approval is substantial. Pharmaceutical companies spend on average 10 years and several billion yen to bring a new drug to market. Data submitted along with new drug applications is therefore valuable intellectual property and should be protected.

1-J-10 Strengthening market mechanisms in the telecommunications sector

(Europe-side recommendation)

<Summary of recommendation>

1. Japan should take immediate steps to exclude NTS costs from the interconnection charge and require the incumbent to absorb rebalanced costs through efficiency and other improvements.

2. Japan should introduce a legislative requirement that the regulator ensure its decisions promote the long-term interests of end-users by focussing on key economic factors, including the need to promote economic efficiency, innovation, investment, and effective competitive outcomes.

3. Japan should strengthen competitive safeguards against abuse of dominance by:
    a) Reinstating the obligation for NTT to notify and price on tariff in all market segments where it is dominant;
    b) Requiring NTT to publish regulatory accounts horizontally across its different businesses and vertically between the network and retail parts of its horizontal business; and
    c) Strengthening firewalls to prevent NTT from leveraging its dominant position in the local loop into new business areas.

4. Inequalities in existing spectrum allocations between mobile operators should be addressed before considering further entry into the market. Payment for spectrum usage should reflect the volume of spectrum used.

<Background>

1. Japanese fixed-line interconnection rates are unacceptably high by world standards. This distorts competition, keeps end-user prices artificially high, and imposes a substantial revenue drain on competitors. By the Japanese Government's own account, the exclusion of non-traffic sensitive (NTS) costs would lower prices to within acceptable benchmark levels. Overseas experience suggests that the incumbent will be able to absorb rebalanced costs without having to pass them on to consumers in the form of higher line rental charges.

2. MPHPT has wide-ranging statutory powers of intervention and control. There are no clearly articulated criteria in the legislation governing the way in which these powers must be exercised. This introduces a high degree of uncertainty and unpredictability into the regulatory process. Most other countries require regulators to ensure their decisions promote the long-term interest of consumers, having regard to key economic factors, as described above. A similar provision is required in Japanese legislation to provide certainty and ensure that decisions are economically robust.

3. Current regulations do not adequately constrain anti-competitive behavior by the incumbent. There is evidence that NTT is actively leveraging its dominant position into new business areas, including by cross-marketing new services to its dominant customer base, in breach of current firewalls. Unfortunately, obligations for NTT to notify and price on tariff have been abolished and there are no requirements for NTT to maintain regulatory accounts horizontally across different businesses or vertically between the network and retail parts of each business unit. It is therefore difficult to monitor anti-competitive behavior, an issue that deserves immediate attention.

4. Current 3G spectrum allocations are unlikely to meet short-term growth requirements for 3G operators. Unfortunately, inequalities in the allocation of

spectrum make it difficult for certain operators to re-deploy spectrum resources for 3G purposes. This issue should be addressed to ensure competitive neutrality and create a level playing field among competing operators. With regards to spectrum usage fees, mobile operators pay the majority of total fees even though broadcasters use the majority volume of spectrum. The spectrum allocation formula should be amended to ensure that spectrum users pay fees relative to the volume of spectrum they use.

For a more detailed overview of these and other challenges, please refer to the European Business Community's position paper "Telecommunications Reform in Japan" (June, 2004).

1-J-11 Foreign tax credit

(Japan-side recommendation)

<Summary of recommendation>

The Japanese government should expand the number of tiers subject to foreign tax credit considerably. Furthermore, the minimum shareholding requirement should be reduced from the current 25% to 5 or 10%.

<Background>

Japanese companies are entitled to the indirect foreign tax credit only up to the second tier subsidiaries under the Japanese tax law. To qualify, Japanese parent company must own, directly or indirectly, 25% or more of the capital or shares in a subsidiary.

In contrast, indirect foreign tax credit under the US tax law is applicable up to the sixth tier subsidiaries. Therefore, a US corporation is able to establish several holding companies at different tier levels with less concern regarding the limitation on the foreign tax credit. The EU will abolish restrictions on tiers in the EU from January 2005 and will gradually reduce the shareholding requirements to 10% by 2009 through Council Directive 2003/123/EC.

These restrictions on tiers could reduce international competitiveness of Japanese companies by double taxation.

