

# The Corporate Counselor

- Insights into Japanese Corporate Law -

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## ESTABLISHING A SUBSIDIARY IN JAPAN—THE CHOICE BETWEEN A *KABUSHIKI KAISHA* AND A *GODO KAISHA*

A *kabushiki kaisha* (the equivalent of an ordinary corporation or “c-corporation” in the United States) is often heralded as the most respectable corporate form from which to conduct business in Japan. Advisors frequently proclaim that a *kabushiki kaisha* projects a sense of confidence and commitment to the Japanese marketplace, and fosters a sense of reliability in lenders, investors, landlords and commercial counter-parties. While this may have been true in the past, it belies why prestigious global companies such as Apple, Cisco Systems, ExxonMobil, and Wal-Mart, to name just a few, currently conduct business in Japan through a *godo kaisha*. A *godo kaisha* (the equivalent of a limited liability company/LLC in the United States) has been available as a corporate form in Japan only since 2006, but despite its recent introduction to Japan’s corporate landscape, it has quickly gained popularity to become a meaningful alternative choice to a *kabushiki kaisha*. This newsletter summarizes key differences between a *kabushiki kaisha* and a *godo kaisha*, and offers factors to consider when selecting a corporate form for a subsidiary in Japan.

Selecting the appropriate corporate form from which to conduct business in Japan is of crucial importance, and such decision should be made based on objective criteria. While a *kabushiki kaisha* has been an available corporate form much longer than a *godo kaisha*, nowadays it would be imprudent to select one corporate form over the other simply due to perceptions that a Japanese customer prefers one form of entity over the other. Rather, each type of business entity has advantages and disadvantages affected by such factors as upfront and periodic costs, industry regulations (e.g., regulators may prefer that market participants operate pursuant to a particular corporate form), legal considerations, tax treatment, and fundraising needs. All of these factors require careful consideration.

Annex A compares a *kabushiki kaisha* and a *godo kaisha* with respect to fundamental corporate matters. The following observations can be drawn from this comparison:

### Godo Kaisha

- the capital registration tax and periodic maintenance/reporting costs associated with a *godo kaisha* are less than the corresponding costs associated with a *kabushiki kaisha*;
- a *godo kaisha* offers considerable flexibility with respect to corporate governance and designation of management responsibilities;

- a *godo kaisha* can receive pass-through tax treatment for U.S. income tax purposes, while a *kabushiki kaisha* cannot; and
- completing a contribution-in-kind can be accomplished more quickly and with lower administrative costs, which can be helpful if a member plans to contribute assets (such as intellectual property rights, assets necessary to conduct the subject business, shares of a company, etc.) to a *godo kaisha* in exchange for a membership interest.

### Kabushiki Kaisha

- a *kabushiki kaisha* is led by its Representative Director(s), a title that is highly revered in Japanese business circles and may make it easier to attract quality executives;
- if equity in the Japan subsidiary will be granted to directors, employees or other third parties or if a capital markets transaction is contemplated, then a *kabushiki kaisha* is the only practical corporate form to provide such equity participation, and if the parent company plans to issue its stock options to directors and employees of the Japan subsidiary, then it will be easier to qualify for a Japanese securities registration exemption for such offer and sale if the offerees work for a *kabushiki kaisha* instead of a *godo kaisha*;
- a *kabushiki kaisha* offers practical advantages to a parent company that wishes to maintain tight control over the operations of a Japan subsidiary with minority shareholders since only a Representative Director of a *kabushiki kaisha* is entitled to bind the company in contracts with third-parties (absent a board delegation to an additional person), while each member (or a designated executive officer) of a *godo kaisha* has such representation power; and
- a *kabushiki kaisha* takes its origins back to 1873, whereas a *godo kaisha* has been available only since 2006, so Japanese statutes, case law and local market practices are more developed with respect to a *kabushiki kaisha* than with a *godo kaisha* (though such difference is likely to wane over time).

