Executive Compensation & Employee Benefits

Contributing editor
Marc Trevino

2018

GETTING THE DEAL THROUGH

© Law Business Research 2018

Executive Compensation & Employee Benefits 2018

Contributing editor

Marc Trevino

Sullivan & Cromwell LLP

Reproduced with permission from Law Business Research Ltd
This article was first published in July 2018
For further information please contact editorial@gettingthedealthrough.com

Publisher
Tom Barnes
tom.barnes@lbresearch.com

Subscriptions
James Spearing
subscriptions@gettingthedealthrough.com

Senior business development managers
Adam Sargent
adam.sargent@gettingthedealthrough.com

Dan White
dan.white@gettingthedealthrough.com

Published by
Law Business Research Ltd
87 Lancaster Road
London, W11 1QQ, UK
Tel: +44 20 3780 4147
Fax: +44 20 7229 6910

© Law Business Research Ltd 2018
No photocopying without a CLA licence.
First published 2015
Fourth edition
ISBN 978-1-78915-022-3

The information provided in this publication is general and may not apply in a specific situation. Legal advice should always be sought before taking any legal action based on the information provided. This information is not intended to create, nor does receipt of it constitute, a lawyer–client relationship. The publishers and authors accept no responsibility for any acts or omissions contained herein. The information provided was verified between May and June 2018. Be advised that this is a developing area.

Printed and distributed by
Encompass Print Solutions
Tel: 0844 2480 112

© Law Business Research 2018

CONTENTS

Global overview 5
Marc Trevino
Sullivan & Cromwell LLP

Argentina 7
Mercedes Balado Bevilacqua and Analía V. Durán
MBB Balado Bevilacqua Abogados

Australia 15
Joydeep Hor and Therese MacDermott
People + Culture Strategies

Belgium 20
Chris Engels and Florence Sine
Claeys & Engels

Brazil 27
Dario Abrahao Rabay, Fábio José Marino Duarte and Tomas Machado de Oliveira
Mattos Filho, Veiga Filho, Marrey Jr e Quiroga Advogados

Chile 32
Ignacio García and Fernando Villalobos
Porzio Ríos García

Costa Rica 36
Dr. Alexander Godinez Vargas
Bufete Godinez y Asociados

Denmark 42
Morten Langer and Torben Mølgaard Hededal
Norrbom Vinding

France 49
Florence Aubonnet, Stéphanie Dumas and Camille Ventejou
Flichy Grangé Avocats

Germany 55
Christian Hoefs and Hendrik Bockenheimer
Hengeler Mueller

Italy 61
Luca Failla
LABLAW – member of L&E Global

Japan 70
Hiroko Shibata
Nishimura & Asahi

Nigeria 77
Jumoke Lambo, Ozofu Ogiemudia and Mary Ekemezie
Udo Udoma & Belo-Osagie

Russia 83
Anna Maximenko and Elena Klutchareva
Debevoise & Plimpton LLP

Spain 91
José Luis Palao, Eduardo Gómez de Salazar, Ana Ortiz and Bernardo Pérez-Navas
J&A Garrigues, S.L.P.

Switzerland 97
Martin L Mueller
Pestalozzi Attorneys at Law Ltd

United Kingdom 103
Chris Walter, Guy Dingley, Hannah Bradshaw and Richard Surtees
Covington & Burling LLP

United States 110
Marc Trevino
Sullivan & Cromwell LLP

© Law Business Research 2018

Preface

Executive Compensation & Employee Benefits 2018

Fourth edition

Getting the Deal Through is delighted to publish the fourth edition of *Executive Compensation & Employee Benefits*, which is available in print, as an e-book and online at www.gettingthedealthrough.com.

Getting the Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique **Getting the Deal Through** format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Argentina, Costa Rica, Italy and Spain.

Getting the Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.gettingthedealthrough.com.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Getting the Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Marc Trevino of Sullivan & Cromwell LLP, for his continued assistance with this volume.

London
June 2018

© Law Business Research 2018

Japan

Hiroko Shibata*

Nishimura & Asahi

Sources of rules and practice

1 Provide an overview of the primary sources of law, regulation and practice that govern or affect executive compensation arrangements or employee benefits.

Executive compensation is primarily regulated by the Companies Act. A listed company must disclose certain details of executive compensation in its annual securities report. The securities report must be prepared in accordance with the requirements of the Financial Instruments and Exchange Act (FIEA).

Employee benefits are primarily governed by the Labour Standards Act and Labour Contract Act. If employee benefits are set out in a collective labour agreement, the Labour Union Act also applies.

Individual executives and employees are taxed according to the Income Tax Act, and companies are subject to the Corporate Tax Act with respect to executive compensation arrangements and employee benefits.

2 What are the primary government agencies or other entities responsible for enforcing these rules?

The Financial Services Agency and the Tokyo Stock Exchange oversee disclosure regulations for executive compensation. The Labour Standards Supervision Office is the primary government agency tasked with the enforcement of employee benefits. Finally, the Internal Revenue Service is the primary enforcement agency dealing with taxation regulations.

Governance

3 Are any types of compensation or benefits generally subject to specific corporate governance requirements or approval by shareholders or government?

