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To Financial Services Agency, Planning and Coordination Bureau, Policy and Legal Division, Finance and Taxation Office in charge of the Tax System Revision Request Comments Research

Comments Concerning the Tax Reform Request for the Fiscal Year 2012

Submitter (If a corporation or organization, enter the information for the section and the staff in charge.)	General Corp. Futures Industry Association - Japan Representative Director: Mitch Fulscher Director in Charge: Koichiro Ohashi
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Occupation (Not applicable for organizations) ※Optional	N/A
Age (Not applicable for organizations) ※Optional	(About years of age) N/A

<Comments>

Submitter	General Corp. Futures Industry Association - Japan		
Topic	Servers, etc., which are located in Japan and owned or leased by a foreign resident investor and on which a program for placing trade orders of financial products including commodity futures products is installed so as to place automatic orders, the server equipment, etc. in question shall not be construed as a Permanent Establishment.		
<Description of the Comment>			
1. Type of the Comment (Check all that apply.)	<<Indicate “●” in the box left to the corresponding item.>>		
	<input checked="" type="checkbox"/>	Related to new provision of a tax measure → Indicate in 2 ~ 8 and 10 ~ 11.	
	<input type="checkbox"/>	Related to extension of an existing tax measure → Indicate in 2 ~ 8 and 10 ~ 11.	
	<input type="checkbox"/>	Related to supplementation of an existing tax measure → Indicate in 2 ~ 8 and 10 ~ 11.	
	<input type="checkbox"/>	Related to abolishment of an existing tax measure → Indicate in 2 ~4 and 9 ~ 11.	
2. Tax Type (Check all that apply.)	<<Indicate “●” in the box left to the corresponding item. For “Others,” specify the tax.>>		
	<National Tax>		<Regional Tax>
	<input checked="" type="checkbox"/>	Income tax	<input type="checkbox"/> Personal resident tax
	<input checked="" type="checkbox"/>	Corporate tax	<input type="checkbox"/> Corporate resident tax
	<input type="checkbox"/>	Inheritance tax, gift tax	<input type="checkbox"/> Business tax
	<input type="checkbox"/>	Registration and license tax	<input type="checkbox"/> Real estate acquisition tax
	<input type="checkbox"/>	Consumption tax	<input type="checkbox"/> Fixed property tax
	<input type="checkbox"/>	Stamp duty	<input type="checkbox"/> Business office tax
<input type="checkbox"/>	Other ()	<input type="checkbox"/> Other ()	
3. Relevant Articles in the Legislation	Article 141, No. 1 of the Corporate Tax Law; Article 185 of the Enforcement Ordinance of the Corporate Tax Law; Article 164, Paragraph 1, No. 1 of the Income Tax Law; Article 289 of the Enforcement Ordinance of the income Tax Law		
4. Details of the Comment	<ul style="list-style-type: none"> · Currently, when a foreign investor installs a program on equipment such as servers located in Japan and engages in automatic placement of trade orders of financial products including commodity futures products, the arrangement is not considered as a permanent establishment only if the foreign investor in question does not own or rent the equipment such as servers, etc. · However, a server located in Japan running an automated trading system does not have direct decision making action initiated by a person(s) located in Japan, nor have active management of actions/services by person(s) located in Japan · Accordingly, with respect to equipment such as servers, etc. installed in Japan that is owned or leased by a non-resident or a foreign corporation, we request that the equipment in question such as servers, etc. is not construed as a Permanent Establishment when a program is installed to automatically place trade orders of financial products including commodity futures products without involving an individual attention of a person located in Japan. · Please note that we intentionally includes commodities products into the financial products as set forth herewith because nowadays commodities futures products are treated as a part of financial products and so does the recognition of our members, and also our members in the commodity futures sector are of the same view with respect to this server PE issue. 		
5. Application Period for the Measure	<<Indicate “●” in the box left to the corresponding item. For “Limited Time,” specify the number of years requiring the measure.>>		
	<input checked="" type="checkbox"/>	Permanent	