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A potential unexpected consequence of utilizing a *godo kaisha* is that a parent company could be held accountable for certain liabilities created by the Japan subsidiary. If the sole managing member of a *godo kaisha* is an entity, then one or more individuals must be appointed to serve as executive officer(s) to perform the duties of the managing member. If an executive officer performs his or her duties with gross



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negligence or with willful misconduct and such actions result in damages to a third-party, then the executive officer *and* the managing member could be held accountable for damages to such third-party. While we believe that the foregoing potential loophole to the limitation on liability of a managing member is more theoretical than actual (which is why no notation is made in Annex A), given the nascent stage of interpreting the rules and regulations applicable to a *godo kaisha*, it is not possible to state categorically that such risk is non-existent.

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Annex A  
Corporate Form Comparison Chart

	<i>Kabushiki Kaisha</i>	<i>Godo Kaisha</i>
<b>Ownership characteristics</b>	stockholder / stock	member / membership interest
<b>Owner's liability for the debts of the corporation</b>	limited to equity purchase price ( <i>which can be as low as JPY1</i> ), with no personal liability for the debts of the corporation	
<b>Corporate governance snapshot</b>	<ul style="list-style-type: none"> <li>• <i>if no board of directors</i>: minimum of one director who has the authority to enter into contracts on behalf of the company</li> <li>• <i>board of directors</i>: minimum of three directors, at least one of whom is designated a "Representative Director" (which provides such person with the authority to enter into contracts on behalf of the company)</li> <li>• depending on size or if a board of directors governance form is selected, one or more statutory auditors must be appointed</li> <li>• governance by board committees (compensation, audit and nomination) and the appointment of executive officers permissible</li> <li>• governance by audit committee and regular board permissible (<i>from May 1, 2015</i>)</li> </ul>	<ul style="list-style-type: none"> <li>• among members, one or more managing members must be designated (i.e., a person who has the right and responsibility to execute the business and operations of the Company). A member can be an individual or an entity.</li> <li>• <i>entity as sole managing member</i>: entity must select individual(s) to serve as executive officer(s) to perform the duties of the managing member. A designated "executive officer" does not need to be an employee of the member</li> </ul>
<b>Minimum capital/registration tax</b>	<ul style="list-style-type: none"> <li>• JPY1</li> <li>• at least 50% of newly raised capital must be allocated to registered capital (remaining allocated to capital surplus)</li> <li>• registration tax equals 0.7% of the registered capital (with a minimum registration tax of JPY150,000)</li> </ul>	<ul style="list-style-type: none"> <li>• JPY1</li> <li>• all capital can be allocated to capital surplus</li> <li>• minimum registration tax of JPY60,000, but no registration tax needs to be paid thereafter if all capital is allocated to capital surplus</li> </ul>
<b>Contribution in kind</b>	unless an exemption applies, value of non-cash contributed assets subject to review by a court-appointed inspector (thereby increasing time and cost)	no requirement for a court-appointed inspector to confirm the value of non-cash contributions
<b>Dividends</b>	<ul style="list-style-type: none"> <li>• no dividend payments permissible if the amount of net assets is less than JPY3 million</li> <li>• interim dividends can be distributed</li> <li>• dividends allocated in accordance with equity participation ratio</li> </ul>	<ul style="list-style-type: none"> <li>• no minimum net asset requirement</li> <li>• dividends can be declared and distributed as frequently as desired</li> <li>• dividends can be allocated at a rate different from equity participation ratio, if specified in the articles of incorporation</li> </ul>
<b>Periodic maintenance costs</b>	<ul style="list-style-type: none"> <li>• annual general shareholders' meeting</li> <li>• public disclosure of condensed balance sheet (and income statement for a "large" <i>kabushiki kaisha</i>)</li> <li>• preparation of annual business report</li> </ul>	<ul style="list-style-type: none"> <li>• no annual general shareholders' meeting required</li> <li>• no public disclosure of financial information required</li> <li>• no annual business report required</li> </ul>
<b>Japan income tax treatment</b>	worldwide income subject to tax, with an effective corporate income tax rate of approximately 39% and withholding tax on dividends of approximately 20% (reduced withholding tax rate under a tax treaty may be available)	
<b>U.S. income tax treatment</b>	corporation	eligible for "check-the-box" election to be treated as a disregarded entity or partnership
<b>Public equity or convertible bond offering possible</b>	yes	no