German Business Network (GBN)

Webcast – Quo vadis Japan: Outlook into the land of rising opportunities

May 18, 2017
German Business Network (GBN)

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### Agenda

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I. Market environment
Market environment
Basic economic data

► 1.2 % GDP annual growth in 2016
► Corporate profits increasing, M&A
► Continuation of expansive monetary policy in 2017
► Corporate tax rate headline decreases towards 30 %
► Expected growth in 2017 around 1.0 %
► Dependency on international markets
► Growth coming from outside of Japan
► In particular China and ASEAN
► 0.2 % Inflation (target: 2 %)
► Unemployment rate: 2.8 % in March 2017
► Jobs-to-applicant ratio in March: 1/1.45 (0.5 in 2010)
Market environment
Abenomics

► “Three arrows“
  ► monetary easing
  ► fiscal stimulus
  ► structural reform
► Growth and increasing profits
► National debt > 250 %
► Japan’s main creditor are its loyal citizens
► More than a quarter of the budget is spent for debt service
► Sustainable fiscal policy and consolidation
► Electric mobility, Trends (overview)
II. Accounting and auditing framework
Accounting and auditing framework

Accounting framework

Japan GAAP

► General concepts are similar for IFRS, with some differences in key areas (revenue recognition, impairment accounting)
► Acceptable for all entities

IFRS

► Only for listed entities; requires notification to the Stock Exchange Oversight Board
► Rising number of Japanese listed entities change to IFRS to attract more foreign investors

JMIS (Japan’s Modified International Standards)

► Special “simplified” IFRS; practically no relevance
Japan GAAS

- General concepts are similar to ISA, with some minor differences
- Applicable to all audit engagements with local audit reports (in Japanese or English language)

ISA

- Acceptable for individual audit engagements when specifically agreed with client

Statutory audits

- Mandatory if either capital exceeds JPY 500 million or total liabilities exceed JPY 20 billion
Accounting and auditing framework
Application in practice

► Sales entity in Japan, set up by group headquarter in Europe
  ► Usually local accounting in Japan Tax or Japan JAAP (may be performed by external tax advisor firm if no accounting team exists in the entity)
  ► GAAP adjustments to group accounting (e.g. German GAAP, IFRS) booked manually in spreadsheets or separate General Ledger accounts
  ► Audit of group reporting package as part of group audit (irrespective of local audit requirements)
  ► Statutory audits required only if legal thresholds are exceeded
  ► Shareholder meetings to be held within 3 months after year-end
III. Tax and legal framework
Tax and legal framework  
Effective corporate tax rates in comparison

Corporate tax rates in international comparison

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>US</td>
<td>41%</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>GER</td>
<td></td>
<td>30%</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>NL</td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>UK</td>
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<tr>
<td>SIN</td>
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<tr>
<td>HK</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Default Tax Rate</td>
<td>38%</td>
<td>32.6%</td>
<td>28.6%</td>
<td>24.3%</td>
<td>23.7%</td>
<td>22.8%</td>
</tr>
</tbody>
</table>

Effective Corporate tax rate (Tokyo-based large sized company)

<table>
<thead>
<tr>
<th>Year</th>
<th>Rate</th>
</tr>
</thead>
</table>
| 2013 | 40.69%
| 2014 | 38.01%
| 2015 | 35.64%
| 2016 | 32.1%
| 2017 | 32.3%
| 2018 | 30%

* Data from the FY13  
Source: Securities report of each company
In Japan, no withholding tax for dividends/interest and royalties under the revised Germany-Japan treaty.

In Germany, 95% tax-exemption for dividends and capital gains from share transfer.

<table>
<thead>
<tr>
<th></th>
<th>Metropolitan Area</th>
<th>Rural Area</th>
<th>Salary, Interest Income</th>
<th>Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>SME (share capital 100 mil JPY)</td>
<td>34.8 %</td>
<td>33.8 %</td>
<td>0 %</td>
<td>0 %</td>
</tr>
<tr>
<td>Large corporation</td>
<td>31.0 %</td>
<td>29.7 %</td>
<td>1.2 %</td>
<td>0.5 %</td>
</tr>
</tbody>
</table>
Japan has three types of interest deduction limitation rules:

- Thin capitalization rules
- Earning stripping rules
- Limitation of DRD for the amount of the interests allocated to acquisition costs of the shares (only applicable to less than 100% shareholding)
- No withholding tax on interest
- Tax consolidation
Management Information and Controls

Japanese companies typically do not prepare detailed monthly management reports or have a tradition of centralized control. Thus, controls and management information tend to be poor.

