Japan

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TAX AUTHORITIES

1. What are the main authorities responsible for enforcing taxes on corporate transactions in your jurisdiction?

The main authority responsible for enforcing national taxes is the National Tax Agency (NTA) (*kokuzei-cho*), which is an external body of the Ministry of Finance. The NTA is responsible for assessing and collecting taxes.

The NTA has:

- One head office.
- 11 regional taxation bureaus (*kokuzei-kyoku*).
- One Okinawa regional taxation office (*okinawa kokuzei-jimusho*).
- 524 tax offices (*zeimu-sho*).

The main authorities responsible for local taxes are the governors of each local government. The responsibilities of each governor are delegated to the tax department of the local government, which enforces local taxes in practice.

2. Is it possible to apply for tax clearances or obtain guidance from the tax authorities before completing a corporate transaction? If yes, provide brief details, including whether clearance or guidance is binding.

Japanese tax laws do not provide a tax clearance system from the tax authority. However, in certain cases, a taxpayer can submit an enquiry before a transaction, to request a written response from the NTA as to whether it will be subject to tax. This advance inquiry would work as a de facto tax clearance. A taxpayer requesting a written response must apply to the regional taxation bureau or the tax office that covers the place for tax payment.

A taxpayer can also obtain informal guidance on the tax treatment of a particular transaction through informal consultation with the tax officers of the regional taxation bureaus or tax offices. This informal guidance may provide some comfort for the taxpayer. When requesting informal guidance, general practice is to disclose the taxpayer's identity and detailed information about the transaction.

MAIN TAXES ON CORPORATE TRANSACTIONS

3. What are the main transfer taxes and/or notaries' fees potentially payable on corporate transactions? In relation to each tax/fee identified, explain briefly:

- **Its key characteristics.**
- **What triggers it.**
- **Who is liable.**
- **The applicable rate(s).**

Taxes on transfer of real estate

Registration and licence tax. This is imposed on a change in the real estate register concerning real estate acquisition. The acquirer is liable to pay this tax. The tax basis is the value of the real estate, which is registered in the fixed asset tax rolls, and the standard rate is 2%. This rate is reduced to 1.3%, if registration is made on or before 31 March 2012 (*Item 1(2)c of Annex 1 to the Registration and Licence Tax Act (RLTA), Article 7, the supplementary provision of it, and Article 72(1)(i)(b), the Act on Special Measures Concerning Taxation (ASMCT)*).

Real estate acquisition tax. This is generally imposed on real estate acquisition and the acquirer is liable to pay it. The tax basis is the value of the real estate, of which amount is primarily derived from that registered in the fixed asset tax rolls. The standard rate is 4%, which may be reduced under Article 11 of the supplementary provision of the Local Tax Act (*LTA*) (*Article 73-15, LTA and Articles 11 and 11-2, the supplementary provision of it*).

As an exception, real estate acquisition tax is not imposed on the transfer of real estate that is made through a merger or demerger (*Article 73-7(ii), LTA*).

Stamp tax

Stamp tax is imposed on a variety of documents, which include:

- Real estate transfer agreements and business transfer agreements (the level of tax per document can be up to JPY600,000).
- Share certificates (the level of tax per document can be up to JPY20,000).
- Merger agreements and demerger agreements (the level of tax per document can be up to JPY40,000) (*Annex 1 to the Stamp Tax law*).

As at 1 March 2011, US$1 was about JPY81.8.

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No stamp tax is imposed on documents not listed in Annex 1 to the Stamp Tax Law, such as share purchase agreements.

4. What are the main corporate and/or capital gains taxes potentially payable on corporate transactions? In relation to each tax identified, explain briefly:

- **Its key characteristics.**
- **What triggers it.**
- **Who is liable.**
- **The applicable rate(s).**

The main corporate taxes that a corporation's income on corporate transactions is potentially subject to are:

- National corporation tax.
- Local inhabitants' tax.
- Local enterprise tax.

Local inhabitants' tax and local enterprise tax are imposed by each local government in accordance with the LTA and ordinances established by each local government, and therefore vary to some extent. In 2008, the government created a new local corporation special tax in exchange for reducing the local enterprise tax.

National corporation tax

This is imposed on the taxable income (*shotoku*) of domestic corporations, foreign corporations and other entities treated as corporations for Japanese tax purposes. Foreign corporations and other foreign entities are only liable to pay corporation tax on income from sources in Japan. Domestic corporations are liable to pay taxes on all taxable income from domestic and foreign sources.

