

Japan Tax Update

Monthly tax update



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2007 Tax Reforms Relating to Corporate Reorganization

On December 14, 2006, a summary paper of the tax reform for the 2007 fiscal year (the "Summary Paper") was released by the Japanese government. A draft bill of the tax reform is expected to be submitted to the Diet for approval in the middle of February, 2007.

Among the proposed tax reforms, an amendment to the tax qualified corporate reorganization rule is likely to draw attention of both Japanese and non-Japanese corporate investors.

New Corporation Law rules relating to corporate reorganizations will become effective on May 1, 2007. These rules will allow more flexibility for corporations carrying out merger and acquisition transactions and will enable foreign investors to acquire a Japanese target via the so-called "triangular merger". According to the Summary Paper, it is proposed that a corporate reorganization solely for shares of the parent corporation (domestic or foreign) of the Japanese acquiring corporation, will be treated as tax qualified to the extent that (1) the parent directly owns and will continue to own 100% of the Japanese acquiring corporation prior to and after the reorganization, and (2) any other requirements for the tax qualified reorganization are met.

The above treatment applies to reorganizations carried out on or after May 1, 2007. Several rules are proposed in relation to this treatment.

First, as a result of the reorganization, if shares of a foreign parent are issued to a non-resident shareholder of the acquired Japanese corporation, the non-resident shareholder will be subject to capital gains taxation based on the application of Japanese tax laws and any relevant income tax treaty upon receiving the new shares. In other words, the non-resident will be subject to Japanese tax if (1) the non-resident is resident in a country that has not concluded a tax treaty with Japan, or (2) the relevant tax treaty does not exempt capital gains taxation in Japan. This rule will apply to reorganizations carried out on or after May 1, 2007.

Second, to prevent abusive use of cross border merger and acquisition transactions carried out under the new rules, it is proposed that for intra-group reorganizations, if the foreign parent (which issues new shares upon the corporate

reorganization in Japan) is a shell company located in a tax haven country and the Japanese acquiring company does not carry out any business in Japan, the transaction will be treated as a tax disqualified reorganization. As a result, the shareholder of the acquired company will be taxable on the disposal of any shares that occurs as a result of the reorganization. This rule will apply to reorganizations carried out on or after October 1, 2007.

You have a vision. PricewaterhouseCoopers helps bring that vision to reality. We hope you enjoy the current issue of Japan Tax Update and appreciate your comments or ideas for what you'd like to see covered in future issues.

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