

Financial Services Tax News

Financial Services Tax Group

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2006 TAX REFORM ON ASSESSMENT STANDARD FOR A FAMILY CORPORATION

The assessment standard for a Family Corporation was revised in the 2006 tax reform. Prior to the 2006 tax reform, the assessment standard for a Family Corporation was based on the total number of issued shares. However, because of changes to the Corporation Law, a corporation can issue shares with restricted voting rights that exceed half of the total issued shares. To prevent corporations from avoiding Family Corporation status by using shares with restricted voting rights, an additional assessment standard has been introduced. This news letter summarizes in outline the change.

1. Summary of the assessment standard prior to the 2006 tax reform

Prior to the 2006 tax reform, a Family Corporation (*dozoku kaisha*) was defined as "a corporation of which three or less individual and corporation shareholders (including their special related individuals and corporations) (excluding such a corporation where it owns its own shares or capital contribution) have more than 50% of the total number of issued shares or amount of capital contribution (excluding shares or amount owned by the corporation as its treasury shares)". A Family Corporation was thus judged on the total number of issued shares of the corporation.

2. Additional assessment standard post 2006 tax reform

In addition to the assessment standard noted in #1 above,

(1) Assessment based on certain number of voting rights and the numbers of voting members in a *Mochibun Kaisha*

In addition to #1 above, certain number of voting rights and number of voting members is now included as part of the assessment standard. That is, a corporation is a Family Corporation where three or less individual and corporation shareholders (including their special related individuals and corporations):

- (i) have more than 50% of the total number of certain voting rights(*) of the corporation (excluding voting rights held by the shareholders who cannot exercise such rights); or
- (ii) are over half of the total member of partners (partners who have execution power if the corporation has set it out) of Mochibun Kaisha (i.e., Goumei Kaisha, Goushi Kaisha and Godo Kaisha) .

(*) Including:

- (a) Voting rights relating to resolution of transfer of all or a substantial portion of business, winding up, continuation, merger, divide, exchange of shares, transfer of shares or investment in kind
- (b) Voting rights relating to resolution to appointment or removal of board of directors
- (c) Voting rights relating to resolution to director compensation, bonus or any remuneration or monetary compensation provided by the corporation
- (d) Voting rights relating to resolution of dividend or profit distribution

(2) Where a voting right considered to be in place

With regard to the voting rights stated above, voting rights held by a person who agrees with another individual or corporation to exercise the same decision in respect of voting rights are considered to be held by the individual or corporation and such individual or corporation is considered as a shareholder of the corporation.

3. Applicability of special tax rate for Special Family Corporation (tax on excess retained earnings)

Prior to the 2006 tax reform, the special tax rate applies to Family Corporation where the number of shares held by the shareholders within three groups are more than 50% of the total number of issued shares. This rule has changed after the reform from three groups to one group. This assessment also applies to #2(1) and (2) above.

4. Effective date

The above tax reform is effective from the fiscal year beginning on or after April 1, 2006.

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