A corporation's taxable income for each accounting period is generally calculated by subtracting deductible expenses from gross income. The normal corporation tax rate is 30%. A reduced rate of 18% applies to the first JPY8 million of taxable income earned by small or medium-sized companies, which are companies with a stated capital of JPY100 million or less. See *Question 35* in relation to the possible reform of national corporation tax.

Local inhabitants' tax

The local inhabitants' tax consists of:

- Tax on a per capita basis, generally based on the capital amount of a corporation and the number of employees, and which ranges from JPY70,000 to JPY3.8 million per year.
- Tax on a corporation tax basis, generally based on the amount of corporation tax.

The tax rate is generally 17.3% (the prefectural rate is 5%, and the municipal rate is 12.3%), though some prefectures impose a slightly higher rate (for example, a corporation with its head office in Tokyo is subject to rates from 17.3% to 20.7%).

Local enterprise tax

The rates and calculation of local enterprise taxes generally differ depending on whether the stated capital amount of a corporation is over JPY100 million or not (*Article 72-2, LTA*).

If the stated capital amount is over JPY100 million, local enterprise tax is imposed based on:

- A value added factor (of 0.48%) on the amount of the added value.
- A capital factor (of 0.2%) on the stated capital amount.
- An income factor (ranging from 1.5% to 2.9% at a progressively increasing rate) on the taxable income.

If the stated capital amount is JPY100 million or less, local enterprise tax is only imposed based on an income factor, at a progressive tax rate ranging from 2.7% to 5.3%.

In addition, insurance companies, electrical suppliers and gas suppliers calculate this tax based on their income (*Article 72-24-7(2), LTA*).

Effective tax rate

The effective tax rate on taxable income for a Japanese corporation is generally about 40% (the rate is a little different in some prefectures) (see *Question 35* in relation to the possible reform of national corporation tax).

Tax treaties and domestic law

The Japanese government has entered into tax treaties and conventions with many countries. When a tax treaty is applied to a transaction and there are differences between the tax treaty and the domestic law, the tax treaty generally prevails. Tax treaties vary from country to country, and stipulate many exemptions, reduced tax rates, and requirements which may apply.

5. What are the main value added and/or sales taxes potentially payable on corporate transactions? In relation to each tax identified, explain briefly:

- **Its key characteristics.**
- **What triggers it.**
- **Who is liable.**
- **The applicable rate(s).**

Consumption tax

Consumption tax is similar to value added tax, as it is calculated by offsetting the amount of consumption tax on taxable purchases (and other certain amounts) from the amount of consumption tax on taxable sales (*Article 30, Consumption Tax Act*).

Consumption tax is imposed on taxable transactions, which generally include:

- The transfer or lease of assets or services that are provided as a business in Japan for consideration (domestic transactions).
- Import transactions.

This chapter focuses on domestic transactions (*Article 4(1)(2), Consumption Tax Act*).

The transfer or lease of assets located in Japan is generally deemed to be made in Japan. However, consumption tax is not

imposed on certain transactions, including the (*Article 6(1), Annex 1, Consumption Tax Act*):

- Transfer or lease of land.
- Transfer of securities, equity interests, loans and other similar financial instruments.

Not only residents and domestic corporations but also non-residents and foreign corporations are liable to pay consumption tax, if the relevant transaction is a Domestic Transaction (*Article 5(1), Consumption Tax Act*).

The rate of consumption tax is 5%, which consists of 4% national tax and 1% local tax (*Article 29, Consumption Tax Act and Article 72-83, LTA*).

6. Are any other taxes potentially payable on corporate transactions? In relation to each tax identified, explain briefly:

- **Its key characteristics.**
- **What triggers it.**
- **Who is liable.**
- **The applicable rate(s).**

Registration and licence tax

When a corporation changes or amends registered matters, it must apply to alter or amend the registered matters with the relevant local legal affairs bureau, which triggers registration and licence taxes. A corporation that increases its stated capital must pay 0.7% registration and licence tax on the increased amount of stated capital (*Item 24(1)d-h of Annex 1 to the RLTA*). This rate may be reduced for a capital increase by merger or demerger.

7. In what circumstances will the taxes identified in *Questions 3* to *6* be applicable to foreign companies (in other words, what "presence" is required to give rise to tax liability)?

