[English Translation]

NFT White Paper

Japan’s NFT Strategy for the Web 3.0 Era

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1. Introduction

(1) “Web 3.0,” the new frontier of the digital economy

“The arrival of the Web 3.0 era is a great opportunity for Japan. But if we continue as we are now, we will surely miss the boat.”

Many of the experts and entrepreneurs we interviewed were unanimous in their expectations for the rapidly expanding digital economy and their sense of concern about the current situation in Japan.

The “Web 3.0” is now attracting the attention of IT companies around the world, and is being viewed as the next-generation frontier in the Internet and digital fields. While there are various interpretations regarding the strict definition of the Web3.0, there is no disagreement that, following on the heels of the “Web1.0” era mainly based on emails and websites, and the “Web2.0” era characterized by the introduction of smartphones and the spread of social network services, a new wave of technological innovation is fundamentally overturning the structure of the Internet and the digital economy. In the Web 3.0 era, the digital economy is expected to shift towards a more decentralized network based on blockchain technologies such as NFTs and crypto assets, where independent users are directly connected to each other without depending on a specific platform.

The United States, the hegemonic state in the Web 2.0 era, issued an executive order on March 9, 2022, expressing its determination and resolve to continue to lead innovation in the Web 3.0 digital economy, and calling to compose a national strategy to advance such measures. Brazil and Mexico have also begun preparations to introduce a central bank digital currency (CBDC) by 2024. Fierce global competition targeting the new digital economic frontier has already begun.
NFTs are considered to be the catalyst that will powerfully expand the digital economy in the Web 3.0 era. “NFT” stands for non-fungible tokens, which is a unique (non-substitutitional) digital token issued on the blockchain.

NFTs, which can prove the uniqueness of digital assets and the authenticity of their transactions on a blockchain, have made it possible to add rarity to digital assets and dramatically increase their economic value. The NFT market as a whole has grown from less than JPY 40 billion in 2020 to more than JPY 4.7 trillion in 2021, an explosive growth of more than 100 times in a single year, and is expanding rapidly worldwide.

Japan has rich, high-quality intellectual property (IP) such as animation and games that are internationally competitive, and has great potential to lead the world in the NFT business and, by extension, the Web 3.0 economy.

In addition, by using NFTs and crypto assets as proof of community membership, rewards, and payment methods, a new form of organizational governance and project execution (Decentralized Autonomous Organizations) can be created that allows diverse stakeholders who share the same mission to participate. Such “DAOs” are beginning to emerge in Japan, and their potential as a new tool for revitalizing local communities and solving social issues is attracting attention. In addition, there is an accelerating movement toward the realization of a form of finance in which individuals support their own financial needs (decentralized finance, hereinafter referred to as "DeFi") and the “metaverse”, a virtual exchange space that transcends gender, nationality, region, race, and other factors.

These efforts can serve as the basis for a new way of growth and distribution that focuses more on creators and authors, person-to-person connections, and communities, as opposed to the current structure which is built on centralized data, captive users and shareholder-centered capitalism.
(3) To drive responsible innovation in the Web 3.0 era

On the other hand, the reality is that Japan's Web 3.0 related businesses are beginning to be left behind by the rest of the world, hampered by the current regulatory and tax systems for crypto assets and NFTs. In the course of our interviews, many pointed out that Japan’s financial regulations and accounting systems are holding back investment, that strict regulations on token issuance are narrowing business opportunities for promising companies, and that our conservative culture discouraging innovation and heavy tax burden are causing promising entrepreneurs and engineers to move overseas.

In order for Japan to exercise leadership in the emerging frontier of the huge digital economy, it is necessary to clearly position the promotion of NFT businesses as a core pillar of the economic growth strategy in the government’s proposal for “new capitalism”. On this basis, the social infrastructure and rules proposed in this document must be immediately put in place to strongly encourage responsible innovation, while taking into consideration the protection of the rights of content holders and users, as well as social and legal interests. Working together with the U.S. and other countries, we must nurture together an ecosystem and a healthy NFT market that will support the Web 3.0 era, and propose a de facto standard for the new digital economy.

(4) The NFT Whitepaper

This NFT Whitepaper was prepared by the Project Team regarding NFT Policies, which was established on January 26, 2022 under the Liberal Democratic Party’s Headquarters for the Promotion of a Digital Society.

In preparing this document, we conducted eight rounds of interviews (Appendix 1) with domestic and foreign experts who are leading various fields related to Web 3.0 and the NFT business, and gathered information to appropriately design the policies required in the Web 3.0 era. In addition, a working group (Appendix 2) consisting of attorneys and others with a high level of expertise in the NFT business and Web 3.0 fields provided significant assistance in organizing and drafting this report.

This document looks ahead to the Web 3.0 era that we are now entering, and focuses not only on the issues specific to NFT businesses, but comprehensively addresses issues and solutions for the development of rules for crypto assets (including stable coins), which are the main payment method for NFT transactions, and the blockchain ecosystem as a whole, which is the foundation of Web 3.0.

In this document, we propose a total of 24 policy recommendations under the following six themes:

1. Establishment and advancement of a national strategy for the Web 3.0 era
2. Measures necessary for NFT business development
3. Measures necessary to protect the rights of content IP holders
4. Measures necessary for user protection
5. Measures necessary to foster a healthy blockchain ecosystem
(6) Measures necessary to protect social and legal interests
2. Establishment and advancement of a national strategy for the Web 3.0 era

A. Issue

Web 3.0 related markets, including NFTs, are expanding rapidly, and the next few years may determine the standards for technical formats and regulatory frameworks, as well as the winners in each market. In light of this situation, the United States issued an executive order on March 9, 2022, ordering the compilation of a government-wide national strategy for digital assets by a certain deadline, and other countries around the world are hurrying to consider strategies for the Web 3.0 era. On the other hand, Japan has not yet defined the position of Web 3.0 and NFT in its economic policy, and has not yet decided who will be responsible for leading the study and promotion of these policies. In addition, the stove-piped government has become a hindrance of innovation and for the public and private sectors to work together. In other words, when private companies and entrepreneurs develop new services utilizing NFTs, etc., they must contact multiple government ministries and agencies to confirm legal issues or request deregulation, which is a heavy burden for startups. It has also been pointed out that even after consulting with them, they are not given clear answers or are given answers with an overly risk-averse attitude.