All types of compensation and benefits are subject to the specific corporate governance requirements that apply to a company based on its corporate governance structure. Under the May 2015 amendment of the Companies Act, a stock corporation may be composed of one of three corporate governance structures: a company with auditors; a company with three committees; or a company with an audit committee. (Note: In this chapter, 'executives' refers to directors in a company with auditors, directors in a company with an audit committee and both directors and officers in a company with three committees.)

Company with auditors

The company with auditors is the most common of the three corporate governance structures. In a company with auditors, any type of compensation or benefits provided as consideration for the execution of the duties of directors and corporate auditors must be approved by a resolution of a shareholders' meeting, unless the compensation was provided for under the company's articles of incorporation. Directors are primarily responsible for the execution of operations, and corporate auditors are responsible for supervising directors. While the title 'officer' may be used, it is not a legal title under the Companies Act. (Note: A company with auditors must have at least one corporate auditor.)

Company with three committees

A shareholder resolution is not required for this type of corporate governance structure. Instead, the compensation committee must approve compensation or benefits for officers and directors as well as the underlying policy rationale behind them through a resolution. Under this corporate governance structure, officers are primarily responsible for the execution of operations, and the term 'officer' is a legal title that triggers requirements under the Companies Act. Officers are supervised by the board of directors and the three committees, which consist of the nominating committee, the compensation committee and the audit committee. Each committee must consist of at least three directors and a majority of the members of each committee must be outside directors.

This type of corporate governance structure was introduced in 2003 by the amendment of the Commercial Code, which was incorporated into the Companies Act in 2006. Currently, among the listed companies, about 60 companies have adopted this corporate governance structure.

Company with an audit committee

As with a company with auditors, under this type of corporate governance structure, compensation and benefits must be approved by a shareholder resolution unless the compensation was provided for under the company's articles of incorporation.

Here, directors are primarily responsible for the execution of operations. Directors are supervised by the board of directors and the audit committee. The committee must consist of at least three directors and the majority of the members must be outside directors. While the title 'officer' may be used, it is not a legal title under the Companies Act in this type of governance structure.

4 Under what circumstances does the establishment or change of an executive compensation or benefit arrangement generally require consultation with a union, works council or similar body?

Executive compensation is generally outside the scope of consultation or collective bargaining with a union.

5 Are any types of compensation or benefit arrangements prohibited either generally or with senior management?

There is no specific type of compensation subject to such prohibition; however, any arrangement that entails a conflict of interest between a company and executives (eg, a loan to a director) requires the approval of the board of directors.

6 What rules apply to compensation of non-executive directors?

There are no specific rules for compensation of non-executive directors. However, if such directors are outside directors (as defined in the Companies Act) in a company with auditors (see question 3), when obtaining the resolution of the shareholders' meeting on directors' compensation, the compensation to be granted to the outside directors must be separately indicated in the applicable agenda. Also, if such directors are serving in a company with an audit committee (see question 3), when obtaining the resolution of the shareholders' meeting on directors' compensation, the compensation to be granted to directors

© Law Business Research 2018

serving as audit members must be separately approved, and such directors have the right to state their opinions regarding the agenda in the shareholders' meeting.

Disclosure

7 Must any aspects of an executive's compensation be publicly disclosed or disclosed to the government?

All companies must disclose to shareholders the total amount of compensation paid or agreed to be paid to executives in a fiscal year in an annual business report. The amounts can be given as the total for officers and directors, respectively.

Listed companies must disclose more detailed information to the public. This information includes the company policy regarding executive compensation, the names of executives who receive compensation of ¥100 million or above, and the individual amounts received by such executives. Such companies must disclose this information in the company's annual securities report in the manner prescribed by the FIEA. Also, listed companies must provide similar levels of disclosure in their corporate governance reports, according to the format designated by the applicable stock exchange rules.

Employment agreements

8 Are employment agreements required or prevalent? If so, what provisions are common?

Employment agreements are required. An agreement does not necessarily need to be in writing, but, according to the Labour Contract Act and the Labour Standards Act, when concluding an employment agreement, an employer must indicate the following listed matters in advance and in writing. If the following terms indicated in writing differ from the actual conditions of employment, the employee can immediately cancel the employment contract:

- term of employment, and if the specific term is designated, the conditions for renewal;
- place of work;
- job description;
- working hours, overtime work, rest periods, holidays and leave, and if the employees work in two or more shifts, matters regarding change in shifts;
- methods regarding determination, calculation and payment of wages (except retirement allowances and extra payments), payment date or period of wages, and matters regarding wage increase; and
- matters regarding termination (including resignation, retirement, dismissal or any other cause for termination).

In addition, if the following matters or terms are to be included in the employment agreement, the employer must also indicate them in writing:

- the scope of workers covered by retirement allowance, and the methods regarding the determination, calculation and payment thereof, and the payment date or terms thereof;
- bonuses and minimum wages;
- meal expenses, work supplies, etc, to be borne by employees;
- matters regarding health and safety;
- matters regarding vocational training;
- matters regarding compensation and allowances for injury or illness suffered off-duty;
- commendations and sanctions; and
- conditions regarding leave of absence.