Corporation tax

Source rules. Foreign companies are only liable to pay corporation tax and income tax on income from sources in Japan (domestic-source income) (*kokunai-gensen shotoku*), which is set out in the Income Tax Act (ITA) and the Corporation Tax Act (CTA) (*Article 161, ITA and Article 138, CTA*).

Taxation by self-assessment. The scope of a foreign company's taxable income varies depending on whether it has a permanent establishment (PE) in Japan, and accordingly the type of PE (*Article 141 and 138, CTA*). For a foreign company that has branch offices, factories or any other fixed places for conducting business in Japan, all domestic-source income is subject to corporation taxes.

Specific rules apply to other foreign companies, for example those involved in construction work in Japan for more than one year, and those with a foreign company which has an agent in Japan authorised to conclude a contract on his behalf (excluding an independent agent).

Capital gains from transfers of certain shares (*see below*) held by a foreign company are subject to corporation taxes under certain conditions, even if the foreign company does not have a PE in Japan:

- The transfer of more than 2% (or 5%, if the shares are listed) of the shares in a corporation that derives 50% or more of the value of its gross assets directly or indirectly from real estate (including related rights on real estate) situated in Japan.
- The transfer of shares, that consists of 5% or more of the outstanding shares in a domestic corporation, by a foreign company, where the foreign company owns 25% or more of the domestic corporation's shares at any time during the taxable year of the transfer, or during the two preceding years.

Withholding tax. Most domestic-source income paid to a foreign company is subject to withholding tax. The rate is generally 20%, but is 10% for certain income, or 15% for interest on Japanese national government bonds, local government bonds, bonds issued by a domestic corporation, bonds issued by a foreign corporation attributed to a business in Japan, and other certain domestic-source income (*Article 212(1), 213(1) and 161, ITA*).

A foreign company with a PE in Japan may be exempt from withholding tax on certain types of income if it obtains a certificate from the relevant authorities and provides a copy of this certificate to the payer of the income (*Article 214, ITA*).

Registration and licence tax

Registration and licence tax relating to transfer of real estate (*see Question 3*) applies to foreign companies, regardless of whether they have a PE in Japan. Registration and licence tax relating to other corporate transactions (*see Question 6*) does not generally apply to foreign companies.

Real estate acquisition tax

Real estate acquisition tax (*see Question 3*) applies to foreign companies, regardless of whether they have a PE in Japan.

Stamp tax

Stamp tax (*see Question 3*) applies to foreign companies if the relevant agreements or documents are executed in Japan, regardless of whether they have a PE in Japan.

Consumption tax

Consumption tax (*see Question 5*) applies to foreign companies if they conduct a transaction subject to consumption tax, regardless of whether they have a PE in Japan.

DIVIDENDS

8. Is there a requirement to withhold tax on dividends or other distributions? If yes, provide brief details.

Dividends or any other form of distribution (including capital repayments or part of the consideration for a share buyback (*see Question 29*)), paid by one Japanese corporation to another Japanese corporation, are subject to withholding tax. The standard rate is 20%, which is reduced to 15% and is further reduced to

7% for dividends paid before 31 December 2011 if shares in the distribution payer are listed on a stock exchange (*Article 212(3) and Article 213(2)(ii), ITA, and Article 9-3, ASMCT and Article 33(2), the supplementary provision of the 2006 amendments thereto (Law No. 23 of 2006)*) (*see Question 35*). Based on the 2011 Tax Reform Proposals (*see Question 35*):

- The period when the reduced withholding tax rate of 7% applies is proposed to be extended from 31 December 2011 to 31 December 2013.
- The threshold of shareholding for the individual shareholders is proposed to be changed from 5% to 3%.

However, whether or not the 2011 Tax Reform Proposals will be enacted by the Diet is not currently clear.

As an exception, dividends-in-kind paid between Japanese corporations within a 100% Group (*see Question 10*) are not subject to withholding tax (*Article 212(3), 174(ii) and 24(1), ITA*).

For the taxation on dividends paid to foreign companies, see *Question 7*.

SHARE ACQUISITIONS AND DISPOSALS

9. What taxes are potentially payable on a share acquisition/ share disposal?

Corporation tax

Corporation tax is generally imposed on capital gains from the disposal of shares (*see Question 4*).

Stamp tax and consumption tax

These do not apply to a share acquisition or share disposal (*see Questions 3 and 5*).

10. Are any exemptions or reliefs available to the liable party? If yes, provide brief details.

Qualified reorganisations

Taxation on share acquisitions and disposals that are made through a merger, demerger, share exchange (*kabushiki-kokan*) or share transfer (*kabushiki-iten*) may be deferred, if they satisfy certain requirements (*see Questions 20, 23 and 26*).