B. Recommendations

First of all, we should design our national strategy to develop of our digital economy in the Web 3.0 era, utilizing NFT and crypto assets, and position it as a pillar of growth for new capitalism. In order for our country to demonstrate leadership in this new and enormous frontier, we should reflect on the lessons learned from the Web2.0 era lead by GAFAM, and immediately gather collective wisdom from the public and private sectors and take action. For this to happen, strong political leadership and clear commitment are required above all.

From this perspective, we recommend that a minister be appointed to be in charge of Web 3.0, and that the government sends a clear message to develop and advance Japan’s national strategy for the Web 3.0 era. Under the minister in charge, the government should take leadership in developing the necessary systems to promote innovation, coordinating among ministries and agencies toward the development of such systems, and collaborating with other countries, including the realization of many of the proposals described in this document. In addition, in order to incorporate the national strategy into concrete measures across ministries and agencies, a cross-ministry organization should be established to bring together the wisdom of the public and private sectors and provide it with sufficient knowledge and authority. In addition, this organization should have a “one stop consultation desk” that centrally receives consultations related to Web 3.0 from the private sector and seeks solutions to promote innovation in cooperation with the public and private sectors.
3. Measures necessary for NFT business development

(1) Organizing interpretations of the applicability of NFT business to gambling

A. Issue

In recent years, the NFT business has been rapidly developing, mainly in Europe and the U.S. Among them, random sales services using NFTs (a sales method in which the NFT to be sold is randomly determined, as in the sale of digital trading card packages or items in online games) have been attracting attention. In many cases, such services include a secondary distribution market system, where the buyer can sell their NFTs using the system above. For example, in the U.S., a service that sells packages that randomly include NFTs, such as videos of athletes playing, has become popular. The service provider sells the NFT packages and receives a commission for transactions on the secondary distribution marketplace of the service. Some of the rarest and most popular NFTs are resold at high prices on the secondary marketplace. The service provider returns the proceeds in the form of licensing fees to the leagues and players’ associations that have licensed the use of their logos and group portraits; hence, DX has been attracting considerable attention as a means of realizing new financial circulations for sports organizations and players.

Many service providers in Japan have been attempting to provide similar services, but the lack of clarity regarding the applicability of the gambling charge (Article 185 of the Penal Code) for such services has created a chilling effect among providers, resulting in a situation where the development of the NFT business has been greatly hindered.²

The Ministry of Justice and other relevant government agencies have yet to express their views on the applicability of the gambling charge for such services, and this situation has continued to create a chilling effect discouraging such service providers from engaging in new NFT business.

B. Recommendations

² Article 185 of the Penal Code states, "A person who engages in gambling shall be punished by a criminal fine of not more than 500,000 yen or an administrative fine. However, this shall not apply if the betting is limited to objects offered for temporary amusement." Many operators are concerned that services such as NBA Top Shot, which conduct random sales based on the existence of a secondary distribution market, may be found in violation of gambling regulations because of the aspect of stimulating the purchaser's gambling spirit.
In order to foster the promotion of the NFT business, setting up a framework that allows service providers to request an opinion on the applicability of the gambling charge before they develop new NFT services from the relevant government agencies, in advance, is essential.

In particular, with regard to the combination of random-type sales and secondary distribution marketplaces using NFTs, given that similar business models have been flourishing overseas, the relevant government agencies should, at the very least, clearly indicate what forms of businesses would not constitute gambling.

The establishment of rules from the perspective of protecting consumers who purchase NFTs through random sales and secondary distribution marketplaces should be analyzed separately, and it is expected that guidelines will be established by service providers based on the views of the relevant government agencies.

(2) Applicability to crypto assets when many NFTs are issued with no apparent difference in appearance

A. Issue

Since NFTs can be interchanged with Type 1 crypto assets such as BTC (Bitcoin), they may fall within the definition of Type 2 crypto assets. In this regard, there is a general view that a NFT, which is not identical to any other NFTs, does not have an economic function such as a means of payment like Type 1 crypto assets, and therefore do not fall within the definition of Type 2 crypto assets either. Having said that, if a large number of indistinguishable NFTs are issued, they may be used as a means of payment, etc., with virtually no differences from ICO tokens, and thus there may be cases where they should be deemed to constitute Type 2 crypto assets. Accordingly, the question arises as to in which case an NFT constitutes a crypto asset.

B. Recommendations

When determining whether similar NFTs are identical, it is necessary to analyze not only the tokens alone, but both the tokens and the digital content associated with them as a whole and determine whether they are substantially identical from the perspective of ordinary users. If they are deemed identical, then the applicability to crypto assets should be determined based on whether such NFTs have economic functions such as a means of payment. In doing so, in order to minimize legal uncertainty so as not to stifle innovation, it is important for the FSA to provide interpretive guidance, including examples and a safe harbor for cases where the NFTs are not considered to have economic functions such as a means of payment as a crypto asset in light of the number of units issued, form of use, etc.

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3 ICO is a generic term for the act of raising funds from the public by issuing tokens electronically by a company or other entity.
(3) Clarification regarding crypto asset settlements on NFT platforms

A. Issue

In NFT trading on NFT platforms, settlement is often made with crypto assets. There is a need for NFT platforms to provide an escrow service\(^4\) for crypto assets to ensure transaction security, but there exists a legal issue whether provision of such an escrow service constitutes a crypto asset exchange business.

More specifically, in NFT platforms, the platform acts as an intermediary for NFT purchase and sale transactions between users. In this case, it is often possible for the delivery of NFTs between the buyer and seller and the delivery of crypto assets as a consideration between the wallets of the parties. Especially in the case of transactions between ordinary users (“P2P transactions”), the platform may provide an escrow service for ensuring transaction security. In this case, the platformer would control the crypto assets it receives from the buyer until delivering them to the seller. The question is whether this control of crypto assets constitutes “control crypto assets for others” and falls within the definition of crypto asset exchange business.