The selection of an organisational structure of international business should be based purely on business reasons. The tax system applicable to the parent company should not interfere with these business decisions. There is a serious concern that double taxation resulting from the tier limitation on the applicability of indirect foreign tax credit would deprive Japanese companies of competitiveness in conducting global business when compared with other foreign multinational companies in international markets.

We recommend that the Japanese government should expand the number of tiers subject to foreign tax credit. Furthermore, given the expected increase of strategic alliances, the minimum shareholding requirement should be reduced to 5 to 10%.

<Relation with the progress reports>

The Japanese report states that appropriate requests would be taken as suggestions to improve the business environment.

1-J-12 CFC rules

(Japan-side recommendation)

We recommend the following two points concerning Japanese CFC rules.

1. To exempt profits for re-investment
2. To increase certainty in their application

<Background>

1. Corporate income tax rates in the EU Member States have recently decreased. In some countries, it has dropped to below 25%, which triggers the application of Japanese CFC rules. As Japanese multinational companies expand in cross-border business transactions in the EU, they tend to establish the European headquarters with holding functions. Because of the criteria of the application of the Japanese CFC rules, there is a risk that the CFC rules are applied to the regional headquarters with holding functions in a country where effective corporate income tax rate is less than 25% even if the functions of the regional headquarters are justifiable from a business point of view.

   The application of Japanese CFC rules would lead to the taxation in Japan of the results of the European headquarters and would reduce the amount that could be reinvested. This would hamper foreign direct investment and reduce the competitiveness.

   In order to avoid negative impact on direct investment, we recommend that Japanese CFC rules should not be applied, under certain anti-abuse conditions, to profits intended for re-investment in business for a long term.

2. Under Japanese CFC taxation regime, whether or not a related company in a low taxation jurisdiction falls under the regime has to be assessed every year. For example, if a related company with sales and holding functions is established in a country with less than 25% corporate tax rate, whether or not it is subject to taxation in Japan may depend on the relative performance of the two functions in a given year. This uncertainty could reduce the attractiveness of Japan as a location for the headquarters or a holding company.

   In order to solve this problem, Japanese government should amend the CFC rules and apply the rules in a more predictable way.

<Relation with the progress reports>

The Japanese report states that appropriate requests would be taken as suggestions to improve the business environment.

Recommendations to the EU

1-E-1 The policy of the EU on taxation and company organisation

(Japan-side recommendation)

<Summary of recommendation>

1. The European Commission and the Member States should realise a common consolidated corporate tax base as soon as possible.

2. Merger Directive (90/434/EEC)

   (a) Its scope should be extended to include the deferral of taxation on unrealised gains on goodwill as well as taxation on the transfer of real estates and other intangible assets in reorganisation.
   (b) The requirements in certain Member States to maintain the holding of shares for a number of years should be abolished.

3. We welcome a proposal for Directive of the European Parliament and of the Council on cross-border mergers of companies with share capital (a 10th Company Law Directive) issued in November 2003. It should be adopted and implemented without delay.

4. A proposal for a 14th Company Law Directive on the cross-border transfer of the registered office of limited companies without liquidation and incorporation should be proposed, adopted and implemented as soon as possible.

5. The European Commission and the Member States should make a swift progress in realising the cross-border offset of losses against profits.

6. We welcome the adoption and implementation as from 1 January 2004 of Directive on the elimination of withholding tax on interest and royalty payments within group companies in the EU (Council Directive 2003/49/EC).

7. A Statute for European Private Company should be introduced as a short-term priority.

8. Corporate governance is important for the internal control of a group of companies. There should be a guideline at the EU level on compliance matters. In addition, binding rules in Member States should not constitute obstacles to cross-border investment.

<Background>

Many Japanese companies are implementing integration and rationalisation of their European business organisation in order to cope with the development of Single European Market. Examples are centralisation of such functions as sales support and accounting.

1. The relation between intra-group transactions and taxation is an important element in decision making in a business. It is highly desirable that companies with international business should be allowed to compute the income of the entire group according to one set of rules and establish consolidated accounts for tax purposes in the EU, as the European Commission stated in its communication in October 2001.

The European Commission and the Member States should continue to make efforts, despite divers interests, to realise a common consolidated corporate tax base as soon as possible.