In practice, employers often satisfy the above requirement by publishing their 'working rules', which all employers with at least 10 employees are required to provide. The working rules present the basic rules, terms and conditions of employment.

Incentive compensation

9 What are the prevalent types and structures of incentive compensation? Do they vary by level or type of organisation?

In current practice, cash compensation linked to the annual net income of a company seems most prevalent. For listed companies, equity-based compensation (see question 15) is also prevalent.

10 Are there limits generally on the amount or structure of incentive compensation? Are there limits that adversely affect the tax treatment of the employer or the executive?

There are no limits generally on the amount or structure of incentive compensation. From a corporate tax perspective, however, with respect to performance-based compensation paid to executives, in order for employers to treat the compensation as a deductible expense under article 34, paragraphs 1 to 3 of the Corporation Tax Act, the following requirements must be satisfied:

(i) the company is not a private holding company (except for a private holding company wholly owned by a non-private holding company);
(ii) the target executive is engaged in the management and operation of the company (a managing executive) and all managing executives receive profit-based compensation in compliance with requirements (i) to (vi);
(iii) the total amount of compensation during the fiscal year is reasonable (considering the contribution of the executive, the size of the company, etc);
(iv) the compensation is paid, or is expected to be paid, within one month of deciding the amount;
(v) the amount is treated as an expense for accounting purposes; and
(vi) the procedures and calculation method comply with the following:
  - the amount is determined according to an objective method based on indexes related to:
    (a) profits referenced in the securities reports (eg, earnings before interest, tax, depreciation and amortisation, return on assets and return on equity);
    (b) stock price in the market (eg, stock price on a specific date, comparison to the Tokyo Stock Price Index, market capitalisation and total shareholder return); or
    (c) sales referenced in the securities reports (only if this index is used together with any index falling under (a) or (b));
  - the maximum amount is fixed and the calculation method is consistent with that used for other managing executives;
  - the calculation method is determined under appropriate procedures (such as obtaining the approval of the compensation committee within three months of the beginning of the accounting year); and
  - after the calculation method is determined, the method is reported in the securities report without delay.

11 Is deferral and vesting of incentive awards permissible? Are there limits on the length or type of vesting and deferral provisions?

It is permissible for executive compensation. It is also permissible for employee benefits, as long as such an award is characterised as a discretionary bonus and is outside the scope of wages or base salary under the Labour Standards Act.

12 Can it be held that recurrent discretionary incentive compensation has become a mandatory contractual entitlement?

In general, no. If a fixed amount is routinely paid regardless of the achievements or performance of employees, however, such amount may possibly be deemed a mandatory contractual entitlement.

13 Does the type or amount of incentive compensation awarded to an executive potentially affect the compensation that must be awarded to other executives or employees?

The type and amount of incentive compensation offered to an executive can affect what is offered to other executives, but not what is offered to employees, because the primary sources of law governing executive and employee compensation are different (see question 1).

With respect to executives, profit-based compensation satisfying the requirements of the Corporation Tax Act (see question 10) will be paid to all managing executives in a consistent manner. Therefore, any amount of incentive compensation paid to a managing executive will affect that of the other managing executives. Also, in practice, a company will adopt a common rule or method for determining the incentive compensation offered to all executives.

© Law Business Research 2018

14 Is it permissible to require repayment of incentive compensation under certain circumstances? Are there circumstances under which such repayment is mandatory?

Currently, there are no circumstances under which repayment of incentive compensation is mandatory under Japanese laws. Nevertheless, some Japanese finance institutes have adopted clawback provisions regarding executives' compensation in response to the Financial Stability Board's 'Principles for Sound Compensation Practices – Implementation Standards' (as of 24 September 2009). With respect to employees' compensation, if the repayment of compensation is characterised as payment of damages, certain restrictions under the Labour Standards Act apply.

Equity-based compensation

15 What are the prevalent forms of equity compensation awards in your jurisdiction? What is a typical vesting period?

In current practice, the prevalent forms of equity compensation awards are stock options and stock compensation using a trust. In addition, while stock purchase plans using a general partnership used to be prevalent, recently, 'restricted stocks' (see 'Update and trends') are gradually gaining prevalence.

Among the four forms of equity compensation awards, stock options are the most common, especially as executive compensation. The maximum amount of the fair market value of stock options at the time of issuance must be within the applicable executive compensation amount that is either approved by a shareholders' meeting, or provided for in the articles of incorporation (in the case of a company with auditors or a company with an audit committee), or approved by the compensation committee (in the case of a company with three committees). The Companies Act sets out mandatory terms and procedures for stock options in general, but leaves the details of the structure of stock options to the company's discretion.

Stock compensation using a trust is also frequently used as an employee benefit and has also recently become popular as a form of executive compensation. A company will establish separate trusts for employment benefits and executive compensation. The trusts will acquire the company's shares from the stock market or treasury shares from the company by using the money entrusted, and will distribute shares to the beneficiaries. The beneficiaries are the executives or employees that have satisfied the requirements for benefits set out in predetermined rules on share distributions. The total (maximum) amount of the funds entrusted by the company for executive compensation, the calculation method of the shares and other details must be approved by the same corporate organ as for stock options.