B. Recommendations

In cases where settlement of NFT transactions, etc., is made in cash, the act of a NFT platform providing escrow services temporarily managing money in connection with the settlement of NFT transactions, etc., is an act of managing the money for itself as a preparatory act for fulfilling its own obligation to deliver the money to the seller. Therefore it can be practically interpreted that this is not an act of managing money for the seller, and should not considered to be a deposit. From the perspective of treating escrow services using crypto assets equally with escrow services using money (fiat currency), while paying attention to the requirements for the prevention of money laundering and terrorist financing (“ML/TF”) (“AML/CFT”), when settlement of NFT transactions, etc. is conducted with crypto assets, the act of managing crypto assets should also be organized as not being an act of managing crypto assets, etc. for another person (seller) if certain conditions are met. However, it is necessary to take into account that if the crypto assets are managed continuously beyond the period required for escrow services, the aspect of managing crypto assets for the seller becomes stronger, and that the risk of leakage of crypto assets becomes higher in the storage of crypto assets than in the case of money. The above points should be clearly stated in guidelines or other means by the FSA to provide interpretive guidance.

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\(^4\) Escrow service refers to a service in which a platform operator not only acts as an intermediary in the buying and selling of goods and other transactions between users, but also receives payment on behalf of the buyer and delivers the payment to the seller after confirming the delivery of the goods from the seller to the buyer, and is used in Internet auctions and flea market applications for transaction safety between parties.
(4) Legal position of banks in NFT related business

A. Issue

Some major banking groups in the U.S. and Europe see great potential in the metaverse, Web 3.0, NFT, etc., and have been active this year in purchasing NFTs that represents virtual “land” in the metaverse (“NFT Land”) and opening virtual branches on it. Also in Japan, a megabank announced in March of this year that it had reached a basic agreement with an overseas game provider to collaborate in NFT related business.

On the other hand, in Japan, banks and banking groups are subject to strict business scope regulations, and it is necessary to consider the extent to which NFT related business can be conducted, and whether each intended business constitutes business ancillary to banking business. For example, it is necessary to acquire NFT land in order to establish a virtual branch in the metaverse, but the FSA’s Supervisory Guidelines for Major Banks (V-6) stipulate that the acquisition of crypto assets by a banking group should be limited to the minimum necessary and that the banking group should be prepared to dispose of them appropriately by selling them quickly, etc. If NFTs are judged in the same way as crypto assets, taking into account that NFTs are tokens on the public chain and have reasonable price movements, it will be difficult to acquire and hold NFTs, and the activities of banking groups in the metaverse will be severely restricted, among other issues.

B. Recommendations

Even though it is difficult for a bank itself to engage in a wide range of NFT related businesses due to business scope regulations, it may be possible for the bank’s subsidiary to engage in a wider range of NFT related businesses after obtaining a license as an advanced banking service company. In this case, the FSA should not become overly conservative due to the lack of precedents when determining the applicability of “other ancillary business” to NFT related businesses and granting approval of the advanced banking service company, while taking into account the risks of NFTs. In addition, the FSA should provide guidance on the above by, for example, providing certain examples.

5 For example, one of the major U.S. banks has announced that it will purchase NFT Land on the decentralized metaverse and open a virtual branch in February 2022. Also, in March of the same year, one of the major UK banks announced a business partnership with a metaverse NFT game provider, whereby the bank will purchase NFT Land on the metaverse NFT game to provide an innovative experience for existing and new customers.

6 The applicability of each item of Article 10(2) of the Banking Act and other ancillary businesses stipulated in the main clause of Article 10(2) of the Banking Act are to be examined. The Supervisory Guidelines for Major Banks, Article V-3-2(4), provides the following four criteria for determining whether a business falls under the category of “other ancillary business.

(i) Is the business concerned equivalent to the business listed in each item of Article 10, Paragraph 1 and Paragraph 2 of the Law?
(ii) Is the scale of the work excessive in comparison with the scale of the specific business to which the work is incidental?
(iii) Is there a functional closeness or homogeneity of risk with the banking business with respect to the relevant business?
(iv) Does it contribute to the utilization of excess capacity legitimately generated by the bank in the conduct of its inherent business?

7 A public chain is a blockchain in which the number of participants (nodes) is not limited and anyone can join the network; many crypto assets such as BTC (Bitcoin) are tokens on public chains, and Web 3.0 services are operated on public chains. On the other hand, a private chain is a blockchain in which certain conditions are set for those who can participate in the network (nodes), and only those whom the operator trusts can participate.
(5) Arrangement of rights related to royalty collection

A. Issue

In Europe and the U.S., the use of NFTs in the sports and entertainment industry has been growing and has become a new source of revenue for performers such as athletes, actors, and artists. For example, in the U.S., as described in (1) above, a service that combines package sales of NFTs including random videos of athletes playing, with the establishment of a secondary distribution market has become popular. In the course of providing such service, a business has entered into comprehensive license agreements with each league and players’ association. The players’ association returns the revenue received as license fees to the respective players.

In the case of NFTs using portraits of athletes and performers, if the revenue from secondary distribution can be regarded as consideration for the use of publicity rights (the exclusive right to use the name, likeness and the like of an individual for commercial benefit), it could be a new way to return revenue to athletes and performers, and thus the sports and entertainment industry in Europe and the U.S. has been focusing on its potential use.

In Japan, however, publicity rights are not a statutory right and have sometimes been handled subject to industry practice. Therefore, even if revenue from secondary distribution is regarded as consideration for the use of publicity rights, the content and scope of publicity rights are unclear, and thus the preconditions for the return of revenue are lacking.

As described above, because the rights and relationship regarding secondary distribution is not sufficiently organized, it is difficult for businesses to provide secondary distribution services for NFTs using portraits of players and performers.

B. Recommendations

Although the publicity rights are rights granted by judicial precedents, they are not statutory rights, and some rules regarding how publicity rights are protected have been established individually by industry practice. However, in light of the potential use of publicity rights in the NFT business, the content and scope of the publicity rights should be clarified through the establishment of soft law or new legislation.

Also, secondary distribution of NFTs using portraits of athletes and performers should be considered as an act protected by the publicity rights, and it is expected that new rules to appropriately return the revenue from secondary distribution of NFTs to the athletes and performers through an agreement between the entity managing the publicity rights (sports organization, entertainment production, etc.) and the athlete or performer, etc. will be developed. In particular, with regard to athletes, there is a concern that questions may arise regarding the method of profit sharing, etc. in the event that an athlete transfers teams or retires after secondary distribution, so it is considered necessary to develop rules that assume such transfers or retirements.

