

# Financial Services Tax News

Financial Services Tax Group

April 2007

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## Judgment on Business Relevancy on Reorganizations

Reorganization for running a joint business is one category of tax-qualified reorganizations and mutual relevancy between the businesses of the parties ("**Business Relevancy**") is one requirement to meet the conditions of reorganization for running a joint business.

In the case of a merger, there must be mutual relevancy between one of the main businesses operated by the target corporation (the "**Business of Target Corporation**") and one of the businesses operated by the acquiring corporation (the "**Business of Acquiring Corporation**") before the merger. Prior to the 2007 Tax Reform, the definition of Business Relevancy was stipulated in the *Corporation Tax Law* only as "the mutual relevancy between Business of Target Corporation and the Business of Acquiring Corporation". In practice, it was difficult to assess whether the Business of Target Corporation and the Business of Acquiring Corporation were mutually relevant.

The Ministry of Finance published an *Ordinance* on April 13, 2007, stipulating the detailed guidelines on the judgment of Business Relevancy on tax-qualified reorganizations. This Newsletter outlines these new guidelines.

## 1. Guidelines of Judgment on Business Relevancy

According to the revised Article 3 of the *Corporation Tax Law Enforcement Regulation*, the following two conditions must be met to find that the Business of Target Corporation and the Business of Acquiring Corporation were mutually relevant:

1) Both target corporation and acquiring corporation shall meet all of the following conditions immediately before the merger:

- i) Owning or renting office, store, plant or other fixed facilities<sup>1</sup>;
- ii) Having employee (or director who exclusively engages in the business for the corporation);
- iii) Engaging in any one of the following activities in its own name and its own account:
  - (a) Sales of goods or other business<sup>2</sup>;
  - (b) Solicitation for offering or conclusion of contract regarding sales of goods or other business through advertisement or promotion;
  - (c) Market research to obtain materials necessary to engage in sales of goods or other business;
  - (d) Application for license to a governmental organization which is required by law to engage in sales of goods or other business, or holding rights of such license;
  - (e) (1) Application for acquisition of intellectual property rights<sup>3</sup> or request, application or similar procedures for registration (except for registration of transfer of the rights) of intellectual property rights; (2) request, application or similar procedures for registration of transfer of intellectual property rights and other similar rights<sup>4</sup> (including registration of rights to apply or rights to use the intellectual property rights); or (3) holding intellectual property rights or holding intellectual property rights and other similar rights;
  - (f) Possession or lease of assets (except for fixed facilities) necessary to engage in sales of goods or other business; and
  - (g) Similar activities mentioned (a) to (f) above

2) The Business of Target Corporation and the Business of Acquiring Corporation meet any one of the following conditions:

- i) The Business of Target Corporation and the Business of Acquiring Corporation are the same kind of business;
- ii) Goods, assets, services (limited to those which are for sales, for lending or for providing) or management resources<sup>5</sup> of the Business of Target Corporation and those of the Business of the Acquiring Corporation are the same or similar; or
- iii) The Business of Target Corporation and the Business of Acquiring Corporation are expected to be engaged in business by utilizing the goods, assets, services or management resources of the Business of Target Corporation and the Business of Acquiring Corporation after the merger.

The Business of Target Corporation and the Business of Acquiring Corporation are presumed to meet the requirements of above 2) where the Business of Target Corporation and the Business of Acquiring Corporation are actually engaged in business as one body by utilizing the goods, assets, services or

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<sup>1</sup> "Fixed facilities" means facilities which are placed in a country or an area where the head office or principal office is located.

<sup>2</sup> "Sales of goods or other business" means sales of goods, lease of assets or providing services continuously executed for the purpose of receiving consideration, including development or production of goods, or development of services.

<sup>3</sup> "Intellectual property rights" means rights related to the intellectual property rights prescribed by the laws or the rights related to benefit which is protected by the laws such as patent, utility model right, breeder's right, design right, copyright or trademark.

<sup>4</sup> "Intellectual property rights and other similar rights" means intellectual property rights, including rights to apply or rights to use the intellectual property rights, which are limited to those necessary for sales of goods and other business.

<sup>5</sup> "Management resources" means equipment used in business, intellectual property rights and other similar rights related to business, production technology, skill or knowledge of employee, know-how of production or sales of goods related to business, know-how of providing services and other resources similar to them.

business resources of the Business of Target Corporation and the Business of Acquiring Corporation after the merger.

## 2. Application to Other Types of Reorganization

The above guidelines shall apply to assess Business Relevancy on the requirements of other types of reorganizations for running a joint business (i.e., corporate split-off, investment in kind, stock exchange or stock transfer). The guidelines also apply to assess Business Relevancy under the provisions for the treatment of an acquiring corporation's loss carry forward and the treatment of taking over a target corporation's loss carry forward in tax-qualified reorganizations.

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