Stock purchase plans using a general partnership used to be the most prevalent form of incentive compensation. Under such plans, eligible executives and employees, respectively, establish or join a general partnership to acquire and hold the company's shares. The funds necessary for the acquisition of shares and operation of the general partnership are technically contributed by the member executives and employees, but the plan substantially functions as an equity compensation award since the company effectively bears the burden by increasing the compensation or salary to cover the amount of such contribution. In addition, the company is allowed to provide subsidies to employees (not to executives) to be used as part of the contribution to the stock purchase plan for employee benefits.

There is no standard vesting period for the above four types of equity compensation. The award is often structured, however, as a substitute for a retirement allowance for executives (a one-time payment at the time of retirement), and in such cases the vesting date is typically scheduled on or after the retirement date (see question 33 for tax benefits).

16 Are there forms of equity compensation that are tax-advantageous or disadvantageous to employees or employers?

Tax-qualified stock options are available and are advantageous to employees and executives since only the amount of capital gain arising from a sale of shares obtained through the exercise of a stock option is recognised as taxable income. Only capital gains tax applies, not income tax. In contrast, for non-tax qualified stock options, in addition to the capital gains, income arising from the exercise of stock options is recognised as salary and is subject to income tax. On the other hand, tax-qualified stock options are disadvantageous for employers as this is not a deductible expense under the Corporation Tax Act (the deduction is allowed only if the income on the side of the relevant employee is recognised as salary subject to income tax).

The tax qualified stock options need to satisfy the following:

- the company issues them by resolution of a shareholders' meeting or the board of directors (as required under the Companies Act);
- they are granted to executives or employees of the issuing company or its subsidiary;
- they are exercised by the executives, employees or their heirs; and
- the subscription agreement between the issuing company and the executives of employees includes the following conditions:
  - the exercise period must fall within the period commencing from two years and ending 10 years from the date of the resolution regarding the issuance of the stock options;
  - the aggregate exercise price of all tax-qualified stock options will not exceed ¥12 million per year per individual recipient;
  - the exercise price per share is equal to or more than the value of one share at the time of the execution of the subscription agreement;
  - the stock options are non-transferable;
  - the shares should be granted upon the exercise of the stock options in accordance with the resolution of the shareholders' meeting or board of directors approving the issuance of the stock options; and
  - in accordance with a prior agreement between the company and a financial instrument operator, shares granted upon the exercise of the stock options must be either:
    - duly recorded in the relevant share transfer account registry of the financial instruments operator; or
    - kept in custody or managed in trust by the financial instruments operator.

17 Does equity-based compensation require registration or notice? Are exemptions, or simplified or expedited procedures available?

Among the three prevalent equity-based compensation methods, stock options and stock compensation using a trust are subject to the following registration and notice requirements under both the FIEA and Companies Act.

FIEA

Stock options

Under the FIEA, a foreign or domestic company offering shares, stock options and certain other types of securities designated by FIEA to persons in Japan is required to file a registration statement with the local regulator regarding the offering and deliver a prospectus to each offeree. Thus, stock options are subject to these registration and prospectus requirements when a company offers stock options to its employees and executives in Japan.

The FIEA also provides several exemptions for the requirements. The exemptions need to be considered mainly in connection with companies whose shares are not listed in Japan, because once the company files a registration statement, it is thereafter required to comply with periodic disclosure and reporting requirements under the FIEA. For companies whose shares are listed in Japan, since they are already subject to periodic disclosure and reporting requirements under the FIEA, there is less need to consider the exemptions than for non-listed companies.

The following is an outline of the three types of exemptions that are typically examined when a company is considering offering stock options to employees and executives.

Exemption 1: offerees are limited to the company and its wholly owned subsidiaries

Companies are exempted from the registration and prospectus requirements when the newly issued stock options are non-transferable and are granted solely to employees, executives or statutory auditors of: the issuing company, the issuing company's direct wholly owned subsidiary (first-tier subsidiary) or the wholly owned subsidiary of the first-tier subsidiary (second-tier subsidiary).

As long as all of the offerees in a particular offering are limited to employees, executives, or statutory auditors of the issuing company

© Law Business Research 2018

or its first or second-tier subsidiaries, there are no other criteria for qualifying for the exemption (such as the number of offerees and stock options' value).

Exemption 2: the aggregate value of the newly issued stock options is under ¥100 million

Companies are exempted from the registration and prospectus requirement when the sum of the offer price and exercise price of the newly issued stock options is below ¥100 million.

If, however, the company concurrently makes any other offering of shares, stock options or certain other types of securities designated by the FIEA, or has made such an offering within one year of the date on which the newly issued stock options were issued, the total offer price (and exercise price, if applicable) in such other offerings will need to be included in determining whether the aggregate value of the newly issued stock options has reached the ¥100 million threshold.

Exemption 3: the number of offerees is fewer than 50

Companies are exempted from the registration and prospectus requirements when the sum of x and y is fewer than 50, where x is the number of offerees of the newly issued stock options and y is the aggregate number of offerees of the same kind of stock options as in x, which were issued within six months of the date on which the newly issued stock options were issued.