Environmental Issues

Environmental due diligence may reveal potentially costly contamination issues.

Real Estate Impairment

Property prices for residential and commercial property have continued to fall since the burst of the real estate bubble in 1991, with residential and commercial property in the Tokyo area at 50% and 75% of their peak prices, respectively.

Accounting Principles

Japanese accounting principals were historically based on tax accounting; however, they have moved towards and are today broadly in-line with IFRS/US GAAP.

Window-dressing

Because of insufficient procedures in Japanese companies, window-dressing issues may appear after the acquisition.

Pensions

Pension funds are often under-funded due to the poor performance of investments, which is likely to result in significant increases in cash premiums in the future.
Tax and legal framework
Acquisition structure – share deal

Seller
- 20.41% income tax in case of individual
- under the domestic participation rule tax exempt
- pre-acquisition dividend: will reduce the corporate seller's capital gain

Buyer
- Financing
  - Tax deductible interest requires taxable income which a mere acquisition company would not have. Ideas:
    - Dividend distribution to Acq Co -> Debt-push down
    - Tax consolidation after 5 years (NOL 9 years//50 %)
    - Merger of Acq Co into Target, for sound business reasons
  - No goodwill recognition (expect for non-qualified, taxable corporate split transactions)
  - Change of ownership and loss limitation rules
  - No transfer taxes
Tax efficient increase of JV share of GER GmbH through share buy-back

- In general, a share buy-back qualifies:
  - partially as a capital return
  - where earnings have been retained: as deemed dividend (for which major shareholders enjoy the participation exemption)
  - as capital gain to the extent not allocable to the above
  - return of capital and deemed dividends are generally determined on a pro-rata basis.

- Deemed dividends are subject to WHT, but can be exempted under relevant treaties.
Tax and legal framework
Net Operating Loss (NOL) – limitations

<table>
<thead>
<tr>
<th></th>
<th>SME</th>
<th>Large size companies (paid-in capital is JPY 100m or less)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Deductible amount</strong></td>
<td>100 %</td>
<td>50 % of taxable income before NOL</td>
</tr>
<tr>
<td><strong>Carryforward period</strong></td>
<td>9Yr (10yrs since FY 2016)</td>
<td>9Yr (10yrs since FY 2016)</td>
</tr>
</tbody>
</table>

NOL – Strategies for tax loss utilization
- Adoption of tax consolidation
- Merger of group companies
- Transactions in which tax losses will be effectively utilized
- Sale of assets (such as intangibles, real estates) to a foreign group company (including a branch) or a 3rd party
- Sales and lease back of assets
- Assumption of liability reserve etc.
- Non-qualified split
## Tax and legal framework

OECD BEPS Heat map on “Base Erosion Profit Shifts”

<table>
<thead>
<tr>
<th>BEPS action plan</th>
<th>Japan</th>
<th>Germany</th>
</tr>
</thead>
<tbody>
<tr>
<td>Action 1 – digital economy</td>
<td></td>
<td></td>
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<tr>
<td>Action 2 – hybrid mismatches</td>
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<tr>
<td>Action 4 – interest deduction</td>
<td></td>
<td></td>
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<tr>
<td>Action 6 – tax treaty abuse</td>
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<tr>
<td>Action 7 – Permanent Establishment</td>
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<tr>
<td>Actions 8 - 10 – Transfer Pricing (TP)</td>
<td></td>
<td></td>
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<tr>
<td>Action 13 – TP documentation, CbCR</td>
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</tbody>
</table>

### Focus Areas

- **High focus area**
  - Changes in tax legislation
  - Draft legislation, projects and discussions
  - Tax authorities’ particular focus area
  - International commitment

- **Increased focus area**
  - Change in practice of tax authorities or tax courts
  - Government statement or press/public consultation

- **Low focus area**
  - Discussion, or projects on the change in tax legislation may be expected.
  - Government’s position is hard to predict at this stage.

