

Japan Tax Update

Monthly tax update



May 2005 Issue 10

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As we all know, the only thing constant is change. And the only way to stay successful is to keep on top of changes — in the economy, the industry, and with regulation.

The "Japan Tax Update" seeks to update you on the latest developments in Japanese tax law that affect Japanese and foreign multinationals having operations in Japan. In addition to providing information on Japanese tax issues, the purpose of this newsletter is to make management aware of changes in the regulatory environment that may have an impact on their business.

Included in this issue are the following articles:

Expected Impact of the Legislation of the Proposed Corporation Law

1. Use of Doing Business in Branch Form Inhibited
2. Automatic Conversion of the Existing YKs to KKs Affecting the "Checked the Box" Status for the US Tax Purposes

1. Use of Doing Business in Branch Form Inhibited

There are current legislative proposals to split the Commercial Code of Japan into the Commercial Code and a Corporation Law. Section 2 of the Commercial Code, dealing with Kabushiki Kaisha, Gomei Kaisha, Goshi Kaisha and Foreign Corporations will be moved to the new Corporation Law.

One section (Article 821) of the Corporation Law, as proposed, will inhibit foreign corporations from doing business in Japan in Branch form if (1) the foreign company has its Head Office in Japan or (2) if the main purpose of the foreign corporation is to conduct business in Japan. "Head Office" is defined as a substantial head office. Both (1) and (2) above are intended to refer to a company which intends to avoid the governance provisions of Japanese laws by establishing a company under foreign corporation laws, even though its true purpose is to conduct business in Japan. These types of companies are called a "para-foreign company". (It is presently unclear what level of activities will be required outside Japan to allow a Japanese Branch to operate within these provisions.)

There are penalties for breach of these provisions, including the imposition of joint and several legal liabilities on the Representative of the Company for all transactions made by the para-foreign company. A monetary fine will also be imposed.

The new Corporation Law (and this Article 821) is not yet enacted, although it has passed the Lower House. We expect that the proposal will be passed in the current Diet session, with likely effect from April 2006.

Affected companies may want to discuss further with Japanese legal counsel. If a business restructuring is required, we stand ready to assist you in identifying tax-efficient solutions to any business reorganization plans that might need to be developed.

2. Automatic Conversion of the Existing YKs to KKs Affecting the “Checked the Box” Status for the US Tax Purposes

The Japanese Diet is considering changes to the Commercial Code. Included in this proposed legislation is a provision to abolish the Yugen Kaisha (“YK”) Law, such that after the enactment date (likely April 2006) it will no longer be possible to form a YK. Existing YKs will be automatically converted into a Special KK (Tokurei Kabushiki Kaisha), and be governed by the Corporation Law sections governing Kabushiki Kaishas (“KK”). As a Special KK, the company will be required to continue to use the name YK in its corporate name.

The proposed Transitional Law provides that Special YKs can adopt shareholder resolutions (and approve the necessary changes to their corporate governance) to convert from a Special YK to a regular KK. The legislative proposals are not clear as to whether Special YKs can retain this status, or whether they must convert to a regular KK within a defined period of time. However, it is clear Special YKs are a form of KK under these proposed Commercial Code changes. As such, it is likely they would be considered a “per se” entity for US corporate tax purposes.

For Japanese tax purposes, a change from a YK to a KK under existing law is a non-taxable event. Although there are not yet any tax laws announced specifically with respect to this required change from a YK to a Special KK, we would expect that this conversion would be considered a non-taxable event. However, if these YKs have checked the box to be considered as a flow through entity for US tax purposes, consideration should be given as to the US tax impact of this legislative proposal.

This proposed change has already passed the Lower House of the Diet and is expected to be enacted into law during the current Diet session, with an expected effective date of April 2006.

If you have any questions regarding this matter, or need assistance in evaluating either the Japanese or US tax ramifications of this proposed change, please do not hesitate to contact us.

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 about our current issue or ideas for what you'd like to see covered in future issues.

If you have any questions, please contact:

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