

Japan Tax Update

Monthly tax update



September 2006, Issue 23

PricewaterhouseCoopers Tax (Zeirishi-Hojin PricewaterhouseCoopers) is the largest professional tax corporation in Japan with more than 350 staff. PricewaterhouseCoopers (www.pwc.com) provides industry-focused assurance, tax and advisory services to build public trust and enhance value for its clients and their stakeholders. More than 130,000 people in 148 countries across our network share their thinking, experience and solutions to develop fresh perspectives and practical advice.

"PricewaterhouseCoopers" refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

This Update is provided for general guidance only, and does not constitute the provision of legal advice, accounting services, investment advice, or professional consulting of any kind. Before making any decision or taking any action, you should consult a professional adviser who has been provided with all pertinent facts relevant to your particular situation.

Zeirishi-Hojin PricewaterhouseCoopers
Kasumigaseki Bldg., 15F
2-5 Kasumigaseki 3-chome
Chiyoda-ku, Tokyo 100-6015
Telephone: 03-5251-2400
<http://www.pwc.com/jp/tax>

*connectedthinking

© 2006 Zeirishi-Hojin PricewaterhouseCoopers. All rights reserved. "PricewaterhouseCoopers" refers to Zeirishi-Hojin PricewaterhouseCoopers or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate and independent legal entity.

Tax Reform in Relation to Corporate Reorganizations (Series Two)

Included in this issue are the following articles:

1. **Share for share exchange (Kabushiki Kokan) and share transfer (Kabushiki Iten)**
 2. **Corporate reorganization under the new Company Code**
1. **Share for share exchange (Kabushiki Kokan) and share transfer (Kabushiki Iten)**

A share for share exchange (Kabushiki Kokan) is a legal procedure under which a company (the "acquiring company") acquires 100% of the shares of another existing company (the "acquired company") in exchange for its shares issued to the shareholders of the acquired company. A share transfer (Kabushiki Iten) is a legal procedure similar to a share for share exchange under which a new acquiring company is incorporated and acquires 100% of the shares of an acquired company in exchange for its shares issued to the shareholders of the acquired company. This procedure is used for creating a holding company between the acquired company and its shareholders.

Both a share for share exchange and a share transfer are legal procedures provided in Article 767 and 762 of the new Company Code respectively. As a result of a share for share exchange, a company (the "acquiring company") acquires 100% of the shares of another existing company (the "acquired company") and shareholders of the acquired company will become shareholders of the acquiring company. Upon carrying out a share transfer, shareholders of the acquired company will become shareholders of a newly incorporated holding company.

The amended corporate tax law provision dealing with a share for share exchange and a share transfer will be applicable to transactions on or after October 1, 2006 (i.e., a share for share exchange and a share transfer that takes effect as documented in the agreement).

Before the amendment, a share for share exchange and a share transfer only trigger taxation on shareholders of the acquired company. After the amendment, taxation of the acquired company will also be triggered if the transaction does not satisfy statutory requirements that are similar to other corporate reorganizations.

	Before the amendment	After the amendment
Tax implications if deferral requirements not met	Capital gain/loss to the shareholders of the acquired company	<ul style="list-style-type: none"> ● Capital gain/loss to the shareholders of the acquired company ● Capital gain/loss on the assets owned by the acquired company
Requirements for tax deferral	<ul style="list-style-type: none"> ● If consideration for the share exchange/transfer is paid by assets other than shares of the acquiring company, such portion should be less than 5% of the gross amount of the consideration. ● The tax basis of the shares (as recognized by the acquiring company) of the acquired company does not exceed the net assets value of the acquired company or the carrying value of shareholders depending upon the number of shareholders. 	<ul style="list-style-type: none"> ● As consideration for the share exchange/transfer, shareholders of the acquired company do not receive any other assets than the shares of the acquiring company. ● The share exchange/transfer is carried out (1) as an intra-group transaction or (2) satisfying the joint business requirement.