		Limited Time (Years)
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6. Necessity for the Measure	<< Specify the reason for implementation of the measure, including the background.>>
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- Along with the progress in data communication technology and the advancement of trading techniques such as algorithm transactions, etc., there is a rising volume of trading – especially in Europe and America – that is conducted by non-resident foreign investors through co-location servers (“co-location trading”). In such cases, the investment valuation of the financial products including commodity futures products or the investment decisions (such as the trading program, etc.) are carried out overseas, while the equipment such as servers, etc. equipped with functions such as trading programs, etc. would be located domestically. An example of this offshore/onshore co-location is the use of terminals located domestically to place orders automatically using the trading program. It is said that more than a majority of the investors in North America use co-location services.
- The performance results of such a co-location investor is dependent on the relevant advantage of the technology in the equipment such as servers, etc. utilized by the investor. Based on the foregoing, there is a strong incentive on each investor to keep the technology confidential i.e. unwillingness to provide brokers with proprietary information regarding hardware configuration. For the purpose of safeguarding the proprietary information of such systems, investors prefer to directly own or possess the servers as opposed to utilizing the equipment of the brokers which provides less control of the equipment.
- European and American markets, which have relatively high volume of such trades, have made tax arrangements with the relevant domestic tax authorities to ensure that such foreign investors’ equipment, such as servers, etc., do not create a permanent establishment (See 11 (1) below.) of the foreign investor in the country in question. This type of accommodation of the needs of foreign investors has led to the growth of new financial services and IT services, such as data center businesses, etc.
- As opposed to Europe and America, the current taxation system in Japan is not accommodating to the interests of foreign investors as the Japan tax regimes requires that foreign investors do not own or rent the equipment such as servers, etc., in consideration of potential permanent establishment risks. As foreign investors are very sensitive to taxation risks, they are hesitant to launch their investments in the Japanese market in full scale, out of the fear for double taxation in their own country [and Japan] which in turn, discourages foreign investors to conduct business in Japan.
- In addition to the above, there are some other needs for the Measure in the broker side, exchange side and other market participant side as follows:
 - i) The current situation reduces competition and choice for foreign investors because, the domestic securities broker, instead of the investor, must own or rent the equipment to meet the requirements of each individual investor. As the servers that meet the investor’s specific needs is often quite costly, the investor is forced to commit to a single broker as the investor is unwilling to pay multiple brokers to purchase equipment specifically tailored for such investor. The tax reform measure will enable the foreign investor to engage in this type of co-locating trading through one purchase of the equipment, and provide such foreign investor with the opportunity to use multiple brokers.
 - ii) The current situation reduces investor mobility. If an investor wishes to change brokers, the investor must incur additional costs to pay the new broker for the purchasing equipment for its specific needs. The tax reform measure will enable the client to change broker without additional cost.
 - iii) The current situation imposes a significant burden on brokers for purchasing and maintaining equipment for investors. The tax reform measure will enable investors to purchase and maintain their own equipment (which those investors prefer to do) and reduce the burden for the brokers.