Whether the previously issued stock options are of the 'same kind' as the newly issued stock options is determined by the type of shares subject to both stock options. The previous stock options will be considered of the same type as the newly issued stock option when both options are issued by the same entity, and the surplus dividends, distribution of residual property and items for which they are allowed to exercise voting rights of such shares are the same.

Stock compensation using a trust

With respect to stock compensation using a trust, if a company allocates its shares or disposes of its treasury shares to the trust, such offering to the trust will also be subject to the registration and prospectus requirements. In this case, the exemptions typically examined are exemptions 2 and 3.

Companies Act

By two weeks prior to the allocation date of stock options and the payment date of shares, an issuing company is required to issue a public notice regarding such in a manner designated by its articles of incorporation (for listed companies, electronic announcement or posting in a daily newspaper is common, and for non-listed companies, posting in an official gazette is common). This public notice can be replaced by individual notices to all shareholders. A company can, however, be exempted from this notice requirement if it files a registration statement or obtains a shareholders' resolution regarding the contemplated issuance.

18 Are there withholding tax requirements for equity-based awards?

With respect to equity-based awards, except for tax-qualified stock options (see question 15), the issuing company is subject to withholding tax requirements. However, the timing of withholding differs depending on the structure of the equity-based awards.

19 Are inter-company chargeback agreements between a non-local parent company and local affiliate common? What issues arise?

They are commonly used, and are allowed as long as there exists economic substance and a legitimate business purpose for the underlying payments or structure, as such payments often entail a transfer pricing taxation issue.

20 Are employee stock purchase plans prevalent or available? If so, are there any frequently encountered issues with such arrangements?

Stock purchase plans using a general partnership are available and used to be prevalent. One frequently encountered issue with this arrangement is how to treat the shares owned by the general partnership when the issuing company faces squeeze-out transactions, such as a tender offer.

Employee benefits

21 Are there any mandatory benefits? Are there limits on discontinuing voluntary benefits that have been provided?

There are three major mandatory benefits for employees: employment insurance, health insurance and industrial accident compensation insurance. The following chart summarises the main features of these mandatory benefits.

	Employment insurance	Health insurance	Industrial accident compensation
Primary source of law	The Employment Insurance Act	The Health Insurance Act	The Industrial Accident Compensation Act
Grounds for benefits	Leave and unemployment	Injury, disease, disability or death not resulting from employment-related cause or commuting	Injury, disease, disability or death resulting from employment-related cause or commuting
Insured employees	All employees, except for: • those who work for a natural person (as opposed to a corporation) operating certain exempted businesses, such as agriculture and forestry; • those who were 65 years old or older when they were first hired; • temporary employees who have worked less than four months; • students (with certain exemptions); and • public employees (with certain exemptions)	All employees who work for: • a legal entity that continuously hires five employees; or • a natural person with more employees (except for certain exempted businesses, such as agriculture and forestry)	All employees, except for those who work for a natural person operating certain exempted businesses, such as agriculture and forestry
Premium	Equally borne by the employees (during the employment period) and employer The employer is obliged to withhold the employee's contribution from his or her salary	The same as employment insurance	Borne by employer

Employers who wish to discontinue voluntary benefits are subject to certain restrictions. If the employer voluntarily introduced benefits through certain programmes that are stipulated by law (such as the Defined Contribution Pension Act or the Defined Benefit Corporate Pension Act), then the discontinuation of those benefits will be subject to the terms of the relevant law. If, however, the employer voluntarily provided benefits outside the scope of any specific regulations, then they can discontinue or change the benefits in accordance with the working rules or labour agreement.

22 What types of employee benefits are prevalent for executives? Are there tax or other financial incentives or disincentives for any employee benefit arrangements?

Executives are insured under the Health Insurance Act, but they are not eligible for employment insurance. Also, executives are generally not eligible for industrial accident compensation insurance, but there are certain exceptions, as with executives of certain small businesses (such as retail businesses with up to 100 full-time employees).

From a tax perspective, the premiums paid by employees for the mandatory employee benefits are deducted from taxable income.

© Law Business Research 2018

Termination of employment

23 Are there prohibitions on terminating executives? Are there required notice periods? May executives be dismissed without cause?

Under the Companies Act, directors can be dismissed at any time by a resolution of a shareholders' meeting. Officers in a company with three committees (see question 3) can also be dismissed at any time by a resolution of the board of directors. As long as the resolution is obtained, there is no requirement that the dismissal be 'for cause'.

Under the Companies Act, however, dismissed executives are allowed to demand damages arising from the dismissal, unless the dismissal was based upon 'justifiable grounds'. The courts tend to interpret justifiable grounds narrowly. Examples of justifiable grounds are the abolition of the department or division of which the relevant executive was in charge, an act committed by the executive that violates laws and regulations or the company's articles of incorporation, a mental or physical disorder, or a lack of ability to perform the required duties of the executive's position.

24 Are there statutory or mandatory minimum severance requirements in your jurisdiction? Are there any other mandatory, post-employment benefits?

There are no statutory or mandatory minimum severance requirements or post-employment benefits. At minimum, employees may receive employment insurance payments after their employment has been terminated (see question 21).

