

# Executive Compensation & Employee Benefits 2019

Contributing editors

Maureen J Gorman and Debra B Hoffman



**Publisher****Tom Barnes**

tom.barnes@lbresearch.com

**Subscriptions****Claire Bagnall**

claire.bagnall@lbresearch.com

**Senior business development managers****Adam Sargent**

adam.sargent@gettingthedealthrough.com

**Dan White**

dan.white@gettingthedealthrough.com

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Meridian House, 34-35 Farringdon Street

London, EC4A 4HL, UK

Tel: +44 20 3780 4147

Fax: +44 20 7229 6910

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# Executive Compensation & Employee Benefits 2019

**Contributing editors****Maureen J Gorman and Debra B Hoffman****Mayer Brown LLP**

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Lexology Getting The Deal Through is delighted to publish the fifth edition of *Executive Compensation & Employee Benefits*, which is available in print and online at [www.lexology.com/gtdt](http://www.lexology.com/gtdt).

Lexology 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 Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured.

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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.

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For further information please contact [editorial@gettingthedealthrough.com](mailto:editorial@gettingthedealthrough.com)

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# Japan

Hiroko Shibata and Takato Masuda\*

Nishimura & Asahi

## SOURCES OF RULES AND PRACTICE

### Overview

- 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.

### Enforcers

- 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

### Governance requirements and shareholder approval

- 3 Are any types of compensation or benefits generally subject to specific corporate governance requirements or approval by shareholders or government agencies? What is the general process for obtaining approval?

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.

### 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.

### Consultation

- 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.

## Prohibited arrangements

- 5 | Are any types of compensation or benefit arrangements prohibited either generally or with respect to 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, and is subject to disclosure in an annual securities report in the manner prescribed by the FIEA and an annual business report in the manner prescribed by the Companies Act.

## Rules for non-executives

- 6 | What rules apply to compensation and benefits 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 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

### Mandatory disclosure of executive compensation

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

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. In addition, a company with three committees must disclose the decision-making process and a summary of the policy regarding executive compensation in its annual business report. Regarding a company with auditors and a company with an audit committee, the disclosure of the decision-making process and a summary of the policy can be omitted.

Listed companies must disclose more detailed information to the public in their annual securities reports in the manner prescribed by the FIEA. This information includes the company's decision-making process and policy regarding executive compensation, the names of executives who receive compensation of ¥100 million or above, the individual amounts received by such executives and certain details regarding performance-based compensation (if applicable). 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

### Common provisions

- 8 | Are employment agreements required or prevalent? If so, what provisions are common? Are any terms prohibited or unenforceable?

Employment agreements are required. An agreement does not necessarily need to be in writing (except in the circumstances described further below), 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.

Under the Labour Standards Act and Labour Contract Act, there are a number of restrictions on the terms and conditions of employment agreements (only for employees, not including directors or officers). For example, an employer must pay salary in cash (ie, benefits in kind are restricted) and must not deduct any expenses from a salary without consent by an employee or a union representing a majority in a workplace.

## INCENTIVE COMPENSATION

### Typical structures

- 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 17) is also prevalent.

## Restrictions

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

There are no limits generally on the amount or structure of incentive compensation, as long as it is within the scope authorised by the shareholders meeting or compensation committee. 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:

- 1 the company is not a private holding company (except for a private holding company wholly owned by a non-private holding company);
- 2 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 (1) to (6);
- 3 the total amount of compensation during the fiscal year is reasonable (considering the contribution of the executive, the size of the company, etc);
- 4 the compensation is paid, or is expected to be paid, within one month of deciding the amount;
- 5 the amount is treated as an expense for accounting purposes; and
- 6 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.

## Deferral

- 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** Are there limitations on the individuals or groups eligible to receive the compensation? Are there aspects of the arrangement that can only be extended to certain groups of employees?

Executive compensation is governed by the Companies Act, and employee salary is governed mainly by the Labour Standards Act and Labour Contract Act, which provide stricter rules to protect employees. Thus,

there are several limitations regarding employee salary (see question 8), which are not applicable to executive compensation.

## Recurrent discretionary incentives

- 13** Can it be held that recurrent discretionary incentive compensation has become a mandatory contractual entitlement? Is this rebuttable?

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. If it is deemed a mandatory contractual entitlement, an employer can discontinue it:

- with the employee's consent; or
- if the discontinuation is deemed to be reasonable.

Note: its reasonability will be scrutinised by a court if an employee disagrees with the discontinuation.

## Effect on other employees

- 14** 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, if an employer intends to treat compensation as a deductible expense, 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.

## Mandatory payment

- 15** 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.

- 16** Can an arrangement provide that payment is conditioned on continuing employment until the payment date? Are there exceptions?

As to executive compensation, it is possible. As regards salary for employees, it is not possible. However, it is possible for bonuses unless the termination of employment is attributable to an employer.