Group taxation regime

In 2010, a new group taxation regime was introduced, which applies to Japanese corporations in a "100% Group". A "100% Group" is a group comprised of corporations having a "100% Control Relationship". A "100% Control Relationship" is either:

- A relationship in which a person or entity holds directly or indirectly all of the outstanding shares in a corporation.
- A relationship between corporations where all of the outstanding shares in the corporations are held by the same person or entity.

If a Japanese corporation transfers certain assets (excluding an asset whose book value is less than JPY10 million) to another Japanese corporation that is within the same 100% Group, recognition of capital gains or losses are deferred until certain trigger events occur such as re-transfer, depreciation, or revaluation of the transferred assets, or dissociation of the transferee corporation (*Article 61-13, CTA, Article 122-14(1), Order for Enforcement thereto*).

11. Please set out the tax advantages and disadvantages of a share acquisition for the buyer.

Advantages

The tax position of the target, which may be directly or indirectly advantageous to the acquirer, is not changed by the acquisition of the target's shares. For example:

- The unrealised gain or loss in the target is not realised at target level.
- Net operating losses, loss carried forward and built-in losses on target assets remain in the target.

Registration and licence tax, real estate acquisition tax, stamp tax and consumption tax do not apply to a share acquisition (*see Questions 3 and 5*).

Disadvantages

The target cannot step up the tax basis of its assets on the acquisition of the shares in the target.

12. Please set out the tax advantages and disadvantages of a share disposal for the seller.

Advantages

These are the following:

- The seller can avoid realising a capital gain or loss by using a share exchange (*kabushiki-kokan*) or share transfer (*kabushiki-iten*) that satisfies certain requirements (*see Question 26*).
- Separate withholding tax applies on a capital gain by an individual shareholder, at a lower rate.
- Registration and licence tax, real estate acquisition tax, stamp tax and consumption tax, which would otherwise negatively affect the purchase price, do not apply to a share disposal (*see Questions 3 and 5*).

Disadvantages

Net operating losses, loss carried forward and built-in losses relating to target assets are not available for the seller.

13. What transaction structures (if any) are commonly used to minimise the tax burden? Give brief details of the effect of each structure.

Share exchange and share transfer

See *Questions 12, 25* and *26*.

Dividend payment before transfer (dividend received deduction)

The full amount of a dividend (after deducting interest expenses relating to debt used to acquire the subject shares), received by a corporation which has owned 25% or more of the outstanding shares in the corporation paying the dividend for six months or more before the date of the dividend, is exempt from the corporate tax base of the receiving corporation.

Half of a dividend amount (after deducting interest expenses relating to debt used to acquire the subject shares) received by a corporation other than set out above are exempt from the corporate tax base of the receiving corporation (*Article 23, CTA*).

For a dividend paid between 100% Group corporations, the amount of the dividend is entirely excluded from its taxable income.

As a result, paying excess cash in the target to the seller as dividends before selling the target's shares reduces the market value of the shares. This can therefore reduce the total amount of tax paid on the whole transaction.

ASSET ACQUISITIONS AND DISPOSALS

14. What taxes are potentially payable on an asset acquisition/ asset disposal?

Corporation tax

Corporation tax is imposed on the seller of an asset relating to a capital gain from the sale (*see Question 4*).

Registration and licence tax

Registration and licence tax is imposed on a real estate buyer on a change in the real estate register (*see Question 3*).

Real estate transfer tax

Real estate transfer tax is imposed on a real estate buyer. The tax base is the assessed value of the real estate (*see Question 3*).

Stamp tax

Stamp tax is imposed on certain types of asset transfer agreements, including real estate transfer agreements and business transfer agreements (*see Question 3*).

Consumption tax

Consumption tax applies to a transfer of assets (*see Question 5*).

15. Are any exemptions or reliefs available to the liable party? If yes, provide brief details.

Taxation on asset acquisitions and disposals made through a merger, demerger, share exchange (*kabushiki-kokan*) or share transfer (*kabushiki-iten*) may be exempted if they satisfy certain requirements (*see Questions 20, 23 and 26*).

Taxation on acquisitions and disposals of certain assets made between 100% Group corporations is deferred (*see Question 10*).

Real estate acquisition tax is not imposed on a transfer of real estate made by merger or demerger (*see Question 3*).