2. (a) In business restructuring, if goodwill is transferred from one Member State to the other, it could trigger taxation in the former state. The cross-border reorganisation of sales networks is often necessary to increase economic efficiency in the Single Market. In such reorganisation, the transfer of goodwill is often unavoidable. However, goodwill transfer could trigger a very high amount of taxation. As a result, companies could be forced to leave economically sub-optimal structure untouched.

   In the annex of the communication COM (2001)582, the European Commission recognised this as an issue and suggested that Directive 90/434/EEC could extend its scope so as to defer the taxation of unrealised gains on goodwill where it is moved to another Member State while preserving the tax claims of the Member State from which goodwill was moved.

   The draft proposal to amend the Directive issued October 2003 (COM(2003)613), however, does not include provisions related to this issue. Furthermore, taxes on the transfer of real estates and other intangible assets in reorganisation are not included in the proposal.

   The European Commission and Member States should recognise the benefit of profound business reorganisation to the competitiveness of European economy and should support it through the introduction of the deferral of taxation on unrealised gains on goodwill as well as on the transfer of real estates and other intangible assets in reorganisation.

   (b) Merger Directive (90/434/EEC) provides for the deferral of corporate tax in the qualified cross-border restructuring of business. In certain Member States, companies are required to hold shares that they have received in exchange of contributed assets for a number of years even if those holding companies cease to function as an operating company.

   In addition to the cost of maintaining these empty companies, tax paid by the subsidiaries of the new holding company will not qualify for Japanese foreign tax credit for the portion distributed through the empty company because the scope of Japanese foreign tax credit is limited to the second tier companies. Therefore, the requirements in certain Member States to maintain the holding of shares for a number of years should be abolished.

3. The taxation regimes for cross-border mergers in the EU have been harmonised by Council Directive 90/434/EEC. Council Regulation EC/2157/2001 will introduce the EU company law framework for cross-border mergers for the SE from October 2004. For the other forms of companies, a 10th Company Law Directive would create the EU company law framework for cross-border mergers.

We welcome a proposal for Directive of the European Parliament and of the Council on cross-border mergers of companies with share capital (a 10th Company Law Directive) issued in November 2003. It should be adopted and implemented without delay.

4. The cross-border transfer of the registered office currently involves liquidation and incorporation of companies, which could trigger exit taxation even if underlying business does not change.

   A proposal for a 14th Company Law Directive, which would provide the EU company law framework for the cross-border transfer of the registered office of limited companies, should be proposed, adopted and implemented as soon as possible.

5. A proposal for Directive for cross-border offset of the losses of permanent establishments and subsidiaries against the profits of the parent company was issued in 1990. The European Commission withdrew the proposal in December 2001. The European Commission announced the intention to initiate a new round of technical preparatory meetings with Member States in 2002 before issuing a new proposal. Such technical preparatory meetings have not been initiated due to opposition by Member States.

   The cross-border offset of losses and profits is a very important issue for business operating in the EU. The European Commission and the Member States should make a swift progress in this area and realise an EU framework for the cross-border offset of losses against profits.

6. We welcome the adoption in June 2003 and implementation as from 1 January 2004 of Directive on the elimination of withholding tax on interest and royalty payments within group companies in the EU (Council Directive 2003/49/EC).

7. The European Company Statute, adopted in October 2001, will enable the establishment of a European Company (SE) from October 2004. The European Company Statute is for public companies. It has been criticised as cumbersome and complex, unsuited to the needs of SMEs', which are 90% of companies in the EU.

   The European Commission published a Communication to the Council and the European Parliament, 'Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward' in May 2003. In the Communication, the European Commission states that it will launch a feasibility study in order to assess the practical needs for – and problems of – a European Private Company Statute by 2005 and that, if the outcome is positive, it will propose a Statute for European Private Company between 2006 and 2008.

   The introduction of a Statute for European Private Company should be a short-term objective in order to meet the needs of private companies in the EU.

8. Corporate governance and its disclosure rules should be implemented throughout a group of companies in a consistent way. In this sense, corporate governance and its disclosure should be regulated at the level of listed companies where disclosure to shareholders is crucial.

However, due to recent corporate scandals in company finance, some Member States are introducing such rules through Company Law that are applied to all companies as binding measures.