Tax implications for shareholders of the acquired company

Before the amendment, only the shareholders who receive consideration other than shares of the acquiring company are required to recognize capital gain/loss (the shareholders who receive the shares are not required to recognize capital gain/loss) to the extent that the portion is less than 5% of the gross consideration of a share transfer/exchange. After the amendment, if any part of consideration is paid by assets other than shares of the acquiring company, all the shareholders are required to recognize capital gain/loss as a result of a share transfer/exchange. This treatment is different from other corporate reorganizations, i.e., merger or split-out, since there is no deemed dividend for shareholders even if the transaction is not a “tax qualified” share transfer/exchange. As a matter of practice, such transaction to pay partially or entirely consideration of a share transfer/exchange by assets other than shares of the acquiring company (ex., cash out share transfer/exchange) will be allowed under the Company Code from May of 2007, this becomes a real issue for the shareholders.

Tax implications for the acquired company

Under the amended tax law, if a share transfer/exchange does not satisfy statutory requirements, the acquired company is required to recognize built-in gain or loss (revaluation gain or loss) of certain assets owned immediately before the share transfer/exchange for the purpose of the computation of a taxable income. The requirements for deferral of income are similar to those put on other corporate reorganizations. Accordingly, a share transfer/exchange under the amended tax law may be more costly than before.

Assets subject to revaluation include fixed assets, land, securities, monetary receivables and deferred assets but exclude any assets with unrealized gains or losses of which the amount of such gain or loss is less than the smaller of (i) 50% of capital/capital surplus, and (ii) Yen 10 million.

With regard to the rules for a revaluation of assets owned by the acquired company upon the entry to/starting consolidated tax return filing, such rules will not be applicable to a “tax qualified” share transfer/exchange.

Further, the tax loss carried by the acquired company will survive after the share transfer only if the transaction is “tax qualified”. Depending upon the circumstances, tax planning for group reorganization should consider the impact of this rule.

2. Corporate reorganization under the new Company Code

Different from the old commercial code, the new Company Code allows corporations (Kabushiki Kaisha (KK) and Mochibun Kaisha (Gomei Kaisha, Goshi Kaisha (GGK) and Godo Kaisha (Japanese LLC))) to carry out a corporate reorganization in more flexible manner.

Under the new Company Code, a KK is able to carry out any type of a corporate reorganization. Godo Kaisha (Japanese LLC) is able to carry out merger, spin off and split out, however in the share transfer or share swap, it is eligible for an acquiring company of the share exchange with Kabushiki Kaisha.

Corporate reorganization	Kabushiki Kaisha (KK)	Mochibun Kaisha	
		Gomei/Goshi Kaisha (GGK)	Godo Kaisha (LLC)
Merger	Can be a surviving company/ a merged company of the merger with KK, GGK or LLC	Can be a surviving company/ a merged company of the merger with KK, GGK or LLC	
Spin off, Split up	Can be a transferor company of spin off or split up with KK, GGK or LLC Can be a transferee company of spin off or split up with KK, or LLC	Cannot be a transferor company of spin off or split up Can be a transferee company of spin off or split up with KK, GGK or LLC	Can be a transferor company of spin off or split up with KK, GGK or LLC Can be a transferee company of spin off or split up with KK, or LLC
Share transfer	Can be an acquired company/an acquiring company of share transfer with KK	Cannot be an acquired company/an acquiring company of share transfer	
Share exchange	Can be an acquired company of share exchange with KK or LLC Can be an acquiring company of share exchange with KK	Cannot be an acquired company/an acquiring company of share exchange	Cannot be an acquired company of share exchange Can be an acquiring company of share exchange with KK

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.

If you have any questions, please contact:

Jack Bird	813-5251-2577	jack.bird@jp.pwc.com
Alfred Zencak	813-5251-2431	alfred.zencak@jp.pwc.com
Ken Leong	813-5251-2945	ken.leong@jp.pwc.com
Takuro Tagai	813-5251-2413	takuro.tagai@jp.pwc.com
Yumiko Arai	813-5251-2475	yumiko.arai@jp.pwc.com