16. Please set out the tax advantages and disadvantages of an asset acquisition for the buyer.

Advantages

These are the following:

- The tax base of the transferred asset may be stepped up.
- Goodwill recognised by a buyer can be amortised, and the amortisation cost is deductible from the buyer's taxable income.

Disadvantages

These are the following:

- The buyer cannot inherit net operating losses and loss carried forward from the seller in an asset acquisition.
- Registration and licence tax, real estate acquisition tax, stamp tax and consumption tax can apply to an asset acquisition.

17. Please set out the tax advantages and disadvantages of an asset disposal for the seller.

Advantages

These are the following:

- An unrealised loss on the transferred asset is realised.
- Net operating losses and loss carried forward are available to offset capital gains arising from an asset disposal.

Disadvantages

These are the following:

- An unrealised gain on the transferred asset is realised.
- Registration and licence tax, real estate acquisition tax, stamp tax and consumption tax, which negatively affect the purchase price, can apply to an asset disposal (*see Question 3*).

18. What transaction structures (if any) are commonly used to minimise the tax burden? Give brief details of the effect of each structure.

Tax qualified transactions can be used (*see Questions 20, 23 and 26*).

LEGAL MERGERS

19. What taxes are potentially payable on a legal merger?

A legal merger is generally treated for tax purposes as follows:

- **Step A.** A target company (target) is deemed to transfer all of its assets and liabilities to an acquiring company (acquirer). The acquirer is deemed to pay cash or transfer its assets (for example, its shares) to the target, as consideration for the assets and liabilities transferred from the target.

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- **Step B.** The target is deemed to distribute cash or assets received as consideration from the acquirer to its shareholders (target shareholders) immediately after receiving them. The target shareholders are deemed to transfer their shares to the target in exchange for the money or assets distributed by the target.

It is assumed that the shareholders of both companies in the legal merger are corporations.

The tax consequences are as follows.

Taxation at corporate level

Corporation tax. The target must recognise capital gains or losses on the assets transferred in Step A (whereas the target is not subject to taxes in Step B), unless the requirements for a Qualified Merger (*defined in Question 20*) are satisfied. Corporation tax is not generally levied on the acquirer for the acquisition in Step A, unless the consideration from the acquirer to the target consists of assets other than the acquirer's shares.

Registration and licence tax/stamp tax. Registration and licence tax may be imposed and the acquirer is liable to pay it (*see Questions 3 and 6*). Stamp tax is also levied on a merger agreement (*see Question 3*).

Other taxes. Consumption tax is not levied on the transfer of the target's assets in a legal merger (*Article 2(1)(iv), Order for Enforcement of the Consumption Tax Act*). Real estate acquisition tax is not levied on the transfer of real estate in a legal merger (*see Question 3*).

Taxation at shareholders' level

Corporation tax. A certain part of the fair market value of the consideration that each of the target shareholders receives from the target in Step B is generally deemed to be a dividend (*Article 24, CTA*), unless the requirements of a Qualified Merger (*defined in Question 20*) are satisfied. The remaining amount is deemed to be consideration for the transfer of shares in the target, which results in a capital gain or loss for the target shareholder (*Article 61-2, CTA*), unless certain requirements (*see Question 20*) are satisfied.

The deemed dividend for each target shareholder (*see above*) is equal to the amount of the fair market value of the acquirer's shares that are received by each of the target shareholders, less an amount roughly equivalent to the total capital and capital reserves of the target multiplied by the percentage of target shares held by the shareholder (the precise formula is set out in the CTA).

20. Are any exemptions or reliefs available to the liable party? If yes, provide brief details.

Taxation at corporate level

In a merger that satisfies certain requirements set out below (Qualified Merger), the target is deemed to transfer all of its assets and liabilities to the acquirer at book value and, simultaneously, the acquirer receives them at book value, which results in a deferral of the recognition of capital gains or losses (*Article 62-2, CTA*).

The requirements for a transaction to qualify as a Qualified Merger vary depending on the capital relationship between the target and the acquirer. This capital relationship is classified into three categories (*Articles 2, Item 12-8, CTA*):

- A 100% relationship.
- A less than 100% but more than 50% relationship.
- A 50% or less relationship.

The requirements to qualify generally become more stringent, the lower the level of the capital relationship. The requirements for a Qualified Merger are as follows.

100% relationship. The target or the acquirer must own directly or indirectly all the shares issued by the other party, or all of the shares of both the target and the acquirer must be directly or indirectly owned by the same individual or the same company (100% relationship).