Since there is a possibility of divergent interpretations presented by practitioners in situations where the relationship between the appropriateness of the “one-chance principle” and the performer’s publicity rights in a cinematographic work may become an issue, such as in the case of secondary distribution of NFTs such as films from which a party of the film have been cut, the views of relevant ministries should be presented.

(6) Use of NFTs as a means to achieve interoperability of multiple metaverse services
A. Issue

Metaverse services are often cited as candidates for areas where NFTs can be utilized. Specifically, the future of using NFTs issued on public chains as a means of enabling digital assets to be brought into and used by each other in multiple metaverse (multi-metaverse) services and achieving interoperability between services is being discussed. However, in order to achieve this, the challenges are how to standardize the blockchain mechanism, the format of NFTs, and the mechanism for managing digital data that is not recorded on the blockchain.

B. Recommendations

In order for Japanese businesses to gain an advantageous environment for doing business and competing in the global market, the key point is how to get involved in and lead international discussions in establishing de facto standards for each of the above mechanisms. It is desirable to establish a forum for cross-industry information gathering and discussion involving blockchain and XR (VR/MR/AR)\(^8\) related businesses, and the government should actively take initiative to realize such a forum and deepen such discussions.

\(^8\) XR (Cross Reality) is a generic term for certain advanced technologies such as VR (Virtual Reality), MR (Mixed Reality) and AR (Augmented Reality).
4. Measures necessary to protect the rights of content IP holders

(1) Response to cases of NFT conversion without the content IP holder's permission

A. Issue

NFTs related to various content are issued and sold, but in some marketplaces, mainly overseas, NFTs are issued and sold by parties other than content holders (rights holders) without their authorization, and there is concern about the occurrence and expansion of consumer damage.

On the other hand, it is difficult to naturally confirm who the parties to the transaction are and whether the NFT was issued with the content IP holder's authorization from the information on the blockchain alone.

B. Recommendations

As a precondition, the reaction for the occurrence of rights infringement should be discussed here at first. The content holder can identify the infringer of copyrights, etc., using the sender information disclosure procedure under the Provider Liability Limitation Act, and seek an injunction against the infringing act or compensation for damages. This is not essentially different from rights infringement cases occurring in existing web-based services. As for infringement cases occurring in marketplaces provided by foreign businesses, there remains an issue of whether the sender information disclosure procedure can be executed swiftly. However, the procedure has progressed to a certain extent including the 2021 amendment to the Provider Liability Limitation Act which has introduced a non-contentious "sender information disclosure order" system, and thus we should first closely monitor its operation and take measures to further revise the system and improve its operation as necessary in the future.

On the other hand, as a measure utilizing blockchain, at the private sector level, by establishing an organization or common framework outside the blockchain that centrally manages information related to identification, verification of corporate existence, and authorization, and by developing a mechanism that allows the marketplace side to reference and easily display such information, it is possible to create a marketplace that is more efficient in its use of blockchains. The study of measures to create a safe and secure NFT transaction environment that is as complete as possible on the Web is underway. Relevant ministries and agencies should encourage the private sector to develop such measures.

More specifically, the marketplace side can directly refer to the authentication information provided by the organization or common framework that the NFT has been legitimately issued by a specific content holder and display it on the service, or the marketplace side can issue an NFT that includes the URI of the authentication information as metadata and display it on the service. The marketplace can refer to the authentication information via such metadata and display it on the service.
In addition, if each marketplace operator conducts an examination of NFT sellers to verify their identity, corporate existence and rightsholder’s permission, this should deter NFT sales personating content holders and unauthorized NFT sales to a certain degree.

We do not believe it is appropriate to impose these mechanisms uniformly, but they may help to deter the occurrence of cases of unauthorized NFT. Therefore it is important to inform content holders and NFT users of the existence of both types of marketplaces, those which utilize the above measures and marketplaces with a high degree of freedom, by, for example, spreading such information through industry associations. By doing this, an environment should be created in which both content holders and general consumers can appropriately choose the services they use.

(2) Design protection in digital space

A. Issue

Cases have arisen where NFTs of digital data are sold that imitate mass-produced products with a somewhat distinctive appearance that are intended to be used within a metaverse service, but the design of such mass-produced products is often not protected by copyright.

On the other hand, design rights, which are a mechanism to protect the original design of a product, in principle protect the design of "articles", and although the scope of protection was extended to certain "images" (images used to operate equipment and images showing the results of operation) by the 2019 amendment of the Design Act, the scope of protection does not extend to imitations of designs in digital space. Although international application procedures for design registration have been established under the Hague Agreement Concerning the International Registration of Industrial Designs, the scope of protection based on design rights differs from country to country, and no jurisdiction provides sufficient protection against the act of imitation in the digital space of a design for a mass-produced product.

B. Recommendations

As an immediate measure, it should be discussed which countermeasure can be taken towards counterfeiting activities based on laws such as the Copyright Act and the Unfair Competition Prevention Act. In the future, the possibility of certain measures through law amendment including the expansion of the scope of protection by design rights, should be considered by the related ministries and agencies.

In addition, considering that the provision and use of metaverse services can easily cross national borders, there is a high need for discussions on harmonization and international coordination of design protection in the digital space, and the government should actively take the initiative to lead such international discussions.

(3) Clarification of rules regarding royalties during secondary distribution

A. Issue

It is sometimes explained that one of the features of NFTs is that issuers can receive a certain amount of royalties when NFTs are distributed secondarily, but the functions for setting the royalty rate and receiving and paying royalties for such secondary
distribution are currently unique mechanisms established by each marketplace. In order to collect royalties across platforms for NFTs issued using the public chain, NFTs must be issued under a standard that allows information on royalties to be set, and each platform must support NFT transactions in accordance with that standard. We do not see any standard such as ERC-721 or ERC-1155, which many marketplaces currently support, that allows for setting information on royalties.

B. Recommendations

The right to collect royalties is not a statutory right. Therefore, as a current measure, the public and private sectors should actively share good examples of marketplaces that set royalty rates for secondary distribution and collect and pay royalties, while at the same time, the public and private sector should consider the issue and sale of NFT content to understand that there are certain limits to the collection of royalties across platforms. It is also desirable to promote the understanding of content holders, etc., and the way to provide alert and other explanations should be considered, for example, in cooperation with industry associations.