	<ul style="list-style-type: none"> · iv) The current situation specifically disadvantages smaller Japanese brokers, who cannot invest considerable resources and funds to purchase high end technology. This limits the ability of smaller Japanese brokers to offer investors access to technologically advanced trading platforms. The tax reform measure will enable smaller Japanese brokers to attract technologically advanced clients and urge the entry of smaller Japanese brokers into the co-location tradings thereby increasing competition among brokers, and increasing investor choice with respect to brokers. · v) The current situation has proved a demonstratable and significant disadvantage to recent Exchange initiatives including: <ul style="list-style-type: none"> · remote membership schemes have been far less popular in Japan, in part due to the permanent establishment issue which has deterred clients from adopting remote membership and attracting more investors to engage in remote trades with respect to Japan exchanges; and · The provision of data centers and managed hosting services for high frequency trading which has not been as successful as comparable offerings overseas, in part due to the issue of permanent establishment. · Therefore, we believe that it is necessary to accommodate the foreign investors' needs through the taxation arrangement described in 4 above. · The action will facilitate investments into the Japanese market and promote expansion of new financial/IT services, thereby fortifying the international competitiveness of our financial and securities markets as the Asian hub. The approach seems to be consistent with the strategic promotion policy of the New Growth Strategy, namely, the promotion of investments into Japan, which was announced previously as well as the purpose and direction of becoming the Asian hub.
7. Effectiveness of the Measure	<p><<Describe (1) Anticipated effect from implementing the measures; (2) How the measure will contribute to the effect in question (the causal relationship between the measures and the effect); (3) Reason why implementation of the measure will be effective even at the expense of reduced tax revenue; (4) Effect of not implementing the measure, etc. as specifically and quantitatively as possible, including past application results, etc.>></p> <p>The same as 6 above.</p> <p>The tax reform measure will resolve the need of foreign investors described in 6 above, thereby promoting domestic investments and greater transaction volume, as well as creating the needs for new financial services, IT services and data centers in Japan. Ultimately, the measure will contribute to creation of new demand for building lease, development/maintenance of equipment, etc.</p>
8. Adequacy of the Measure	<p><<Specify the necessity and adequacy of implementing the tax measure aside from subsidy granting, deregulation, etc.>></p> <p>As mentioned in 1 above, the tax reform measure is applicable to cases where foreign investors own or rent server equipment, etc. in Japan, and it is not a request of deregulation, etc. or request for subsidy payments. It should also be noted that as the current tax law and regulatory practice has not created tax revenue for Japan, the tax reform measure will not cause any decrease in tax revenue.</p>

9. Issues Concerning Abolishment	<(1) Justification for the Abolishment> <<Specify the reason why the existing tax measure should be abolished.>>	
	-N/A	
	<(2) Anticipated Effects from the Abolishment> <<Specify the effects from abolishment of the existing tax measure.>>	
	-N/A	
10. Increase/Decrease in Revenue, etc.	<(1) Amount of the Increase/Decrease in Revenue> <<Indicate the anticipated increase/decrease in tax revenue (million yen) ascribed to the implementation/abolishment of the measure. In the first line, indicate the estimated amount of the increase/decrease in revenue in comparison with the current system. In the parenthesis in the second line, indicate the estimated amount of the increase/decrease in revenue in comparison with this rule.>>	
	First Year	Regular Years
	Increase in Revenue: 65,999 million yen	Increase in Revenue: 65,999 Million yen
	<(2) Basis for the Calculation or Reason Why No Increase/Decrease in Revenue Will Occur> <<If the amount of the increase/decrease in revenue is indicated in (1), indicate the basis for calculation of the amount (equation, sources, etc.). If no amount of the increase/decrease in revenue is indicated in (1), indicate why there would be no increase/decrease in revenue.>>	