The only requirement is that the consideration from the acquirer must solely consist of shares of the acquirer, or shares in the acquirer's parent company that directly owns all its shares (parent company).

Relationship of less than 100% but more than 50%. The target or the acquirer owns directly or indirectly less than 100% but more than 50% of the shares of the other party, or less than 100% but more than 50% of the shares of both the target and the acquirer are directly or indirectly owned by the same individual or the same company.

The requirements are as follows:

- The same requirement for a 100% relationship (*see above*).
- About 80% of the target employees will continue to engage in the business of the acquirer after the merger.
- The principal target business (or a target business, if it has several) will continue to be conducted by the acquirer.

50% or less relationship. Where the target and the acquirer do not have a 100% relationship or a less than 100% but more than 50% relationship, a merger to jointly conduct a business may still be treated as a Qualified Merger if all the following requirements are met:

- The same requirements for a less than 100% but more than 50% relationship (*see above*).
- A mutual connection between the principal target business and any business of the Acquirer (not limited to its principal business).
- Either of the following is met:
  - the sales amount, number of employees, capital amount or other similar characteristics of the target's principal business or a related business of the acquirer is no more than about five times greater than the size of that of the other;

- at least one of the senior directors or equivalent in the target and in the acquirer before the merger is respectively expected to be appointed as a senior director or equivalent of the acquirer after the merger.

- The target shareholders who are expected to hold shares of the acquirer (or the parent company) after the transaction must hold at least 80% of the shares of the target before the transaction. This requirement does not apply if the target has 50 or more shareholders.

Group taxation regime

Recognition of capital gains or losses on certain assets is deferred for mergers between members of a 100% Group regardless of whether or not the merger is a Qualified Merger (*see Question 10*).

Taxation at shareholders' level

If the merger qualifies as a Qualified Merger, the target shareholders do not need to recognise deemed dividends (*Article 24(1)(i), CTA*).

If the consideration paid for the merger consists solely of the acquirer's shares or the shares of the parent company, the consideration amount of the shares transferred by the target shareholder is deemed to be their book value, regardless of whether the merger qualifies as a Qualified Merger. This results in a deferral of the recognition of capital gains or losses for the target shareholders (*Article 61-2(2), CTA*).

21. What transaction structures (if any) are commonly used to minimise the tax burden? Give brief details of the effect of each structure.

If the target has a lot of properties with built-in gains, it is common to seek a Qualified Merger to defer recognising capital gains. If the target has a lot of properties with built-in losses, it is common to seek a non-Qualified Merger (a legal merger that does not meet the requirements of a Qualified Merger), to realise capital losses.

JOINT VENTURES

22. What taxes are potentially payable on establishing a joint venture company (JVC)?

The following two methods are commonly used to contribute assets to a joint venture company.

Demerger

In a demerger under the Companies Act, the assets and liabilities of a contributor's business are assumed by a newly established company in an incorporation-type demerger (*shinsetsu-bunkatsu*), or an existing company in an absorption-type demerger (*kyusyu-bunkatsu*). The company typically issues its shares to the contributor in exchange for the assets and liabilities transferred. From a tax perspective, there are two types of demerger:

- Spin-off-type demergers (*bunsya-gata-bunkatsu*).

- Separation-type demergers (*bunkatsu-gata-bunkatsu*).

In a separation-type demerger, consideration for the transferred assets and liabilities is immediately distributed to the contributor's shareholders once the contributor receives it. In a spin-off-type demerger, the consideration is not distributed to the contributor's shareholders. Since it is common to use a spin-off-type demerger to establish a joint venture company, this section focuses on the tax consequences of spin-off-type demergers.

Corporation tax. Capital gains or losses on assets that are transferred by the contributor are recognised for calculating its taxable income (*Article 62(1), CTA, see Question 4*), unless the demerger satisfies requirements similar to those for a Qualified Merger (Qualified Demerger) (*see Question 20*). Taxes are only levied on the contributor, provided that the consideration consists solely of the contributed company's shares.

Registration and licence tax/stamp tax. Registration and licence tax may be payable by the contributed company (*see Questions 3 and 6*). Stamp tax is also levied on a demerger agreement (*see Question 3*).

Other taxes. Consumption tax is not levied in a demerger (*see Question 19*). Real estate acquisition tax is not levied on the transfer of real estate in a spin-off-type demerger (*see Question 3*).