There should be a guideline at the EU level as to how to apply binding measures in Member States so that they should not constitute obstacles to cross-border investment.

<Relation with the progress reports>

1. According to the Commission Services' Progress Report of April 2004, the Commission services will pursue their work, taking account of the results of the consultations carried out, in particular with regard to the pilot project of applying 'Home State Taxation' to small and medium enterprises. The Commission will make a recommendation for action in this field in 2004.

   The Commission considers that accounting rules are key to the concept of a common tax base. The IFRS (formerly IAS), the compulsory standards for the consolidated accounts of listed companies in the EU as from 2005, provide a useful neutral starting point for discussing the technical tax issues. The Commission intends to establish an Expert Group to discuss the detailed tax principles that would have to be applied on the basis of using the IFRS as a starting point.

2. The Commission Services' report states that the Commission is not satisfied with the current limited scope and practical implementation of Directive 90/434/EEC on Mergers. With the view of addressing this issue and of extending the applicability of the Directive to companies formed under the European Company Statute, the Commission presented a proposal in October 2003.

   With regard to tax deferral on real property transactions and transfer of other intangible assets, after consulting the Member States on the possible amendments in the Commission's working groups and the prospect of reaching a final agreement, the Commission decided to limit its proposals. Member States would be most unlikely to agree to extending the scope of the Merger Directive to Japan-based companies, considering that such matters should fall within the scope of their individual bilateral tax treaties with Japan.

3. No mention in the progress report.

4. New recommendation. Therefore, no mention in the progress report.

5. The Commission Services' report states that there are at present major limits in cross border loss relief between Member States, which can lead to double taxation. Following the withdrawal of the outstanding proposal, the Commission services have now started an internal analysis of legislative options, taking account of important developments in the rulings of national courts and ECJ, and, in addition, are about to commence consultations with Member States with a view to presenting a more comprehensive initiative in this area in late 2004/early 2005.

6. The Commission Services’ report states that the Directive exempting from withholding taxes interest and royalty payments made between associated companies of different Member States is currently in force.

7. No mention in the progress report.

8. New recommendation. Therefore, no mention in the progress report.

1-E-2 Movement of workers in the EU

(Japan-side recommendation)

<Summary of recommendation>

1. As soon as a Council Directive on the conditions of entry and residence of third-country nationals for the purpose of paid employment and self-employed economic activities (COM2001/386) is adopted, the procedure for Japanese nationals to obtain a work and residence permit, or a residence permit for self-employed, for intra-corporate transferees should be further simplified and accelerated.

2. The European Commission and the Member States should eliminate double taxation related to occupational pension as soon as possible

3. We welcome the implementation of Council Regulation 859/2003 that has extended the provisions of Regulation 1408/71 to nationals of third-countries who are not already covered by those provisions solely on the ground of their nationality.

<Background>

As Japanese companies carry out reorganisation of their European businesses in order to cope with the development of a single market, the need to move their key staff across the borders is increasing. In order to support efficient movement of human resources, the procedure to obtain a work and residence permit - or a residence permit for self-employed - for intra-corporate transferees of Japanese nationals to a Member State should be further simplified and accelerated. In addition, the delays in the mutual recognition of occupational pension schemes from the point of view of taxation on contributions and payouts, and resulting possible double taxation, are obstacles to business development that involves cross-border assignments of staff.

1. For the smooth and efficient running of international businesses, it is essential that companies are able to dispatch key personnel including directors. Such transfers do not have any negative impact on the labour market in the host country. On the contrary, it will expand employment in the host country through the development of business. The requirement to obtain a work and residence permit – or a residence permit for self-employed statutory directors – for intra-corporate transferees from Japan to an EU Member States is usually a formality and it is rare that the application of intra-corporate transferees is questioned with substantial reasons. However, the burden on companies as

well as employees and their families is substantial, which does constitute an obstacle to swift development of business.

A proposal for a Council Directive on the conditions of entry and residence of third-country nationals for the purpose of paid employment and self-employed economic activities (COM2001/386) should be adopted and implemented without delay. It should enable the spouses to engage in economic activities in the host country. They should be granted the same rights as the holder of the permit, such as a work and residence permit, and a residence permit for self-employed.

