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Japan's "National Strategy" for Digital Assets and Web 3.0: Tax Reform, Stablecoins, NFTs, Investment, and International Leadership

Since taking office in 2021, Japanese Prime Minister Kishida Fumio has sought to establish "[a new form of capitalism](#)" in Japan. At the center of his vision has been a "[national strategy](#)" to develop Japan's "digital economy in the Web 3.0 era"—something his government has deemed "[key](#)" to the "realization of the digital society" and Japan's economic future. Amidst "intense competition" globally, Japan has "embarked on large-scale investments" to "[pioneer\[\] the future of Web3](#)"—a "decentralized network based on blockchain technology"—position itself as the "most mature market in the world," and "[make Japan the global hub of 'responsible innovation.'](#)"

Now, two years into this project, Japan has implemented sweeping changes from persistent tax reform to leading the regulatory charge on the international stage. And earlier this year Japan became one of the largest economies in the world to [launch a pilot](#) for a Central Bank Digital Currency (CBDC). Japan's Digital Agency has said its work has "only just begun," and time will tell whether its efforts have worked to secure Japan's place as a leader in the new and expanding digital economy.

I. Japan's Experience with Digital Assets & the "Crypto Winter"

Japan "once led the world's crypto industry." Then, it suffered frequent large-scale hacking incidents that were met with a strong regulatory reaction. This reputation and regulatory burden combined with high taxes and a lack of regulatory clarity put Japan's once world-renowned crypto industry on the back foot.

In 2014 and 2017, Japan's crypto industry suffered two crippling hacking incidents. The latter hack of Coincheck saw a loss of \$500 million and consumer confidence. In response, the Japanese government "established regulations" to protect "consumers and investors."

It now requires crypto exchanges operating in Japan to, among other things, segregate customer fiat currency and crypto assets from the exchange's own assets, entrust customer currency to third-party Japanese banks or trusts managed by trustees with customers identified as the beneficiaries, store at least 95% of customer currency in non-internet connected "cold wallets," and back all internet connected currency by separate exchange-owned crypto assets held in its own cold wallet. In short, Japan's crypto exchange service providers must strive to guarantee the investment.

This regulatory framework has proved a double-edged sword. The "current regulatory and tax systems," in part, caused "Japan's Web 3.0 related business" to "be left behind by the rest of the world." Yet, it may have helped it survive the current "crypto winter."

This so-called “crypto winter” has seen “falling” crypto asset prices, “crashing” algorithmic stablecoins, and the “collapse” of certain “major global crypto exchanges” like FTX. These events have had an “undeniable” impact on the industry, slowing “the development of blockchain based web3 business.” But, because of its strong consumer-protection regulations, Japan has “limited the impact of the recent global crypto exchange collapse.” In fact, the Chief Fintech Officer of Japan’s Financial Services Agency (FSA) has said that it is likely all of [“FTX Japan’s Japanese customer assets will be returned”](#) despite “the Chapter 11 global bankruptcy” of the exchange.

II. Adoption of a New “National Strategy”

Japan has “seen the industry suffer in the past” and survived. This is why Prime Minister Kishida’s administration believes that “Japan is positioned to play a unique role in the crypto industry” and that now is the “opportunity for Japan” to implement a “national strategy” to “vigorously promote the development of an internationally competitive web3 business environment” and “demonstrate leadership in international regulatory discussions.” The administration has emphatically declared that Japan “must not miss this opportunity.”

The Japanese government launched its “national strategy” in January 2022 when the Liberal Democratic Party, Japan’s ruling party, established its Headquarters for the Promotion of a Digital Society. Since then, its Web3 Project Team has consistently proposed legislative and regulatory reforms directly to the Party. Many of these reforms have been adopted, but others remain pending.

a. Tax Reform

Perhaps the most fundamental component of Japan’s “national strategy” is the creation of “an attractive development environment and tax system for entrepreneurs and engineers” that “facilitates investment.” These tax reform efforts have focused on two aspects of the tax policy: (1) corporate year-end taxation and (2) the individual tax rate.

(1) Corporate year-end taxation. Traditionally, all crypto assets held by companies were subject to a “market-to-market valuation if an active market exist[ed] for those assets.” In other words, regardless of whether those assets were not being actively traded by the company or even lost value over the year, the company holding them remained subject to a tax on their fair market value. This tax could be as much as 35%. To promote a “token financing friendly environment” for business Japan’s Web3 Policy Team proposed two reforms. First, exempt “tokens continually held by the issuing corporation” from “year-end market-to-market taxation for corporate income tax purposes.” Second, exempt “tokens issued by other companies and held by third parties that are not for short-term trading purposes.”

The first reform went into effect in June 2023. The second reform has just been [proposed](#) for the 2024 legislative agenda by the FSA and [adopted](#) by the Ministry of Economy, Trade and Industry (METI). Adopting these two measures will likely put an end to the longstanding disadvantage domestic corporate investors were placed in compared to overseas investors who could rely on more favorable tax treatment.