- **Not a focus area**
  - No legislation, projects and discussions
Scope of qualified R&D will expand

- Current: Product development or improvement, origination or invention of technology
- NEW: Development costs for IoT, Big Data, AI (i.e. service R&D or R&D for industry 4.0)

Examples of service R&D include:

- Health care services – collection and analysis of personal health information (e.g. exercise, sleeping conditions or heartbeat) to provide tailored fitness or dietary plan
- Anticipation of natural disaster services – collection and analysis of geography and weather conditions by drones to anticipate natural disasters
- Agricultural services – collection and analysis of temperature or humidity at farms by sensors to distribute useful information for cultivation

Changes to additional R&D credit

- The high standard-type R&D credit will be extended (additional two years)
- As an alternative to the high standard-type R&D credit, companies can increase the credit limit of the general R&D credit by 10% (to 35%)
- The step-up-type R&D credit will be repealed
Tax and legal framework
Tax treaty trends: Japan-Germany tax convention now effective

- Introduction of a fiscally transparent entity concept (Art. 1)
- Tie-breaker rule for individual residents of both states (Art. 4)
- Introduction of AOA on the determination of the income attributable to a PE (Art. 7)
- Source country taxation of capital gain on certain real estate holding companies (Art. 13)
- Objective and principal purpose tests for the entitlement of benefits (Art. 21)
- Switch-over clause for hybrid arrangements, e.g. non typical silent partnerships, Kommanditgesellschaft, for which Germany may deny the exemption method (Art. 22)
- Mandatory arbitration in mutual agreement procedures (Art. 24)

<table>
<thead>
<tr>
<th></th>
<th>Dividends</th>
<th>Interest</th>
<th>Royalties</th>
<th>AOA (internal dealings)</th>
<th>Anti-avoidance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Parent-subsidiary (shareholding in %)</td>
<td>Other</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Old treaty</strong></td>
<td>10 %</td>
<td>15 %</td>
<td>10 %</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>(holding at least 25 % for 12 month)</td>
<td></td>
<td></td>
<td>10 %</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>New treaty</strong></td>
<td>0 %</td>
<td>15 %</td>
<td>0 %</td>
<td>Recognized</td>
<td>LOB PPT</td>
</tr>
<tr>
<td>(holding at least 25 % for 18 months)</td>
<td></td>
<td></td>
<td>0 %</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(holding at least 10 % for 6 months)</td>
<td></td>
<td></td>
<td>0 %</td>
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</tbody>
</table>
Tax and legal framework
Japan’s reaction to BEPS Action 13
Base Erosion and Profit Shift (“BEPS”) – OECD Initiative

Transparency readiness

Country-by-Country Report
High level information about multinational corporation’s (“MNC”) jurisdictional allocation of revenue, profits, taxes, assets and employees to be shared with all tax authorities where the MNC has operations.

Master file
High level information about the MNC’s business, transfer pricing policies and agreements with tax authorities in a single document available to all tax authorities where the MNC has operations.

Local file
Detailed information about the MNC’s local business, including related party payments and receipts for products, services, royalties, interest, etc.

+ Notifications
Consumption tax rate hike was postponed again
A bill to postpone the consumption tax rate increase was passed by the Diet on 18 November 2016. The consumption tax rate hike, together with reduced tax rate system, was postponed by two and half years to 1 October 2019. Simplified method for SMEs will be repealed.
Tax and legal framework
Japanese Inheritance Tax liabilities on foreigners

► Unlimited taxpayer
  ► Heir is resident of Japan at time of death, or
  ► Decedent is resident in Japan at time of death
  ► Heir is subject to inheritance tax on the value of worldwide assets, NEW if having stayed in Japan for 10 years or holding a permanent resident or spouse visa
  ► NEW: IF having stayed a shorter period with Type 1 Visa, only Japan assets

► NEW: Extended unlimited taxpayer
  ► After having stayed in Japan for at least 10 years
  ► For 5 years after departure from Japan

► Limited taxpayer
  ► Heir is neither resident in Japan at time of death nor
  ► Decedent has a residence in Japan at time of death nor
  ► Subject to extended unlimited tax liability
  ► Heir is subject to inheritance tax on the value of Japanese assets only
IV. Industry highlights to Japan embracing the future
Industry highlights to Japan embracing the future
Life Sciences

► Megatrends
  ► Quickly aging population heading towards “superaging” society
    ► 2016: 27.3 % of population (125 million) older than 65 years
    ► Shrinkage in overall population to below 100 million by 2053, and to 88 million by 2065 estimated
    ► Declining birth rates for 10 years
    ► By 2065, 1.2 workers support 1 elderly (1965: 9.1 workers)
  ► Increasing costs for healthcare and elderly care