Furthermore, as soon as this proposal is adopted, the procedure for Japanese nationals to obtain a work and residence permit or a residence permit for self-employed for intra-corporate transferees should be further simplified and accelerated by, for example, entering into an agreement with Japanese government based on Article 3 of Directive. It should enable an application for a work-resident permit or a residence permit for self-employed after entering the assigned Member State, which is possible for EU nationals assigned to work in Japan.

2. As companies transfer more and more employees across the EU, the costs arising from double taxation on contributions and payouts become significant. The key problem is that pension funds have been set up for one country and that contributions to funds based in other Member State are not necessarily tax deductible. When payouts are taxed as income while contributions are not tax deductible, there will be double taxation.

   Directive on the activities of institutions for occupational pension, which enables the creation of an EU-wide pension fund, was adopted in June 2003. Furthermore, the European Commission has opened infringement proceeding against several Member States that appear to apply discriminatory tax rules to contributions to pension funds based in other Member States.

   We welcome the progress made in this area. The European Commission and the Member States should continue to make efforts in order to eliminate double taxation related to occupational pension as soon as possible.

3. The Council Regulation (1408/71) determines the treatment of basic pension when people move between Member States. This regulation was only applicable to those who have the nationality of a Member State or refugees, and their families.

   Council Regulation 859/2003 has extended the provisions of Regulation 1408/71 to nationals of third-countries who are not already covered by those provisions solely on the ground of their nationality. It has been brought into effect since June 2003.

   We welcome the improvement.

<Relation with the progress report>

1. Not mentioned in the progress report.

2. According to the Commission Services' report, Community provisions in the field of social security, in particular Regulation (EEC) 1408/71 co-ordinate, but do not harmonise arrangements for people who exercise their right to free movement within the European Union. Member States continue to be responsible for the funding and organisation of their social security systems. They are therefore free to determine details of their own social security systems, including which benefits shall be provided, the conditions for eligibility and the value of these benefits, as long as they adhere to the basic principle of equality of treatment and non-discrimination as laid down in the Regulation.

   The second stage consultation on the possible content of the portability of supplementary pension rights was launched in September 2003. Based on the responses of the Social Partners, the Commission is currently preparing a proposal for a Directive in this area which is likely to be presented in autumn 2004.

3. The Commission Services' report states that Regulation (EEC) 1408/71 has been amended, that its provisions have been extended since June 2003, and that, as a result, Japanese nationals and their families can now rely on the Community provisions in the field of coordination of social security systems when moving within the EU.

1-E-3 Community Patent

(Japan-side recommendation)

<Summary of recommendation>

1. Proposal for a Council Regulation on the Community patent should be adopted and implemented as soon as possible.

<Background>

Intellectual and industrial property rights in the EU have been protected by national systems of law. A unified European systems, which co-exist with the traditional ones at the national level, have been established with the Community trademark and Community designs. An agreement to adopt Regulation on the Community patent was reached in a Council meeting in March 2003.

After more than one year, however, the proposal has not been adopted. In addition, there is a possibility that it may have to be withdrawn. We would like to urge the EU and its Member States to adopt the proposal and implement it as soon as possible.

<Relation with the progress report>

The Commission Services' report states: 'The Competitiveness Council came close to reaching an agreement on the outstanding issues at its meeting in November 2003. It nevertheless failed to agree on the length of the period under which translations of claims can be filed. The Commission hopes to make further progress on this initiative during the course of 2004.'

1-E-4 Personal Data Protection

(Japan-side recommendation)

<Summary of recommendation>

There should be a legal framework that allows subsidiaries of Japanese companies in Member States to transfer personal data to Japan or a third country where such data is handled without additional guarantees being necessary.

<Background>

Directive 95/46/EC of the European Parliament and of the Council on the protection of individuals with regard to the processing of personal data and on the free movement of such data, stipulates that a third country should have an adequate level of protection in order personal data to be transferred from the Member States without additional guarantees being necessary.

Recently introduced Japanese personal data protection law is not regarded as providing an adequate level of protection because its provisions do not foresee a transfer of data to a third country.

The EU should review Japanese personal data protection law with a view to recognise it as providing an adequate level of protection. If this is not possible, a legal framework should be created in the EU so that personal data from subsidiaries of Japanese companies in Member States could be transferred to Japan or a third country where such data is handled without additional guarantees being necessary.