	<ul style="list-style-type: none"> · As mentioned in #8 above, the foreign investors who have the need to own/rent the server equipment for automated trade transactions in Japan have yet to engage in investments in the Japanese market, and thus generate no tax revenue currently. Therefore, there will have no decrease in the revenue by adopting the tax reform measure. · Adoption of the tax reform measure can lead to a rise in the tax payments by the financial instrument dealers in Japan as a result of influx of foreign investors and the subsequent rise in the market trade volume, as well as greater revenue from the relevant tax payers, such as data center businesses. · The amount of the increase in revenue shown above is the outcome of the calculation of the increase in the commission income of financial instrument traders as well as exchanges based on hearings with our members (impact on trade proceeds,) and situations in Europe and America (proportion of the automated trades, etc. in the entire markets). · The above amount is calculated as follows: <table border="0" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 35%;"></th> <th colspan="2" style="text-align: center; border-bottom: 1px solid black;">Equities Transactions</th> </tr> <tr> <th></th> <th style="text-align: center; border-bottom: 1px solid black;">Broker Commission</th> <th style="text-align: center; border-bottom: 1px solid black;">Exchange Fee</th> </tr> </thead> <tbody> <tr> <td>Market Value</td> <td style="text-align: right;">200,000,000,000,000</td> <td style="text-align: right;">200,000,000,000,000</td> </tr> <tr> <td>Average Fee</td> <td style="text-align: right;">0.07%</td> <td style="text-align: right;">0.003%</td> </tr> <tr> <td>Revenue</td> <td style="text-align: right; border-top: 1px solid black;">140,000,000,000</td> <td style="text-align: right; border-top: 1px solid black;">6,000,000,000</td> </tr> <tr> <td colspan="3" style="padding-top: 10px;"> </td> </tr> <tr> <th></th> <th colspan="2" style="text-align: center; border-bottom: 1px solid black;">Derivatives Transactions</th> </tr> <tr> <td>TFX Market Volume</td> <td style="text-align: right;">11,000,000</td> <td style="text-align: right;">11,000,000</td> </tr> <tr> <td>Average Fee</td> <td style="text-align: right;">50</td> <td style="text-align: right;">100</td> </tr> <tr> <td>Revenue</td> <td style="text-align: right; border-top: 1px solid black;">550,000,000</td> <td style="text-align: right; border-top: 1px solid black;">1,100,000,000</td> </tr> <tr> <td colspan="3" style="padding-top: 10px;"> </td> </tr> <tr> <td>TSE Market Volume</td> <td style="text-align: right;">27,000,000</td> <td style="text-align: right;">27,000,000</td> </tr> <tr> <td>Average Fee</td> <td style="text-align: right;">50</td> <td style="text-align: right;">100</td> </tr> <tr> <td>Revenue</td> <td style="text-align: right; border-top: 1px solid black;">1,350,000,000</td> <td style="text-align: right; border-top: 1px solid black;">2,700,000,000</td> </tr> <tr> <td colspan="3" style="padding-top: 10px;"> </td> </tr> <tr> <td>OSE Market Volume</td> <td style="text-align: right;">87,500,000</td> <td style="text-align: right;">87,500,000</td> </tr> <tr> <td>Average Fee</td> <td style="text-align: right;">50</td> <td style="text-align: right;">70</td> </tr> <tr> <td>Revenue</td> <td style="text-align: right; border-top: 1px solid black;">4,375,000,000</td> <td style="text-align: right; border-top: 1px solid black;">6,125,000,000</td> </tr> <tr> <td colspan="3" style="padding-top: 10px;"> </td> </tr> <tr> <td></td> <td style="text-align: right;">146,275,000,000</td> <td style="text-align: right;">15,925,000,000</td> </tr> <tr> <td>Total Revenue</td> <td></td> <td style="text-align: right;">162,200,000,000</td> </tr> <tr> <td>Corporate Tax</td> <td></td> <td style="text-align: right;">40.69%</td> </tr> <tr> <td>Tax Revenue Increase</td> <td></td> <td style="text-align: right; border-top: 1px solid black;">65,999,180,000</td> </tr> </tbody> </table>		Equities Transactions			Broker Commission	Exchange Fee	Market Value	200,000,000,000,000	200,000,000,000,000	Average Fee	0.07%	0.003%	Revenue	140,000,000,000	6,000,000,000					Derivatives Transactions		TFX Market Volume	11,000,000	11,000,000	Average Fee	50	100	Revenue	550,000,000	1,100,000,000				TSE Market Volume	27,000,000	27,000,000	Average Fee	50	100	Revenue	1,350,000,000	2,700,000,000				OSE Market Volume	87,500,000	87,500,000	Average Fee	50	70	Revenue	4,375,000,000	6,125,000,000					146,275,000,000	15,925,000,000	Total Revenue		162,200,000,000	Corporate Tax		40.69%	Tax Revenue Increase		65,999,180,000
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11. Other Information for Reference	<<(Example) Theses/Submissions, etc. of Experts on the Significance, etc. of the Measure>>																																																																					

	<p>PE Tax System Concerning Financial Instruments Trades, etc. in Major Countries</p> <ul style="list-style-type: none">① United States: Under the domestic law concerning federal income tax, securities transactions are excluded from the taxation on business operation of non-residents/foreign corporations.② United Kingdom: The government released its opinion that servers in electronic commercial transactions do not constitute a PE when a non-resident does not provide a party to engage in business activities within the United Kingdom.③ Hong Kong: The newsletter of the Revenue and Customs Ministry specified that business activities engaged through servers do not correspond to a PE as long as there are no activities conducted by people.
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