## EQUITY-BASED COMPENSATION

### Typical forms

- 17 What are the prevalent forms of equity compensation awards in your jurisdiction? What is a typical vesting period? Must the arrangements be offered to a broad group of employees, or can the employer select the participants?

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' are gradually gaining prevalence.

With respect to stock options, 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.

In terms of restricted stocks, companies will issue ordinary shares in exchange for in-kind contribution of the monetary remuneration claims by allottees. Restricted stocks are typically subject to contractual terms agreed between the company and each allottee, such as a certain share transfer restriction period and conditions for the acquisition of such stock by the company. If the company allots restricted stocks to its executives, the total (maximum) amount of remuneration claims to be paid by the company as executive compensation, the total (maximum) number of shares to be allotted to executives and other details must be approved by the same corporate organ as for stock options.

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 36 for tax benefits).

The employer can select the participants, taking into consideration applicable requirements regarding deduction and (if they are granted to employees) applicable employment laws requirements.

- 18 Must equity-based compensation be granted by the company's board of directors (or its committee) or can the authority be delegated to officers or employees of the company? Are there limitations or requirements that apply to delegation?

In general, the issuance procedure for stock options or shares as equity-based compensation is the same method as that for third party allotment. With respect to a company with auditors and a company with an audit committee, in principle, its board of directors must decide the total number of stock options or shares to be issued, the amount per stock option or share to be paid in and other fundamental terms set out in the applicable article of the Companies Act. In the case of a company with three committees, these terms must be decided by its board of directors or by an officer authorised by its board of directors. Notwithstanding the above, in cases where the amount to be paid in is particularly favourable to allottees, the approval of a shareholders' meeting is inevitable.

### Tax treatment

- 19 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 or 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 instrument operator; or
    - kept in custody or managed in trust by the financial instrument operator.



## Registration

### 20 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 for registration statements 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 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).

If the aggregate value of the newly issued stock options is ¥100 million or more, companies must file an extraordinary securities report, which is a relatively simple form, even though they are exempted from the registration and prospectus requirements.

#### 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.

Even under this exemption, in cases where the aggregate value of the newly issued stock options is ¥10 million or more, companies must submit a securities notification (which is not disclosed to the public) to the local regulator. Where it is lower than ¥10 million, neither a registration statement nor a securities notification is required.

#### 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.

This exemption only applies to a company that is not obliged to file its annual securities report under the regulations of the FIEA.

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.

## Restricted stock

When a company offers employees and executives its ordinary shares as restricted stocks in Japan, these ordinary shares are subject to slightly different registration and prospectus requirements from the requirements mentioned above. In the case of issuing shares, exemption 1 is unavailable. Therefore, in many cases, companies submit securities notifications or registration statements, depending on the aggregate value of shares to be issued (see exemption 2). With respect to filing a registration statement, a company can use a certain simplified form (eg, names, addresses and other information of allottees can be omitted), if the company allots restricted stocks to employees and executives belonging to the company or its affiliates.

## 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 (in case of stock options) and the payment date of shares (in case of restricted stock and stock compensation using a trust), 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.



## Withholding tax

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

With respect to equity-based awards, except for tax-qualified stock options (see question 17), the issuing company is subject to withholding tax requirements. However, the timing of withholding differs depending on the structure of the equity-based awards.

## Inter-company chargeback

- 22 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.

## Stock purchase plans

- 23 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

### Mandatory and voluntary employee benefits

- 24 Are there any mandatory benefits? Are there limits on changing or discontinuing voluntary benefits that have been provided?

#### Mandatory employee benefits

There are three major mandatory benefits for employees, as follows:

- 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
<b>Primary source of law</b>	The Employment Insurance Act	The Health Insurance Act	The Industrial Accident Compensation Act
<b>Grounds for benefits</b>	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

	Employment insurance	Health insurance	Industrial accident compensation
<b>Insured employees</b>	All employees, except for: <ul style="list-style-type: none"> <li>• those who work for a natural person (as opposed to a corporation) operating certain exempted businesses, such as agriculture and forestry;</li> <li>• those who were 65 years old or older when they were first hired;</li> <li>• temporary employees who have worked less than four months;</li> <li>• students (with certain exemptions); and</li> <li>• public employees (with certain exemptions)</li> </ul>	All employees who work for: <ul style="list-style-type: none"> <li>• a legal entity that continuously hires five employees; or</li> <li>• a natural person with more employees (except for certain exempted businesses, such as agriculture and forestry)</li> </ul>	All employees, except for those who work for a natural person operating certain exempted businesses, such as agriculture and forestry
<b>Premium</b>	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

### Discontinuation or change of voluntary employee benefits

Employers who wish to discontinue or change 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 by amending the working rules or labour agreement. The working rules can be amended without the consent of the applicable employees as long as such amendment is reasonable (note: its reasonability will be scrutinised by a court if the employees disagree with the amendment). To amend a labour agreement, the consent of the counterparty (ie, a union or employee group) is necessary.