25 What executive severance payment level is typical?

Under the Corporate Tax Code, if a severance payment is 'unreasonably high', the company cannot treat it as a deductible expense. Although there are no clear official guidelines as to what is a 'reasonable' severance payment, the Order for Enforcement of the Corporate Tax Code provides the following as examples of relevant factors in that determination:

(i) the number of years of service;
(ii) the individual situation regarding the retirement; and
(iii) the average annual amount of retirement allowance of comparable companies.

In practice, item (ii) is generally considered to include the amount of monthly remuneration immediately prior to the retirement and the executive's personal contributions to the company. Accordingly, the amount of retirement allowance tends to be proportional to the duration of service. However, external events, such as a change in control, are highly likely to undermine the reasonableness of the amount.

In addition, under the Companies Act, executive severance payments need to be approved by a shareholders meeting or the compensation committee (see question 3); therefore, from a procedural perspective, there is limited flexibility in determining the amount of the severance payment.

26 Are there limits on dismissal for 'cause'? Are there any statutory limits on 'constructive dismissal' or 'good reason'? How are 'cause' or 'constructive dismissal' defined?

With respect to the dismissal of executives, see question 23.

With respect to dismissal of employees, employers are subject to the judicially developed doctrine of abusive dismissal. Under this doctrine, employers are prohibited from dismissing employees unless the dismissal has objectively reasonable grounds and is considered to be appropriate in general societal terms. A dismissal conducted in violation of this doctrine will be invalid. The scope of 'objectively reasonable grounds' under this doctrine is limited and include, for example:

- the employee's lack or loss of the skills or qualifications required to perform the work;
- a breach of working discipline committed by the employee;
- managerial reasons arising from compelling business necessity, such as an adjustment in the number of employees required owing to a severe business downturn; or
- where a union demands the dismissal of an employee based on a union-shop agreement.

In general, the courts will only uphold the propriety and validity of a dismissal if the reasons are grave and there are few options on the part of the employee by which to mitigate the gravity.

27 Are 'gardening leave' provisions typically used in employment terminations?

Such provisions are occasionally used. They are permitted as long as the compensation provided during the period of leave and the length of the leave are reasonable.

28 Is a general waiver or release of claims on termination of an executive's employment normally permitted? Are there any restrictions or requirements for the waiver or release to be enforceable?

A general waiver or release of claims on termination is generally permitted; however, such waiver or release by an employer that is a corporation is not enforceable without the unanimous consent of the shareholders or unless it accords with one of the following procedures:

Procedural requirements	Applicable executives	Highest amount to be waived
A special resolution of a shareholders' meeting	Executives (see question 3)	Any amount exceeding that calculated by using a certain metric stipulated by the Companies Act (including the highest compensation paid to the executive)
A specific provision in the articles of incorporation	A resolution of the board of directors – directors in a company with auditors (see question 3)	The same as above Any liability arising from gross negligence or wilful misconduct cannot be waived
The articles of incorporation	Directors who are not engaged in the execution of operations	The higher of the amount (x) provided in the articles of incorporation or (y) the amount obtained by using a method similar to that used in the special resolution of a shareholders' meeting Any liability arising from gross negligence or wilful misconduct cannot be waived

Post-employment restrictive covenants

29 What post-employment restrictive covenants are prevalent? What are the typical restricted periods?

In general, non-compete and confidentiality covenants are common post-employment restrictive covenants.

Covenants regarding non-solicitation of customers or employees are also common, but their use depends on the position held or the business engaged in by the relevant employee or executive.

With respect to a restriction period, for a post-employment restrictive covenant to be deemed valid and enforceable, the period cannot exceed what an employer's reasonable business necessity would demand. There are no clear standards for judging necessity and reasonableness, and the courts decide these issues by considering various factors (see question 30).

30 Are there limits on, or requirements for, post-employment restrictive covenants to be enforceable? Will a court typically modify a covenant to make it enforceable?

Since post-employment restrictive covenants may restrict the employee's freedom of choice in employment and limit his or her livelihood, there are limits on their enforceability. Specifically, the courts will uphold their validity only if the restrictions are within the employer's reasonable business necessity, and will often modify the covenant and admit its enforceability in a narrower scope. In general, in judging necessity and reasonableness, the courts consider the following:

- the period;
- the geographical scope;
- the targeted business activities and scope of the restriction;
- the position or business that the relevant employee or executive held or engaged in; and
- any compensatory measures provided to the employee.

© Law Business Research 2018

Update and trends

Certain preferential tax treatment for a new type of stock compensation (restricted stocks) has become available by an amendment of the Corporation Tax Act and relevant orders, which came into effect on 1 April 2016. The requirements regarding restricted stocks were further amended in April 2017.

For restricted stocks satisfying the relevant requirements, the following tax treatment is available:

- on the side of the executives, the income tax on the restricted stocks is deferred until the transfer restriction actually expires, and the taxable income is calculated based on the fair market value of the stock as of the transfer-restriction expiry date; and
- on the side of the company, it may deduct expenses under the Corporation Tax Act in such amount of the rights (see (iii) below) contributed by the executives in exchange for the restricted stocks that is in proportion with the number of restricted stocks that actually become transferable.