Contribution in-kind

A contribution in-kind is treated as a transfer of assets from the contributor to a contributed company, in exchange for shares in the contributed company for tax purposes.

Corporation tax. Corporation tax is levied on capital gains or losses from a transfer of assets in a contribution in-kind (*Article 22(2), CTA*), unless the contribution in-kind satisfies certain requirements similar to those for a Qualified Merger or a Qualified Demerger (Qualified Contribution In-kind) (*see Questions 4 and 20*).

Other taxes. Unlike a legal merger or demerger, consumption tax is levied on the transfer of certain assets in a contribution in-kind (*see Questions 5 and 20*), and real estate acquisition tax is levied on the value of transferred real estate (*see Question 3*). Registration and licence tax and stamp tax are also generally levied (*see Questions 3 and 6*).

23. Are any exemptions or reliefs available to the liable party? If yes, provide brief details.

Recognition of capital gains or losses from the transfer of assets in a demerger or contribution in-kind is deferred if the demerger or contribution in-kind satisfies the requirements of a Qualified Demerger or Qualified Contribution In-kind (*Article 2, Items 12-11 to 12-14, 62-2, 62-3, and 62-4, CTA, see Question 22*).

Recognition of capital gains or losses from a transfer of certain assets between Japanese companies in a 100% Group is deferred until certain events occur including, amongst others, re-transfer, depreciation, or revaluation of transferred assets (*see Question 10*).

24. What transaction structures (if any) are commonly used to minimise the tax burden? Give brief details of the effect of each structure.

If contributed property has an unrealised gain, it is common for the contributor to seek a Qualified Demerger or a Qualified Contribution In-kind. If the contributed property has an unrealised loss, it is common for the contributor to seek a non-Qualified Demerger or a non-Qualified Contribution In-kind.

COMPANY REORGANISATIONS

25. What taxes are potentially payable on a company reorganisation?

Legal mergers, demergers, share exchanges (*kabushiki-kokan*), and share transfers (*kabushiki-iten*) are all categorised as reorganisations (*Companies Act*).

For the tax consequences of legal mergers and demergers, see *Questions 19* to *24*.

Share exchange and share transfer

In a share exchange under the Companies Act, an existing company (A) becomes a wholly owned subsidiary of another existing company (B) by transferring, by operation of law, all the shares in A to B, in exchange for issuing or transferring shares in B to A's shareholders.

In a share transfer under the Companies Act, a company (C) becomes a wholly owned subsidiary of a newly formed parent company (D) by transferring, by operation of law, all the shares in C to D, in exchange for issuing or transferring shares in D to C's shareholders.

Although no assets are transferred from the company that becomes the wholly owned subsidiary in both cases (unless a share exchange or share transfer is categorised as a Qualified Share Exchange or Qualified Share Transfer (*see Question 26*)) certain assets of the subsidiary must be revalued at fair market value, so that capital gains or losses are deemed to arise (*Article 62-9, CTA*).

The shareholders of the company that becomes the wholly owned subsidiary are not deemed to receive dividends. However, since the shareholders transfer their shares and receive new shares in the company that becomes the parent company, capital gains or losses are recognised in a share exchange or a share transfer (*Article 62(1), CTA*), unless certain requirements are satisfied (*see Question 26*).

26. Are any exemptions or reliefs available to the liable party? If yes, provide brief details.

In a share exchange or a share transfer that satisfies certain requirements (similar to the requirements for a Qualified Merger, *see Question 20*) ("Qualified Share Exchange" or "Qualified Share Transfer") or is otherwise conducted in a 100% Group, the assets of the company that becomes the wholly owned subsidiary need not be revalued at fair market value. Therefore, capital gains or losses on those assets may be deferred (*Article 62-9, Article 2, Items 12-16 and 12-17, CTA*).

At shareholder level, recognition of capital gains or losses from the transfer of shares is deferred, regardless of whether the transaction qualifies as a Qualified Share Exchange or Qualified Share Transfer, if the consideration consists solely of either:

- The acquiring company's shares (for example, B or D in *Question 25*).
- The shares of the acquiring company's parent company which directly owns all of its shares (in case of triangular reorganisations).

27. What transaction structures (if any) are commonly used to minimise the tax burden? Give brief details of the effect of each structure.

It is common to use qualified reorganisations when the company which becomes a wholly owned subsidiary owns properties that have appreciated in value. If a company has built-in losses, it is common to use non-qualified reorganisations.