(2) Individual tax rate. Currently, income derived from crypto asset transactions is taxed as “miscellaneous income,” which has a “minimum tax rate of 55%” when “income tax and inhabitant tax” are combined. And this

tax is imposed “not only when crypto assets held are exchanged for legal tender” but also “when they are exchanged for other crypto assets.” This tax situation is “more severe” than in most other countries, has led to a large “outflow of taxpayers overseas,” and “impeded tax reporting by taxpayers.” The Web3 Policy Team proposed four reforms. First, tax crypto asset transactions at a flat 20%. Second, only tax those “gains and losses” when they are converted to fiat currency, exempting “the exchange of crypto assets” from taxation. Third, allow individuals to carry losses forward up to three years. Fourth, apply the same tax rate to “crypto asset derivatives transactions.”

Despite an emergency proposal by the Headquarters from Promotion of a Digital Society in November 2022, these reforms were excluded from the 2023 agenda, and it is unclear whether these proposals will be made part of the 2024 legislative agenda.

b. Stablecoin Regulatory Framework

Another pillar of Japan’s “national strategy” is promoting the issuance and circulation of permissionless stablecoins.¹ As of this year, the “[market capitalization of stablecoins totaled \\$129.5 billion](#).” Creating an “environment” where stablecoins “can be used safely and openly,” is “necessary” to impact and capture some of that market and “promote digital asset trading” and “other web3 industries.”

In June of 2022, Japan became one of the first major economies in the world to provide a regulatory framework for stablecoins. Japan’s newly amended Payment Services Act defines stablecoins as an “electronic payment instrument” and establishes a new regulated “intermediary of electronic payment instruments” business category. The amendment went into effect June 1, 2023.

Now, trust companies and funds transfer operators are authorized to issue and transact in stablecoins consistent with existing capital maintenance requirements. This gives them access to the “1 quadrillion yen a year” “market for corporate payment settlements.” It is no wonder then that four major banks and digital lenders are already planning to issue their own stablecoins, including Mitsubishi UFJ Financial Group (MUFG), who is preparing to issue the yen-pegged Progmatic Coin. Additionally, other “traditional” companies that previously had “little involvement with crypto assets” are now making “major investments in the web3 field.”

And as of December 2022, the FSA lifted a ban on the listing of foreign-issued stablecoins. One impact of these reforms is that Circle, a major financial technology stablecoin intermediary, is now “[considering issuing a stablecoin in Japan](#).”

c. Non-Fungible Tokens (NFTs)

This is where Japan’s digital asset “national strategy” began. In April 2022, the Web3 Policy Team, then known as the Project Team regarding NFT Policies, issued the Team’s first white paper outlining the “national strategy to develop [Japan]’s digital economy in the Web 3.0 era, utilizing,” among other things, “NFT[s].”

Japan believes that “NFTs” are “the catalyst” of the “digital economy in the Web 3.0 era.” To that point, the “NFT market” grew from “JPY 40 billion in 2020” to “more than JPY 4.7 trillion in 2021.” Japan has “rich, high-quality intellectual property” in the form of “animation and games” that it believes are “internationally competitive,”

giving Japan the “great potential to lead the world in the NFT business and, by extension, the Web 3.0 economy.”

To capitalize on its intellectual property and NFT market growth, Japan has sought to promote the active use of Japanese NFTs. One step it has taken has been to deregulate some NFTs as crypto assets. In March 2023, the FSA announced that any NFT with a “unit price of 1,000 or more or an issuance of 1 million or fewer” did “not fall under the definition of a crypto asset.” This likely places those NFTs on a more favorable regulatory and tax footing.

But NFT businesses and content creators still “face significant hurdles.” For one, regulatory ambiguity has made companies anxious to adopt a prevalent NFT model whereby a “random sales model for NFTs” is combined “with a secondary circulation market,” common in fantasy sports in the U.S. and Europe. Businesses are concerned that it may run afoul of Japan’s anti-gambling laws. These same laws also make it unclear whether Japanese businesses can legally license their intellectual property to be used in overseas NFT businesses. And the inability of Japanese companies to enter the marketplace has led to concerns about others “free-riding” on their valuable intellectual property.

In addition to protecting the rights of content holders and securing their data, clarifying and updating these legal hurdles is necessary “for the further development of Japan’s content industry in the web3 era.”

d. Investment

Yet another aspect of Japan’s “national strategy” is a reform of existing corporate forms to promote investment in “blockchain-related businesses by public-private funds.” Globally, in 2022, web3 startups “[raised \\$15.1 billion](#),” a fifteen fold increase from 2018. Japan believes it can capitalize on this momentum if “appropriate legal and tax frameworks are established,” encouraging investors to “gather in Japan.”

Part of establishing an appropriate legal framework has been opening new funding avenues for partnerships through digital assets and recognizing a new corporate form built on web3 technology: the Decentralized Autonomous Organization (DAO).