► Responses to megatrends
  ► Quicker approval process for new pharmaceuticals and medical equipment
  ► Development of robotics for healthcare and elderly care
  ► Digital offers targeted specifically at elderly customers (e.g. medication surveillance, navigation, games)
Industry highlights to Japan embracing the future
Japanese demographics

From tree to kite
Japanese population pyramids, m

1950

2005

2050, forecast

Age 1.2 0.8 0.4 0 0.4 0.8 1.2 Age 1.2 0.8 0.4 0 0.4 0.8 1.2 Age 1.2 0.8 0.4 0 0.4 0.8 1.2

Men Women

Total: 128m
Total: 95m
Total: 83m

Source: National Institute of Population and Social Security Research
Per capita costs are still moderate compared to the USA and other OECD countries, but well above OECD average.
Industry highlights to Japan embracing the future
Life Sciences

► Creative robotics solutions can help resolve some issues with “superaging” societies
Industry highlights to Japan embracing the future
Automotive (OEM and suppliers)

► Megatrends:
  ► Urbanization continues - Tokyo and Osaka areas grow while rural areas depopulate
  ► Individual mobility within megacities – 1~3 hours of daily commuting in public transportation means
  ► Environmental concerns increase – eco-friendly transportation required

► Responses:
  ► public and private investments in public transportation
  ► high taxation on individual car ownership
  ► new car sharing models on local levels
  ► consolidation in OEM industry (Mitsubishi controlled by Nissan)
  ► OEM investment in electric vehicles, connected cars etc.
Industry highlights to Japan embracing the future
Automotive industry

Automotive production Japan

Japan Electric Car Sales (January 2017 vs January 2016)

For more monthly sales charts and reports, check out http://evobsession.com/electric-car-sales/

<table>
<thead>
<tr>
<th>Model</th>
<th>January 2017</th>
<th>January 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nissan LEAF</td>
<td>1,431</td>
<td>2,503</td>
</tr>
<tr>
<td>Mitsubishi Outlander PHEV</td>
<td>190</td>
<td>801</td>
</tr>
<tr>
<td>BMW i3</td>
<td>80</td>
<td>100</td>
</tr>
<tr>
<td>Nissan e-NV200*</td>
<td>75</td>
<td>50</td>
</tr>
<tr>
<td>Mitsubishi i-MiEV</td>
<td>31</td>
<td>31</td>
</tr>
<tr>
<td>Tesla Model S</td>
<td>15</td>
<td>25</td>
</tr>
<tr>
<td>Mitsubishi Minicab MiEV</td>
<td>11</td>
<td>23</td>
</tr>
<tr>
<td>BMW 330e*</td>
<td>10</td>
<td>0</td>
</tr>
<tr>
<td>BMW i8*</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Tesla Model X</td>
<td>5</td>
<td>0</td>
</tr>
<tr>
<td>Mitsubishi Minicab MiEV Truck</td>
<td>4</td>
<td>6</td>
</tr>
<tr>
<td>Toyota Prius Plug-In</td>
<td>0</td>
<td>46</td>
</tr>
</tbody>
</table>

*Some sales figures are estimates.
Source: EV Obsession Get the data
Industry highlights to Japan embracing the future
Business environment for German companies in Japan

- Large domestic market
- Stable political, legal and socio-economic environment
- Opportunity to export from Japan to other markets within Asia or world
- German exports of goods and services to Japan in 2015: EUR 17 bill (second largest export market in Asia after China)
- Estimated number of German subsidiaries in Japan: 450 (according to AHK Japan), of which 11% act as regional H/Qs for Asia
- Doubling of average Foreign Direct Investments (FDI) from Germany to Japan to around USD 700 Mio per year after 2008 (versus USD 372 Mio per year from 2002 through 2008)
- Japan is a leading market with regards to robots, mobility and life science
- Significant rise in inbound tourism in last few years - 2016: 24.0, 2015: 19.7, 2014: 13.4 (million visitors per year, according to JNTO)

Source: business climate survey 2016 by AHKJ
Industry highlights to Japan embracing the future
Business environment for German companies in Japan

Growth outlook by German businesses within 12 months (2016):
► Significant decrease: 0 %
► Decrease: 13 %
► No change: 17 %
► Improvement: 53 %
► Strong improvement: 17 %

German companies assess their generally positive outlook detached from the overall economic development in Japan

Profitability data of German businesses in Japan:
► 89 % companies are profitable
► Active for less than 5 years: EBT ratio between 0 and 2 %
► Active for more than 5 years: EBT ratio between 2 and 10 %