The major requirements for the above tax treatment under the Corporation Tax Act and the orders are that:

(i) they must be stocks that have market prices (or stocks to be converted into such stocks);
(ii) they are granted to the executives or employees of the company issuing such stocks or its subsidiaries of which the majority of voting rights are held (and expected to continue being held) by the issuing company;
(iii) they may be issued by a contribution-in-kind of executives or employees' rights to claim a specific amount of monetary compensation;
(iv) they must be subject to a transfer restriction for a specific duration; and
(v) they must be subject to an obligation for their return to the company if the executive or employee has not continued to provide his or her service throughout a predetermined period.

Further, by an amendment of the Corporation Tax Act and relevant orders, which came into effect on 1 April 2017, in order for any equitybased compensation for executives to be treated as deductible expenses, such forms of compensation also need to satisfy the same requirements for the deduction applicable to cash compensation for executives. Therefore, for instance, a company may treat the cost regarding stock options as deductible expenses if the stock options satisfy the applicable requirements for the following:

- predetermined salary (in short, compensation for continued services throughout a predetermined period, to be paid in a defined amount and at specified times, as provided in article 34, paragraphs 1 to 2 of the Corporation Tax Act);
- performance-based compensation (see question 10); or
- retirement allowance (see question 34).

31 What remedies can the employer seek for breach of post-employment restrictive covenants?

The employer may seek forfeiture of unpaid severance and recoupment of paid severance as long as such arrangements are clearly provided for in advance by the relevant employment agreement or working rules. In connection with employees, however, the courts often deem severance as 'a deferred payment of wages'; therefore, a reduction in an employee's wages is usually permitted only if significant misconduct substantially undermined his or her past contribution. This is the case even if the employer is entitled to forfeiture or recoupment by relevant employment agreements or working rules.

The employer may also seek compensation in damages, but it bears the burden of proof regarding the amount of damages. If breach of a restrictive covenant falls under trade secret misuse under the Unfair Competition Prevention Act, the employer may utilise statutory presumption. Statutory presumption assumes that the profit obtained by a trade secret infringer is the damage suffered by the trade secret holder when calculating compensatory damages.

Pension and other retirement benefits

32 Are there any required pension or other retirement benefits? Are there limits on discontinuing voluntary benefits that have been provided?

Welfare pension insurance is required for employees and executives who work for an employer that is:

- a legal entity and continuously hires at least one employee; or
- a natural person who continuously hires five or more employees (except for certain exempted businesses, such as agriculture and forestry).

The welfare pension is intended to support the living expenses of participants who reach the age of 65 in accordance with the Welfare Pension Insurance Act. Premiums are equally borne by the employees and employer (except for certain exempted employees, such as those on maternity leave) and the employer is obliged to withhold the employees' contribution from their salaries.

With respect to the discontinuation of voluntary benefits, see question 21.

33 What types of pension or other retirement benefits are prevalent for executives? Are there tax or other financial incentives or disincentives for any employee benefit arrangements?

Employees who become executives remain beneficiaries of welfare pension insurance (see question 32). Japanese companies rarely offer additional pension plans for executives. Therefore, welfare pension insurance is the most common pension benefit for executives.

With respect to other retirement benefits for executives, cash retirement allowances (see question 25) are still prevalent for both executives and employees. Upon satisfaction of the following requirements, executives and employees receive favourable tax treatment regarding income tax (in short, only half the amount of the retirement allowance is taxed):

(i) the retirement allowance is a lump-sum payment received on retirement; and
(ii) (only for executives) the length of service exceeds five years.

These requirements also apply to stock options and stock compensation using trusts (see question 15). In practice, the tax authority currently treats a 'one time exercise of stock options within 10 days following retirement' as satisfying requirement (i).

From the perspective of the company (ie, an employer), in order for the retirement allowance for executives to be deemed a deductible expense under the Corporate Tax Act, the following requirements must be satisfied:

- the amount of retirement benefits is reasonable (considering the contribution of the executive, the size of the company, etc); and
- the amount of retirement benefits is not linked to the performance of the company (ie, linked only to the length of the service) or, if the amount is linked to such performance, the requirements regarding incentive compensation (see question 10) are satisfied.

34 May executives receive supplemental retirement benefits?

Such retirement benefits are allowed provided they are approved by a shareholders' meeting or the compensation committee (see question 3).

Indemnification

35 May an executive be indemnified or insured for claims related to actions taken as an executive, officer or director?

A company is permitted to indemnify its executives to a certain extent in connection with a shareholder derivative action if the executive in question did not commit wilful misconduct or gross negligence regarding his or her duties and the board of directors approves such indemnification.

With respect to insurance, particularly directors' and officers' liability insurance, although there has been some controversy as to whether a company should bear the premium, it is generally considered permissible if the board of directors approves the company bearing the insurance premium and the content of the insurance is subject to the

© Law Business Research 2018

supervision of outside directors (such as approval of all outside directors or a committee of which the majority of the members are outside directors).

Change in control

36 Under what circumstances will an asset sale in your jurisdiction result in an automatic transfer of benefit obligations to the acquirer?

Unless both parties agree to the transfer of benefit obligations associated with the asset, no 'automatic' transfer will occur, because an asset sale is only effective to the extent specifically agreed upon by the acquirer and the transferee.