In the case of further efforts to achieve cross-platform royalty collection, we should work with industry associations to encourage the coordination of information on royalty settings among marketplaces and propose standards that enable the setting of such information (e.g., EIP-2571: Creators' Royalty Token standard\textsuperscript{10} and ERC-2981: NFT Royalty Standard\textsuperscript{11} are well-known.), and certain efforts should be made to encourage the adoption of such standards.

\textsuperscript{10} https://github.com/ethereum/EIPs/issues/2571  
\textsuperscript{11} https://eips.ethereum.org/EIPS/eip-2981
(4) Promote understanding among content holders (e.g., create model terms for content licenses)

A. Issues

In order to further develop the NFT business in Japan and to increase Japan's presence in the global NFT market, it is expected that Japan's rich IP contents (e.g., games, manga, anime, movies, music, art, etc.) will be used more widely.

However, some content holders are reluctant to enter the NFT business because they do not fully understand the impact of issuing NFTs on their content.

B. Recommendations

In addition to the measures described in (1) through (3) above, in order to make content holders feel more comfortable with entering the NFT business, it is necessary to educate content holders to accurately understand what kinds of rights will be granted to holders of NFTs that represent the content in connection with the copyrights and other intellectual property rights of such content, when issuing and distributing NFTs that represent the content.

To this end, individual information sessions and consultation desk services for content holders in the industry should be established.

In addition, the terms of the license granted to NFT holders are usually set by NFT market platform operators in the current transaction practice, but the terms vary depending on platform operators and NFT contents. For this reason, model clauses should be created that set forth the terms of the license with respect to the content to be granted to NFT holders, the rights and responsibilities of the parties involved, as well as points to be noted for each clause based on the characteristics of NFT transactions, in order to promote understanding of content holders and further promote and support their review and negotiation of the terms of the license.
5. Measures necessary for user protection

(1) Efforts to clarify transaction details

A. Issue

Many NFTs are designed to give their holders the right or status to use the content and services within a certain range, but the content varies widely and is not always in a form that is naturally easy for the general consumer to understand. The content is explained in various ways, such as in the metadata (supplementary information) of the NFT itself or published by the issuer on its own website, but there is no uniform method. In addition, there are NFTs that do not entail any rights or status for the holder, and have no meaning beyond simply being held and transferable.

B. Recommendations

One possible countermeasure would be to attempt to establish a certain typology for the content of rights and status attached to NFTs, and then establish a standard method to describe and indicate the content in an easy-to-understand manner.

In the future, an organization or a common framework outside the blockchain that centrally manages information on rights and status should be established, and a mechanism could be developed to allow the marketplace to reference and easily display such information. The private sector is already considering such measures.12 Responsible ministries and agencies should encourage the private sector to make progress in these efforts.

(2) Efforts to deter problems associated with unauthorized NFT cases

A. Issue

In the case of unauthorized content NFT described in 4(1) above, there is concern that general consumers may purchase such NFTs without knowing it, resulting in trouble. Though NFTs are purchased using NFT marketplaces, the transactions themselves are recorded in the blockchain, and the revision or deletion of the recorded data is basically impossible. Therefore, recovery of damages incurred by consumers who have paid for such NFTs must be left to civil remedies between the parties outside of the blockchain.

However, transactions on marketplaces are often conducted anonymously, in which case it is not easy to identify the counterparty to the transaction (even more so if the marketplace is operated by a foreign business). The mechanism for requesting disclosure of sender information under the Provider Liability Limitation Act is not available for identifying the counterparty of a transaction. Therefore, in order to identify the counterparty of a transaction as a precondition for seeking civil remedies, a party to the transaction must either expect voluntary disclosure by the marketplace operator or, if this constitutes a crime, it is theoretically considerable to wait for the discovery through criminal procedures. However, this is a very cumbersome approach, and is not an option that consumers in general would normally choose.

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B. Recommendations

The measures described in 4(1) above can be effective in addressing these issues. First, at the private-sector level, an organization or common framework outside the blockchain that centrally manages information related to identification, verification of corporate existence, and authorization, and a mechanism that allows the marketplace side to reference and easily display such information will be developed. The study of measures to create a safe and secure environment for NFT transactions is underway.

In addition, if each marketplace operator conducts an examination of NFT sellers to verify their identity, corporate existence, and rightsholder’s permission, this should deter NFT sales personating content holders and unauthorized NFT sales to a certain degree.

It is not appropriate to impose these mechanisms uniformly, but they may help to deter the occurrence of cases of unauthorized NFT, so it is important to inform content holders and NFT users of the existence of both marketplaces utilizing the above measures and marketplaces with a high degree of freedom by, for example, informing through industry associations. By doing this, an environment should be created in which both content holders and general consumers can appropriately choose the services they use.

(3) Secure content data not stored on the blockchain

A. Issue

NFTs related to various contents are issued and sold, but only the transaction history of the NFT itself is recorded on the blockchain, not the corresponding content (illustrations, videos, etc.) data. Content data is usually placed on a web server, etc., prepared by the NFT issuer or the business operator that provides the NFT issuance service. Given this situation, there is a risk that the data itself may be lost or replaced after the transaction, and there is also a risk that the web server itself may stop operating and the means of accessing the content itself may be lost.

If these risks materialize, only NFTs lacking referenceable content data will remain, and this may lead that such NFTs will become virtually worthless.

B. Recommendations

The current countermeasure should be to explain the existence of such risks to consumers, and to encourage industry associations to establish rules through guidelines for explanatory items, etc.

In addition, relevant ministries and agencies should take initiative in researching the possibility of utilizing data storage that does not depend on a specific entity, such as the mechanism of decentralized storage (e.g. the Inter Planetary File System (IPFS) is well-known).
6. Measures necessary to foster a healthy blockchain ecosystem that supports NFT business

(1) Tax reform suitable for the blockchain economy

A. Issue

One of the major obstacles to starting a blockchain related business in Japan is corporate taxation based on the year-end mark-to-market valuation of crypto assets. When a company issues tokens and holds a certain number of them in-house without transferring them, if the tokens fall under the category of “crypto assets for which there is an active market,” the company will be subject to corporate tax on the unrealized gains as a result of the year-end mark-to-market valuation under the Corporation Tax Law even though there is no cash revenue from the tokens held by the company. This taxation on the market value of tokens issued by the company is an extremely heavy burden for companies, and as a result, many blockchain related startup companies are not starting up in Japan, but are instead moving overseas.