<Relations with progress report>

New recommendation. Therefore, no mention in the progress report.

1-E-5 The enlargement of the EU

(Japan-side recommendation)

<Summary of recommendation>

1. Institutional reforms should be realised so that the EU could speed up its decision-making. In taxation area, in particular, unanimity requirements in the Council should be abolished.

2. Act against counterfeited, pirated and contraband goods should be reinforced at the new and extended border of the EU.

<Background>

1. It appears that institutional reforms of the EU including the reforms of the decision-making system that is crucial after the enlargement are not going smoothly.

In the area of corporate taxation policy where businesses expect further development, the current decision-making requires the unanimous agreement of the Member States in the Council, which hampers progress in this area.

In our opinion, although the Member States should retain competence over their taxation policy, it is necessary to have EU rules in areas where uncoordinated taxation policy constitutes obstacles to cross-border business activities. The unanimity requirements in the Council should therefore be removed under certain conditions in order to speed up decision-making in the area of taxation policy. Furthermore, reforms should be brought about so that the decision making process in general will be accelerated in order to reinforce Single Market.

2. With 10 new Member States, the border of the EU has been moved and extended from May this year. At the new border of the EU, the authorities may be less effective against counterfeited, pirated and contraband goods than at the old border where officials are more experienced.

   The EU and its Member States should make utmost efforts to prevent an increase in goods infringing an intellectual property right entering the EU after the enlargement. Furthermore, the EU should exert every efforts to support and train the personnel of the new Member States.

1-E-6 Tariffs and tariff classification

(Japan-side recommendation)

<Summary of recommendation>

1. The tariff rates of the EU on certain manufactured goods are very high compared with those of other developed countries and should be lowered. For example, the tariff rate of the EU on consumer electronics products is 14% while that of Japan is mostly 0%, and the tariff rate of the EU on passenger vehicles is 10%, while that of Japan is 0%, and that of the USA 2.5%.

2. The EU still changes tariff classification intentionally and arbitrarily. This is often the case with digital technology products. This situation should be improved.

<Background>

1. Very high tariff rates are applied on Japanese manufactured goods in the EU as compared to other developed countries. These high rates are being applied to consumer electronics products such as the camcorder which is an IT related products (14% for EU and 0% for Japan) and passenger vehicles (10% for EU, 0% for Japan and 2.5% for USA). High tariff rates prevent the supply and diffusion of these products at reasonable prices. Ultimately, this harms the European consumer. Tariff rates should be lowered.

2. The Information Technology Agreement (ITA) aims to remove all tariffs for IT products. This would make it possible to realise a digital economy for consumers with a reduction in IT investment cost. However, there are an increasing number of products with digital

technology and supporting computer network that do not meet the current classification standard of an ITA product.

Recently, it has become increasingly difficult to distinguish the difference between consumer electronics products and IT related products as information technology, telecommunication and consumer electronics products are increasingly relying on similar digital technologies.

As a result, products that really should be classified within the ITA do not receive this classification and consequently a higher tariff rate is applied. At the same time, the lack of transparency is also a problem that needs to be improved.

3. High tariff rates and unreasonable tariff classification are barriers that restrict the promotion and expansion of the geographic and product coverage of the ITA. Together, they create a disincentive to the EU's own ambition to become the most competitive and dynamic knowledge based economy in the world by the year 2010 -- as stated at the Lisbon European Council in 2000,

<Relation with the progress report>

As for tariff classifications in the EU, the classification is made in accordance with the rule of the HS Convention and has as its objective to find the correct heading in the nomenclature used in the EU tariff. The EU also strongly opposed the last Japan proposal to include multifunctional products into the list of ITA products. As for non-agricultural products, the EU mentioned that the launch of the non-agricultural market access negotiations within the WTO Doha Round provides an opportunity for both the EU and Japan to reduce overall tariff levels.

Tariff rate issues were removed from last year's recommendation and were not included in progress report, though it was taken up in the recommendation until 2002. We understand that the level of import duties should be of no consequence to the proper classification of products. Nevertheless, the high tariff rate being applied for certain items requires that we include this issue in our proposal again for 2004.