



# Financial Services Tax News

Financial Services Tax Group

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## Automatic Conversion of Existing Y.K.'s to K.K.'s Under New Japanese Corporation Law – Potential U.S. Tax Impact

On June 29, 2005, a legislative proposal was passed by the Japanese Diet. The new law will abolish the Yugen Kaisha (“Y.K.”) Law effective April 2006. This would result in it no longer being possible to form a Y.K. after that date. An existing Y.K. will automatically be converted into a “Special Y.K.” (Tokurei Yugen Kaisha) and will be governed by corporate laws governing Kabushiki Kaisha’s (“K.K.”). As a Special Y.K., the company will be required to continue to use the name ‘Y.K.’ in its corporate name.

The new law provides that Special Y.K.’s can adopt shareholder resolutions (and approve the necessary changes to their corporate governance) to convert from a Special Y.K. to a regular K.K. The new law is not clear as to whether Special Y.K.’s can retain this status, or whether they must convert to a regular K.K. within a defined period of time. However, it is clear that Special Y.K.’s are a form of K.K. under the new law. As such, for U.S. tax purposes, it is likely they would be considered a “per se” entity taxable as a corporation for U.S. tax purposes.

### Potential Impact

Although there are not yet any tax laws announced specifically with respect to this required change from a Y.K. to a Special Y.K., we would expect that this conversion would be considered a non-taxable event for Japanese tax purposes.

However, if a Y.K. has elected to “check the box” and be considered a flow-through entity for U.S. tax purposes, consideration should be given to the U.S. tax impact of this new law, which would effectively create an outbound incorporation of the Y.K. for U.S. tax purposes. Potential tax ramifications could include, for example, taxation of built-in gain assets held by the Y.K. and triggering of various loss recapture rules.

In addition, passage of the legislation may mean that U.S. taxpayers operating in Japan in a Y.K. format will have to operate in corporate form for U.S. tax purposes on a going forward basis. Such a situation could have significant tax impact and should be carefully analyzed to maximize planning opportunities and minimize detrimental tax results.

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