B. Recommendations

A tax reform or revision of the tax treatment should be made to exclude tokens (including so-called “governance tokens”) held by the issuing company itself from the year-end mark-to-market valuation even if they fall under the category of “crypto assets for which there is an active market”, and to tax them only when they are transferred to a third party and actually generate income, after clarifying their legal treatment and accounting practice.

(2) Easing of evaluation standards for token issuance

A. Issue

In the Web 3.0 business, tokens, which are crypto assets, are usually issued and used, but in order for these to be issued and used in Japan, the crypto assets must be sold by regulated crypto asset exchange service providers. Currently, it takes a long time for the Japan Virtual and Crypto Assets Exchange Association (JVCEA) to evaluate each new crypto asset prior to its offering in Japan, causing token issuers to give up issuing tokens in Japan and inviting Japanese Web 3.0 startups to flee overseas. This situation is an obstacle to the development of Web 3.0 business in Japan.

B. Recommendations

Considering the current situation where a large number of new crypto assets are issued along with the development of Web 3.0 and the limited resources of the JVCEA, it is unlikely to be an optimal and sustainable procedure for the JVCEA to constantly conduct in-depth evaluation of each new crypto asset in advance. In addition, a lengthy evaluation process would not be in line with the speed of Web 3.0 businesses, which is subject to global competition. In light of these points, the JVCEA should review its evaluation procedures, while giving due consideration to user protection, and should take steps to relax its evaluation criteria in order to promote innovation in Web 3.0 businesses in Japan. In doing so, from the perspective of global competition, Japan should continuously and regularly examine whether the evaluation procedures
in Japan are unnecessarily cumbersome compared to the rules for listing new crypto assets in the U.S. and other Web 3.0 advanced countries.  

13 Although the legal requirement is prior notification (Article 63-6, Paragraph 1 of the Payment Services Act, the JVCEA's self-regulatory rules require prior evaluation of each new crypto asset at the JVCEA.

14 For example, only one IEO (Initial Exchange Offering) with a new sale has been approved in the past, and even in that case, it took more than a year from the start of negotiations with the JVCEA to the actual sale. Even in cases that do not involve a sale, the JVCEA conducts a thorough preliminary review of each individual crypto asset, and there are currently many cases pending review.

15 The JVCEA announced the introduction of the "Green List" system as an effort to improve the efficiency of crypto asset evaluation. Under this system, crypto assets that have been listed on a Japanese crypto asset exchange service provider for at least six months and that meet the conditions that three or more Japanese crypto assets exchange service providers are already listed them will be designated as "Green List" crypto assets by the JCVEA. Crypto asset exchange service providers will be able to list such crypto assets without evaluation by the JVCEA, simply by conducting an appropriate evaluation on their own. The introduction of this system can be evaluated as a step toward streamlining the evaluation process. However, since it applies only to previously issued crypto assets, the listing of new crypto assets and the first listing in Japan of previously issued crypto assets will require the same lengthy evaluation procedures as in the past. This is insufficient for promoting innovation in the Web 3.0 businesses, and further relaxation of the standards is required.

16 For example, the New York State Department of Financial Services (NYDFS) introduced "Guidance Regarding Adoption or Listing of Virtual Currencies" in 2019, which requires crypto asset exchanges to provide a list of new policy sets out a general framework for (1) governance, (2) risk assessment, and (3) monitoring, etc., with respect to internal policies to be developed for the listing or adoption of crypto assets, and allows crypto asset exchangers to list or adopt new crypto assets without NYDFS approval if they have completed their own verification in accordance with such internal policies.

17 Abbreviation for Simple Agreement for Future Tokens. It refers to a mechanism whereby a company that intends to issue tokens through an ICO in the future receives funds from investors in exchange for a certain number of tokens to be issued in the future.
(3) Diversification of investment vehicles and schemes for blockchain related businesses

A. Issue

In order to develop NFT businesses, it is necessary to promote investment in blockchain related businesses. One way to facilitate access to investment by investors is through venture capital funds and other funds. In foreign countries, investors are already acquiring tokens through funds and other means. For example, startup companies overseas have already raised funds by using SAFT\textsuperscript{17}, and sovereign wealth funds have also embarked on similar investments.

On the other hand, in Japan, one of the investment vehicles and schemes commonly used to set up funds, for example, is the Limited Partnership for Investment (so-called LPS) under the Limited Partnership Act for Investment. However, the business that can be carried out by the Limited Partnership for Investment is limited to business enumerated in Article 3(1) of the Law, and, the acquisition and holding of crypto assets and tokens are not explicitly included in the covered business. Therefore, it is not necessarily clear whether LPS can invest in a business that acquires and holds tokenized assets (securities, monetary claims, etc.) (e.g., so-called security tokens that tokenize the enumerated securities) that are the subject of the covered businesses enumerated in the same paragraph of the same article. In addition, it is understood that an LPS cannot basically be used as a vehicle for investment in businesses that acquire and hold other crypto assets or tokens.

B. Recommendations

In order to diversify the investment vehicles and schemes available for investment in crypto assets and tokens, first, as an interpretation of the current law, it should be clarified that businesses that acquire and hold tokenized assets (securities, monetary claims, etc.) that are the subject of the covered business as defined in Article 3.1 of the Limited Partnership Act for Investment (e.g., so-called security tokens that tokenize the enumerated securities) are included in the covered business of the LPS. In addition, businesses that acquire and hold other cryptographic assets and tokens should be added to the businesses covered by the same paragraph of the same article in order that LPSs should be made available as investment vehicles/schemes for investment in businesses that acquire and hold crypto assets or tokens. In addition, various possibilities to promote investment in blockchain related businesses, such as investment by the Government Pension Investment Fund (GPIF), should be explored.

(4) Ensure opportunities for accounting audits of companies issuing crypto assets, etc.

A. Issue

There are cases in which companies that issue or hold crypto assets that support NFT businesses are unable to obtain an accounting audit by a certified public accountant or auditing firm because it is difficult to issue an audit opinion on the accounting treatment of crypto assets due to the absence of accounting standards, resulting in a serious impediment to the development of businesses utilizing crypto assets in Japan.

B. Recommendations
While there has been some clarification of the accounting standards applicable to companies that issue or hold crypto assets\textsuperscript{18}, sufficient clarification of the accounting standards particularly with respect to cases where the company "issues" and "holds" its own crypto assets has not been made.