Currently, Japan restricts investment business limited partnerships to fundraise through conventional means—shares, stock options, and security tokens. These same partnerships are also required to invest more than half of their capital domestically. Plans to remove both restrictions are being considered by METI for 2024. This would allow startups to raise money through the sale of digital assets and open more investment opportunities to maximize capital growth, allowing greater reinvestment in domestic startups.

The other push is for recognition of DAOs. DAOs are entities that operate by granting governing voting functions to owners through security tokens. This makes membership and operation fluid and fast. Currently, however, “there is no clear legal framework for DAOs that ensures limited liability for its members and provides” a corporate form agile enough for its operation. Even the LLC model has certain rules—such as requiring LLCs to list all members and their personal information in the articles of incorporation—that pose an untenable administrative burden. While the Web3 Policy Team has routinely recommended reforms in this area, it is

unclear when such reforms will be made. The Digital Ministry, however, has [created its own DOA](#) to facilitate research.

e. International Leadership

While the “national strategy” focuses on Japan’s domestic development, a key component has always been international leadership. And over the past two years, Japan has made great strides on the international scene both as a regional leader and through its G7 Presidency.

Regionally, Japan has begun to rise as a leader in the digital marketplace. In May 2023, Prime Minister Kishida [launched](#) the Digital Innovation Center at the Economic Research Institute for ASEAN and East Asia. He has also highlighted the development of a regional cross-border payment system in collaboration with a Japanese startup and the National Bank of Cambodia called the “Bakong system” that connects countries throughout the region through use of Cambodia’s CBDC and stablecoins. In 2022, [this system](#) had over 8.5 million users and handled over \$15 billion in payments, and it has plans to expand.

Globally, Japan served as the President of the G7 for 2023. The government sought to use its Presidency as an opportunity to “take a proactive leadership role, clarify its position as a leader in technology-neutral and responsible innovation, and look to the future of web3.” In particular, it sought to emphasize its history of strong “consumer and investor protection,” create uniformity on international private laws regarding data and digital asset transfers, and push for adoption of the “travel rule” for digital assets to combat money laundering and terrorist financing by requiring crypto exchanges to transfer source and destination information when transferring assets.

Japan made the most of its G7 Presidency and its members appeared to echo Japan’s “national strategy” talking points. The [G7 leaders agreed](#) that “regulation and oversight are critical” to address “risks posed by crypto-asset activities” and to “avoid regulatory arbitrage, while supporting responsible innovation.” The [heads of the nations’ central banks agreed](#) that a “reliable, stable, and transparent global payment system is the key foundation” of their economies and that web3 technologies like CBDCs and stablecoins have a “substantial role to play.” And the [nations’ digital and technology ministers agreed](#) with “the Japanese Presidency’s vision for a Society 5.0” and the development of “innovative and competitive digital ecosystems.”

The result of those agreements has included an update to the G7’s “inventory of rules for digital markets,” agreement to convene a summit on digital assets and security in the Fall of 2023, support for the adoption of the “travel rule,” which Japan formally adopted in April 2022, and [an event](#) hosted by Japan with the World Bank to “accelerate” the transition to a “secure and resilient digital infrastructure.”

III. Next Steps

Japan’s “national strategy” will continue to play out over the coming years as the government proposes new reforms, identifies new areas for improvement, and tracks progress. Japan is taking its digital economic future seriously, but as the head of Japan’s Digital Agency has said, their work is just beginning.

In addition to the pillars of Japan’s “National Strategy” discussed above, the Web3 Policy Team has identified dozens of new areas to explore. This includes optimizing web3 technology for community revitalization through

NFTs, empowering disabled or socially isolated individuals to find gainful employment in the metaverse and engaging with “private sector businesses such as law firms” in light of the increasingly complex and far-reaching impacts of these economic and legal reforms.

Japan’s ruling party convenes its annual meeting in the Fall to adopt and establish legislative priorities for the coming year. As it meets this year, it is important to watch the next steps it takes towards advancing Japan’s “national strategy” to secure its digital future.

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Footnotes

¹There are two types of stablecoin blockchains: permissioned and permissionless. "Permissioned" stablecoin blockchains operate as part of a "centralized system in which there is an entity (specific company or group) that manages and operates the blockchain, and only those authorized by the entity can participate in the transactions on the blockchain or its verification." In contrast, "permissionless" stablecoins are "open and decentralized" and "allow anyone to participate in the transactions and their verification on the blockchain without the existence of an entity that manages or operates that blockchain." For more information on stablecoins, see Stephen Anstey, "A Brief Primer on Cryptocurrencies, Stablecoins, Tokenization, and Central Bank Digital Currencies," *Digital Assets Regulation Blog* (April 3, 2023), <https://www.jdsupra.com/legalnews/a-brief-primer-on-cryptocurrencies-5013034/>.