RESTRUCTURING AND INSOLVENCY

28. What are the key tax implications of the business insolvency and restructuring procedures in your jurisdiction?

In restructuring procedures such as those under the Civil Rehabilitation Act and the Corporate Reorganisation Act, a company revalues its assets at the start of the procedures, and realises its gains or losses (*Articles 25 and 33, CTA*).

A company in restructuring can use its past net operating losses to offset gains from the procedures, such as income from discharge of debt or revaluation of its assets (*Article 59, CTA*).

SHARE BUYBACKS

29. What taxes are potentially payable on a share buyback?

In a share buyback, part of the received money is deemed to be dividends (*Article 24, CTA*) and the rest is deemed to be consideration for the purchased shares, which results in capital gains or losses for shareholders (*Article 61-2, CTA, see Question 19*).

30. Are any exemptions or reliefs available to the liable party? If yes, provide brief details.

Dividend received deduction (*see Question 13*) also applies to a deemed dividend in a share buyback, including, for the avoidance of doubt, when conducted by a Japanese corporation from another Japanese corporation in the same 100% Group.

31. What transaction structures (if any) are commonly used to minimise the tax burden? Give brief details of the effect of each structure.

It is unlikely that there is a specific structure that would minimise the tax burden triggered by a share buyback.

PRIVATE EQUITY FINANCED TRANSACTIONS: MBOs

32. What taxes are potentially payable on a management buyout (MBO)?

There are complex methods available to bring about an MBO, and their tax consequences differ depending on each method.

In one of the most common methods:

- The management buys a controlling stake in the target company through a tender offer.
- After this, in a shareholders' meeting of the target company, the shareholders, including the management, resolve to convert the common stock of the target company into classified stock, so that the minority shareholders are squeezed out for cash. Capital gains or losses are, in principle, recognised at the shareholders' level (*see Question 33*).

33. Are any exemptions or reliefs available to the liable party? If yes, provide brief details.

Through a sophisticated mechanism, management that conducts an MBO and its target company can receive the benefit of a tax deferral on capital gains or losses, under certain requirements.

34. What transaction structures (if any) are commonly used to minimise the tax burden? Give brief details of the effect of each structure.

This depends on the actual situation, that is, on whether a party wants to defer capital gains or realise capital losses (*see Question 21*).

REFORM

35. Please summarise any proposals for reform that will impact on the taxation of corporate transactions.

The 2011 tax reform bill (2011 Tax Reform Proposals) which was proposed by the Japanese government in January 2011 primarily proposed the following reforms. However, following the earthquake that struck Japan on 11 March 2011 and other related disasters that subsequently occurred (including the accidents at the nuclear power plants in the Fukushima prefecture), it is not currently clear whether or not the 2011 Tax Reform proposals will be enacted by the Diet.

Reduction of the applicable tax rate

The effective tax rate that is applicable for fiscal years commencing on or after 1 April 2011 is expected to be reduced by about 5% by reforms planned for 2011. This will be achieved by reducing the normal corporation tax rate from 30% to 25.5%. The reduced rate of 18% that will apply to small or medium-sized companies will also be amended to 15%.

Carry-forward losses

Under current Japanese tax law, a company that consecutively files a blue return (*aoiro-shinkoku*) may carry forward its tax losses in any given tax year for deduction from taxable profits for the following seven years. The 2011 Tax Reform Proposals, however, will amend tax loss carry-forward rules. These amendments include an extension of the carry-forward period from seven years to nine years (which will be applicable to tax losses incurred in fiscal years ending on or after 1 April 2008), and as to companies other than small and medium-sized companies, the reduction of the ceiling on the deductible amount from 100% to 80% of the taxable income for the tax year (which will be applicable to fiscal years commencing on or after 1 April 2011).

Change to the scope of small or medium-sized companies

Current Japanese tax law excludes a company from qualifying as a small or medium-sized company if 100% of its shares are directly or indirectly held by one large-sized company (a company with stated capital of JPY500 million or more). Under the 2011 Tax Reform Proposals, a company with 100% of its shares held directly or indirectly by two or more large-sized companies in one 100% Group will also be excluded from the scope of small or medium-sized company although its share capital is JPY100 million or less.

Corporate Q&A

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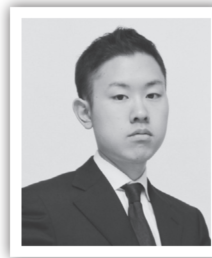

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