In light of this situation, the JICPA, ASBJ, other industry organizations, and experts should work closely together to promptly eliminate the obstacles to obtaining an accounting audit by a certified public accountant or audit firm for accounting treatment of crypto assets. In addition, the necessary accounting standards should be clarified, and the implementation of proactive accounting audits by certified public accountants and auditing firms should be encouraged to ensure that companies issuing or holding crypto assets have the opportunity to have their accounts audited as soon as possible. Furthermore, clarification of the accounting standards applicable to NFT transactions should also be promptly considered, taking into account the actual status of transactions.

\textsuperscript{18} The accounting treatment of companies holding crypto assets has been clarified to some extent by the “Practical Solution on Tentative Treatment of Accounting for Virtual Currency under the Funds Settlement Law”, Practical Response Report No. 38, published in March 2018 by the Accounting Standards Board of Japan (ASBJ), and the “Examples of Major Accounting Procedures in the Trading Business for Crypto Assets” published in June 2020 by JVCEA, a self-regulatory organization. Regarding the accounting treatment of companies issuing crypto assets, the ASBJ released “Discussion Paper on Accounting Treatment of Issuance and Holding of ICO Tokens that Fall under Crypto Assets under the Funds Settlement Law or Electronic Record Transfer Rights under the Financial Instruments and Exchange Law” in March 2022, which was open for public comments until June 8 of the same year.
(5) Revision of income taxation for users

A. Issue

Under the current tax system, crypto assets are regarded as “proprietary value that can be used against unspecified persons for the purpose of payments” under the Funds Settlement Act. Profits arising from the sale or use of crypto assets are not recognized as capital gain income, but generally recognized as “miscellaneous income”, and the following tax treatments apply

(i) Taxation of income tax on profits and losses arising from crypto asset transactions

Profits and losses arising from crypto asset transactions conducted by individuals are subject to income tax and inhabitant tax at the maximum rate of 55% since they are, in principle, classified as miscellaneous income under the Income Tax Law.

(ii) Taxation when crypto assets are exchanged for other crypto assets

Not only when a crypto asset held is exchanged for legal tender such as Japanese yen or US dollars, but also when a crypto asset is exchanged for other crypto assets, such exchanges are considered as the alienation of crypto assets, and as a result, income tax will be imposed on gains or losses arising from the alienation of the crypto asset.

B. Recommendations

Taxation of crypto assets should be reexamined, including whether or not making profits and losses arising from crypto asset transactions conducted by individuals should be subject to separate taxation on declaration at the rate of 20%, taking into consideration the legal treatment of crypto assets and the fairness of taxation.

(6) Arrangement of taxation of income tax and consumption tax in cross-border transactions

A. Issue

The taxation of cross-border NFT transactions is not necessarily clear in the following points. This is considered as a disincentive to promote cross-border NFT transactions.

(i) Taxation of income tax and corporate tax

If an overseas business conducts an NFT transaction with a Japanese resident or domestic corporation, is it subject to withholding taxation and income taxation in Japan?

(ii) Consumption taxation

If an overseas business conducts an NFT transaction with a Japanese resident
or domestic corporation, is the transaction taxable for consumption tax purposes as a domestic transaction?

B. Recommendations

The taxation of income tax and consumption tax in the case of cross-border NFT transactions should be clarified. In order to ensure fairness in taxation of domestic and foreign businesses, appropriate enforcement should be carried out in cases where income and consumption taxes are imposed and for this purpose, appropriate measures, such as the establishment of necessary systems, should be taken.

In addition, in order to ensure proper enforcement in taxation of cross-border NFT transactions, since it is necessary to properly cooperate with overseas authorities, an international cooperative framework should be established and operated.

(7) Establishment of a system allowing decentralized autonomous organizations (DAOs) to be incorporated.

A. Issue

In the blockchain ecosystem, a new form of organizational governance called DAO, which does not have a specific central administrator or hierarchical structure, but has a governance system that is operated autonomously by its members and participants based on codes and other information recorded in a distributed ledger such as a blockchain, is attracting attention. Due to its decentralized nature, there are many unclear points regarding applicable laws, the legal status of DAOs, the content of legal rights and obligations of members and participants, taxation, etc. In the United States, some states are allowing DAOs to be incorporated as limited liability companies (LLC). For example, in Wyoming, a law allowing DAOs to be incorporated as LLCs (commonly known as the DAO Law) went into effect on July 1, 2021.

On the other hand, in Japan, there is no system that allows DAOs to be legally incorporated, and there are many unclear points such as applicable laws and regulations (governing laws), legal status, content of legal rights and obligations of members and participants, and taxation, etc.

B. Recommendations

DAOs, a new governance system in which diverse stakeholders who agree on the same mission can participate, has the potential to be used as a tool to solve various problems and issues that occur in the real world, and expected to be used as a tool for, among others, revitalizing local regions, solving social issues, and managing sports organizations.

Just as the state of Delaware in the U.S. has been chosen by many companies as the place of incorporation in the area of corporate law due to its advanced corporate law and excellent judicial system, it would be beneficial for U.S. states to take legislative measures to allow DAOs to be incorporated ahead of other states and countries and clarify the limited liability of members and participants, etc., which could have the effect of attracting the establishment of DAOs in each state. Also, DAOs are often established as foundations in Switzerland and other countries.

In Japan, taking into account the above global trends, the legal status of DAOs under Japanese law, the content of legal rights and obligations of members and participants, taxation, etc. should be promptly clarified. Further, a system should be

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established to allow DAOs to be incorporated (for example, “DAO special zones” and “blockchain special zones”) using national strategic special zones.

(8) Develop and secure entrepreneurs and engineers skilled in blockchain technology

A. Issue

In Japan, there is a lack of entrepreneurs and engineers with a certain level of knowledge and skills in the blockchain field, and there is concern that the development of NFTs and blockchain related services will therefore slow down. Furthermore, there is a worldwide shortage of entrepreneurs and talented engineers who have the potential to innovate in the Web 3.0 era, and countries are competing for human resources by promoting the development environment, light tax burden, and ease of VISA issuance.