Challenges and Concerns:
► Obtaining qualified employees (78 %), exchange rate risk (56 %), high salaries (34 %), retention of employees (33 %), regulatory hurdles (32 %)

Source: business climate survey 2016 by AHKJ
METI proclaims the new vision for the future of Japanese industries:

“Connected Industries”

Modelled after Germany’s ‘Industrie 4.0’ and France’s ‘Industrie du Futur’, it is based on 3 pillars:

- **New Digital Society**: utilizing new technologies such as ‘Artificial Intelligence’ and ‘Robotics’ for enabling humans and machines to work together
- **Multilevel Cooperation**: Connecting individuals, companies, regions and countries essential for effective solutions
- **Human Resource Development**: Developing knowledge and skills for the digital age
Industry highlights to Japan embracing the future
Taking it a step further: “Society 5.0”

► The Japanese government’s initiative to transform business and society:

"Society 5.0"

► **Concept:** While supporting the economy, formulating solutions for the main challenges facing Japanese society, particularly the country's aging population, pollution and natural disasters.

► **How to promote "Society 5.0“:** Breaking down five walls: administrative barriers, legal barriers, knowledge barriers around digitalization, workforce barriers, and social acceptance.

► **Objectives:** Securing broad acceptance for digitalization at all levels of society by focusing on the positive changes that increased digitization offers to all Japanese people.
Industry highlights to Japan embracing the future
“Connected Industries” – Latest highlights

► E-commerce turnover in 2016: EUR 64 billion, expected to grow every year by 8.7 % by 2020
► Spending on IT and telecommunication per capita in 2014: EUR 1,510 => 3rd place globally
► 75 % of all Japanese people own a smartphone and 65 million Japanese use digital media
► Robots automation: 211 robots per 10,000 workers => second place in global ranking in robot density (Korea 1st, Germany 3rd)
► Domestic demand for robots to be expected to grow by 14 % between 2015 and 2020 (according to Nomura Research Institute)
► Corporations and government intensify push for co-operations with US and German counterparties to work together on ‘Internet of Things’ (IoT) by setting standards and exchanging information. Expected, annual IoT growth rate until 2020: 10 – 15 % (source: Germany Trade & Invest)
Industry highlights to Japan embracing the future
Startup scene in Japan – overview

► Startup scene in Japan is small compared to other countries like the US or China
► Entrepreneurial activity in Japan, as measured by ‘Global Entrepreneurship Monitor (GEM), is considered low
► Innovation is typically taking place within large Japanese corporations but not through an ‘outside’, disruptive startup scene
► In the past few years, however, the startup scene has developed and is becoming more popular, attracting high talent. Venture capital funding has increased from around USD 1 bill. in 2014 to around USD 2 bill. in 2015
► Accelerator/incubator programs and offerings for co-working spaces are becoming popular
► Venture capital is rather provided by corporations, while institutional investors remain risk-averse
Industry highlights to Japan embracing the future
Startup scene – showcase companies

Major startup fundings in Japan:
► Spiber (Biotech): Using a new class of materials based on proteins for clothing and other humanitarian use
► mercari (ecommerce): Sales platform for community powered shopping app
► freee (SAAS): Simplifying back office tasks (accounting, payments)
► RakSul (Marketplace): Connecting users with printing companies across Japan
► SmartNews (Media): Mobile news and discovery app
► Bizreach (Professional services): Recruiting and applicant tracking service
► Midokura (SAAS): Network virtualization
► Kabuku (Manufacturing): Using 3D data for revolutionizing manufacturing processes
The future of work
When machines become workers
Industry highlights to Japan embracing the future

Japan – Rising to the challenges

► Japan is considered a rules based society, changing only in incremental steps
► Japan has proven in the past, however, that it can rise to the challenges when necessary (Meiji restoration after 1868, economic development after 1945)
► Current challenges (aging of society, strengthening foreign competition, loss in leadership in certain industries, sluggish growth) have been recognized and are being addressed on many levels
► Government campaigns ‘challenge’ the rules, to initiate change
► Japan remains a powerhouse in ‘innovation’, ranked No. 2 in the world (Bloomberg Innovation Index)
► Manufacturing technology and know-how will continue to be top notch, while embracing new technology such as digitalization/IoT
→ Opportunities for German companies to do business and co-operate
V. Q & A/Wrap-Up
Thank you!
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