37 Is it customary to provide for executive retention or related arrangements in connection with a change in control?

It is not customary, but if the acquirer wishes to retain a current executive, the acquirer will often require that executive to sign a letter of acceptance or a retention agreement (which is typically prepared by the acquirer), and its submission will be a closing condition for the acquirer in the agreement for the underlying transaction.

38 Are there limits or prohibitions on the acceleration of vesting or exercisability of compensation in a change in control? Are there restrictions on 'cashing-out' equity awards?

Executive compensation must be approved by a shareholders' meeting or by the compensation committee (see question 3). Therefore, if any change of compensation exceeds the scope of the approval, that change cannot be put into effect.

With respect to 'cashing out', there are no restrictions, but if an employee or executive intends to sell shares of the company (ie, the employer) to the company itself, the sale must comply with the procedural requirements for stock repurchases in the Companies Act and, if the company is listed, the sale will be subject to insider trading rules.

Multi-jurisdictional matters

39 Do foreign exchange controls rules apply to the remittance of funds, or the transfer of employer equity or equity-based awards to executives?

An employer must file an after-the-fact notification with the Bank of Japan if it pays monetary compensation exceeding ¥30 million to a non-Japanese resident.

If a non-Japanese resident receives shares as compensation or upon the exercise of stock options, he or she must file an after-the-fact notification with the Bank of Japan. In addition, if the shares are those of a non-listed company or 10 per cent or more shares of a listed company, an additional after-the-fact notice requirement will apply.

40 Must employment agreements, employee compensation or benefit plans, or award agreements be translated into the local language?

There is no such requirement. However, working rules often include basic terms of employee compensation or benefits, and an employer must file its working rules with the competent Labour Standards Supervision Office. Upon filing, a Japanese translation will be required.

41 Are there prohibitions on tax gross-up, tax indemnity or tax equalisation payments?

While there are no such prohibitions, in current practice, these kinds of provisions are not typical with respect to Japanese domestic executives and employees. They are sometimes used, however, with respect to non-Japanese executives who work away from their home countries.

42 Are choice-of-law provisions in executive employment contracts generally respected?

They are generally respected for executive (but not employee) contracts, unless the application of the agreed upon governing law would be against public policy, in accordance with the General Rules for Application of Laws.

* *The author would like to thank Yujin Suga, Kozo Kuromatsu, Fumihiko Sawada, Bonso Morimoto and Mary Prager for their assistance with this chapter.*

NISHIMURA & ASAHI

Hiroko Shibata **h_shibata@jurists.co.jp**

Otemon Tower, 1-1-2 Otemachi
Chiyoda-ku
Tokyo 100-8124
Japan

Tel: +81 3 6250 6200
Fax: +81 3 6250 7200
www.jurists.co.jp

© Law Business Research 2018

Getting the Deal Through

Acquisition Finance
Advertising & Marketing
Agribusiness
Air Transport
Anti-Corruption Regulation
Anti-Money Laundering
Appeals
Arbitration
Art Law
Asset Recovery
Automotive
Aviation Finance & Leasing
Aviation Liability
Banking Regulation
Cartel Regulation
Class Actions
Cloud Computing
Commercial Contracts
Competition Compliance
Complex Commercial Litigation
Construction
Copyright
Corporate Governance
Corporate Immigration
Corporate Reorganisations
Cybersecurity
Data Protection & Privacy
Debt Capital Markets
Dispute Resolution
Distribution & Agency
Domains & Domain Names
Dominance
e-Commerce
Electricity Regulation
Energy Disputes
Enforcement of Foreign Judgments
Environment & Climate Regulation
Equity Derivatives
Executive Compensation & Employee Benefits
Financial Services Compliance
Financial Services Litigation
Fintech
Foreign Investment Review
Franchise
Fund Management
Gaming
Gas Regulation
Government Investigations
Government Relations
Healthcare Enforcement & Litigation
High-Yield Debt
Initial Public Offerings
Insurance & Reinsurance
Insurance Litigation
Intellectual Property & Antitrust
Investment Treaty Arbitration
Islamic Finance & Markets
Joint Ventures
Labour & Employment
Legal Privilege & Professional Secrecy
Licensing
Life Sciences
Loans & Secured Financing
Mediation
Merger Control
Mining
Oil Regulation
Outsourcing
Patents
Pensions & Retirement Plans
Pharmaceutical Antitrust
Ports & Terminals
Private Antitrust Litigation
Private Banking & Wealth Management
Private Client
Private Equity
Private M&A
Product Liability
Product Recall
Project Finance
Public M&A
Public-Private Partnerships
Public Procurement
Real Estate
Real Estate M&A
Renewable Energy
Restructuring & Insolvency
Right of Publicity
Risk & Compliance Management
Securities Finance
Securities Litigation
Shareholder Activism & Engagement
Ship Finance
Shipbuilding
Shipping
State Aid
Structured Finance & Securitisation
Tax Controversy
Tax on Inbound Investment
Telecoms & Media
Trade & Customs
Trademarks
Transfer Pricing
Vertical Agreements

Also available digitally

Online

www.gettingthedealthrough.com

ISBN 978-1-78915-022-3

© Law Business Research 2018