In this regard, Japan has taken certain measures, such as expanding the scope of the stock option tax system to include outside high-level human resources such as engineers who contribute to the growth of startups. However, there are few students majoring in IT at universities in Japan, and the number of valuable entrepreneurs and engineers who emigrate abroad to avoid the heavy tax burden and excessive regulations tends to increase. It is also assumed that some overseas entrepreneurs and engineers wish to move to Japan, but are hesitant to do so because of the difficulty in obtaining a VISA and entering the country with the Corona disaster, in addition to the tax burden and development environment.

B. Recommendations

In the short term, Japan should advance its efforts towards the aforementioned reforms and deregulation in order to support the development of blockchain related services. Japan should also make the tax and social security burden more acceptable to entrepreneurs and engineers. In addition, it is necessary to consider measures to encourage overseas human resources who will pioneer the Web 3.0 era to move to Japan, through means such as the issuance of a special visa (crypto-VISA) for personnel with a certain level of knowledge and skills in crypto-asset related businesses.

In the mid- to long-term, in order to build a sound blockchain eco system that supports NFT business, it is essential to develop and secure human resources in Japan who will be responsible for blockchain technology and other advanced digital-related technologies. For this purpose, the government should take the lead in fostering and securing human resources for advanced digital technologies, in cooperation with the business community and educational institutions, by utilizing the “Digital Human Resource Development Platform,” which will provide educational content and curricula, practical learning opportunities, etc., to be established in the future.
7. Measures necessary to protect social and legal interests

(1) Introduction of measures such as mandatory identification, etc. to prevent money laundering

A. Issue

The risk of money laundering/terrorist financing (ML/TF) using NFTs cannot be ruled out, given the possible high value of NFTs, the easiness of transferring NFTs through the blockchain, and the fact that robust legal frameworks have not been established in each country. On the other hand, currently, regulations regarding the prevention of ML/TF (AML/CFT), including the obligation of identity verification, etc. (KYC), do not apply to NFT transactions, except when NFTs fall under the category of crypto assets. Given this current situation, the question is how to address this issue from the perspective of promoting innovation and balancing it with AML/CFT objectives.

B. Recommendations

At the FATF19, which leads the international AML/CFT framework, ML/TF risks have long been analyzed for crypto assets, etc., and the regulatory framework that each country should adopt has already been presented, but discussions have only just begun for NFTs.

Therefore, we need to consider what kind of AML/CFT methods should be used for ML/TF, taking into account (1) the situation where NFT is used for ML/TF overseas and in Japan, (2) ML/TF tactics using NFT, (3) AML/CFT methods using technology, and (4) the current and future situation of introduction of regulations, etc. in each country, while also considering the balance with innovation promotion. It is necessary to examine from multiple perspectives, cooperating with the public and private sectors, whether and what kind of AML/CFT is necessary and effective. 20

(2) Regulation of NFT transfers to countries/regions subject to economic sanctions

A. Issue

19 It stands for “Financial Action Task Force," which is an international organization that creates standards for measures to prevent ML/TF.
20 Based on these considerations, guidelines may first be developed by relevant industry associations.
NFTs can be sent basically anywhere in the world through the blockchain. This makes it possible to transfer them to sanctioned countries such as North Korea, Iran, and Russia, as well as to conduct NFT transactions with persons based in those regions and pay them for the crypto assets as consideration.

If these transactions fall under the category of payment, etc. under the Foreign Exchange and Foreign Trade Law, and furthermore meet the prescribed requirements, the competent minister can mandate that the transactions require government authorization. However, for example, since many overseas NFT platforms have not introduced identity verification, it is possible that users may conduct NFT transactions with persons in the sanctioned countries/regions without authorization and transfer crypto assets without being aware of such fact. In addition, if domestic NFT platforms allow persons from sanctioned countries/regions to register as users without their knowledge, it will result in encouraging transactions that violate the Foreign Exchange Law.

On the other hand, as seen in the case of Ukraine where crypto assets and NFTs are widely used to provide humanitarian aid and assistance, there are cases where prompt remittance of funds utilizing the immediate availability of crypto assets and NFTs can make a significant contribution to humanitarian assistance, etc. The disadvantages of uniformly requiring identity verification cannot be ignored. Therefore, the question is how to reduce the risk of NFT transfers to countries and regions subject to economic sanctions in cross border transactions.

B. Recommendations

In light of the fact that NFT transactions will become more active in Japan in the future, it is necessary for the public and private sectors to consult with each other to spread awareness among the public that even NFT transactions could be subject to the authorization under Foreign Exchange Law in certain cases.

Further, as noted in (1) above, it is necessary to consider this issue from multiple perspectives through public-private consultations and international cooperation.
8. Concluding Remarks

There is always a great deal of uncertainty involved in implementing policies related to new industries and technologies. This is even more so when there are no precedents to serve as a reference, or no examples by other countries to benchmark against. However, we should not allow our fear of policy failure or concern over potential side effects, to ruin our chances for future economic growth, the kind of which that arrives only once every few decades. Politicians must take responsibility to correctly estimate risks and promote responsible innovation in the Web 3.0 era with a determination to move forward even if the circumstances do not guarantee zero risk.

At the same time, policy support and regulatory frameworks need to continue to evolve flexibly in response to the rapidly expanding and evolving NFT business and Web 3.0 economy. We plan to continue to solicit a wide range of opinions from interested parties and to continuously review and update the recommendations listed in this document. Because this is a new policy field in which it is difficult to rely on precedents, we propose to take this opportunity to build a new form of open innovation with the private and public sectors sharing challenges and goals and bringing together their wisdom. This approach should become a new pillar of the proposed “new capitalism”.

[End]
# NFT Policy Project Team Interview Schedule

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## NFT Policy Project Team Working Group

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<tr>
<td>Hironori Inagaki, Attorney at Law</td>
<td>Nishimura &amp; Asahi</td>
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<td>Tsutomu Endo, Attorney at Law</td>
<td>Nagashima Ohno &amp; Tsunematsu</td>
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<tr>
<td>Ken Kawai, Attorney at Law</td>
<td>Anderson Mori &amp; Tomotsune</td>
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<td>Keiji Tonomura, Attorney at Law</td>
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<td>Kaku Hirao, Attorney at Law</td>
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<td>Masafumi Masuda, Attorney at Law</td>
<td>Mori Hamada &amp; Matsumoto</td>
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<tr>
<td>Ryo Matsukura, Attorney at Law</td>
<td>Working Group Secretariat</td>
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<td>Takumi Naito, Attorney at Law</td>
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