### Typical employee benefits and incentives

- 25 What types of employee benefits are prevalent for executives? Are there tax or other financial incentives or disincentives for such 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.

## TERMINATION OF EMPLOYMENT

### Rules for termination

- 26 | 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.

### Mandatory severance pay

- 27 | Are there statutory or mandatory minimum severance requirements? 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 24).

### Typical severance pay

- 28 | 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:

- 1 the number of years of service;
- 2 the individual situation regarding the retirement; and
- 3 the average annual amount of retirement allowance of comparable companies.

In practice, item (2) 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.

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.

### Reasons for dismissal

- 29 | 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? Are there legal or customary rules relating to effecting a termination for 'cause' or 'constructive dismissal'?

With respect to the dismissal of executives, see question 26.

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.

### Gardening leave

- 30 | Are 'gardening leave' provisions typically used in employment terminations? Do they have any special effect on benefits?

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. So long as the employment technically remains valid during the garden leave period, the garden leave will not have any special effects on mandatory benefits (see question 24). In connection with any contractual benefits, it depends on the applicable terms.

### Waiver of claims

- 31 | 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

### Typical covenants

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

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

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 33).

### Enforceability

- 33 | 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.

### Remedies for breach

- 34 | 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

### Required retirement benefits and incentives

- 35 | Are there any required pension or other retirement benefits?  
Are there limits on discontinuing or modifying 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 or change of voluntary benefits, see question 24.

### Typical retirement benefits and incentives

- 36 | What types of pension or other retirement benefits are prevalent for executives? Are there tax or other financial incentives or disincentives for such employee benefit arrangements?

Welfare pension insurance (see question 35) is the most common pension benefit for executives.

With respect to other retirement benefits for executives, cash retirement allowances (see question 28) 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):

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

These requirements also apply to stock options, restricted stocks, and stock compensation using trusts (see question 17). With respect to stock options, in practice, the tax authority currently treats a 'one-time exercise of stock options within 10 days following retirement' as satisfying requirement (1).

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.

### Supplemental retirement benefits

- 37 | 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

### Directors and officers

- 38 | 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 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

### Transfer of benefits

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

Under Japanese law, there seems to be no specific legal scheme which may transform an 'asset sale' into an 'automatic transfer of benefit obligations to the acquirer'.

### Executive retention

- 40 | 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.

### Expedited vesting of compensation

- 41 | 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, including 'cashing-out' exceeds the scope of the approval, that change cannot be put into effect.

- 42 | Are there adverse tax consequences for the employer or the executive relating to benefits or payments provided pursuant to a change in control?

For employers, if benefits or payments provided pursuant to a change in control fail to satisfy the requirements under the Corporate Tax Code (see question 28), such benefits or payments will not be deductible. For executives, in order to receive favourable tax treatment, benefits or payments provided pursuant to a change in control must follow the requirements in accordance with the Income Tax Act (see question 36); otherwise, the entire amount of such benefits or payments will be treated as taxable income.

## MULTI-JURISDICTIONAL MATTERS

### Exchange controls

- 43 | 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 additional notification with the Bank of Japan if he or she results in holding 10 per cent or more shares of the company.

### Local language requirement

- 44 | 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.

### Net salary arrangements

- 45 | 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.

### Choice of law

- 46 | 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.

## UPDATE AND TRENDS

### Key developments of the past year

- 47 | What were the key cases, decisions, judgments and policy and legislative developments of the past year?

By the amendment of the Cabinet Office Ordinance on the Disclosure of Corporate Affairs that came into force on 31 January 2019, the scope of mandatory disclosure regarding executive compensation in an annual securities report has been enhanced. In particular, additional details regarding the decision-making process and compensation policy (such as the name of the person or body that has the authority to decide the policy and applicable steps for the determination of compensation) are required to be disclosed. Moreover, if a company adopts any performance-based compensation, the following details must be disclosed:

- its policy regarding the proportion of performance-based compensation and non-performance-based compensation (if such a policy exists);
- the applicable indicator for the performance-based compensation;
- the reason why the company adopts the indicator;

- the decision-making process to fix the amount of performance-based compensation; and
- the target indicator and results of achievement in the recent fiscal year.

Listed companies whose fiscal year ends in March, which is prevailing in Japan, were required to prepare their annual securities reports for fiscal year 2018 in accordance with the new amendment. Therefore, this year, most listed companies prepared their annual securities reports without any samples or precedents. In time there will be description of newly required disclosure items, will eventually be formed.

\* *The authors would like to thank Mary Prager for her assistance with this chapter.*

## NISHIMURA & ASAHI

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**Hiroko Shibata**

[h\\_shibata@jurists.co.jp](mailto:h_shibata@jurists.co.jp)

**Takato Masuda**

[t\\_masuda@jurists.co.jp](mailto:t_masuda@jurists.co.jp)

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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](http://www.jurists.co.jp)

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