NISHIMURA & ASAHI

The Corporate Counselor

- Insights into Japanese Corporate Law -

March 2015/No.18

PRIMER ON STAMP TAXES IN JAPAN

In a country that has founded and embraced some of the most advanced technologies in the world, it seems almost paradoxical that Japan still maintains a medieval-like scheme of requiring the placement of a physical stamp (*shū'nyū inshi*) on certain documents in order to generate tax revenues for the government. A common misunderstanding is that the imposition of a Japanese stamp tax applies only to contracts involving securities, real property and immigration visas. This is not the case. Japan's Ministry of Finance seeks to collect stamp tax revenue on various Japan-related commercial arrangements. Fortunately for the tax payer, the stamp tax payment amount can be quite low on a per transaction basis and may not even apply if certain procedures are legitimately followed. The failure to comply with Japan's stamp tax requirements, however, can lead to costly penalties.

This edition of the Corporate Counselor provides, in a question-and-answer format, an overview of Japanese stamp tax legislation, highlights when a stamp tax payment arises, and explains the consequences of compliance failure.

What documents are subject to a stamp tax and what is the amount of the tax?

Not all Japan-related contracts are subject to a stamp tax. A Japan stamp tax duty accrues only in connection with the execution in Japan of an original contract listed in Annex 1 to Japan's Stamp Tax Act (such category of taxable agreements is referred to in this newsletter as a "covered agreement"). Covered agreements include real estate sales agreements, promissory notes, loan agreements, transportation agreements, merger agreements, articles of incorporation and bills of lading. The amount of the stamp tax payment obligation generally accrues at a progressive rate depending on the consideration amount stipulated in the covered agreement, but certain types of covered agreements have a fixed stamp tax amount regardless of the underlying consideration amount.

<ins>Annex A</ins> to this newsletter lists the stamp tax for a variety of covered agreements frequently executed in connection with commercial transactions in Japan.

M&A practitioners should note that:

· a stamp tax payment obligation does not accrue in connection with the execution of a share purchase agreement, but a stamp tax payment obligation does arise in connection with the execution of other common acquisition agreements, such a merger agreement, a demerger agreement and an asset sale/business transfer agreement (the rational for such distinction is not expressed in the statute);

· an employment agreement is not subject to a stamp tax, however, a consulting or service agreement (*ukeoi keiyaku*) tied to a specific project is subject to a stamp tax; and

· a loan agreement is subject to a stamp tax.

The determination of the applicable stamp tax amount is not always a straight-forward exercise. For example, an agreement containing various commercial arrangements (e.g., a merger agreement that contains an embedded loan covenant) would be subject to a stamp tax payment based on the levy schedule for a loan agreement (without regard to the merger agreement stamp tax levy schedule). Also, there are grounds to argue that a stamp tax payment obligation could arise with respect to a non-binding letter of intent that outlines the deal terms for a covered agreement. Counsel should be consulted when the parties are assessing the stamp tax amount with respect to an all-encompassing agreement or a letter of intent because the analysis under such circumstances is not always straight-forward and highly dependent on the facts at hand.

How are amendments to a covered agreement handled?

The determination of the stamp tax amount arising from an amendment to a covered agreement requires a complex matrix analysis concerning: (i) whether the change to the covered agreement is a material amendment (a change is generally understood to be material if the amendment involves a provision that is required by Japanese law to be included in the subject covered agreement or is otherwise cited as being a material matter under the *Commissioner's Directive on Interpretation of the Stamp Tax Act*) and, if so, whether the material change involves a modification to the consideration amount of the covered agreement, and (ii) whether the stamp tax levy is calculated based on the change to the covered agreement's consideration amount, or whether a fixed stamp tax amount applies.

If an amendment to a covered agreement involves an increase to its consideration amount (which is ordinarily always considered a material amendment), then the increase in the consideration amount generally would be used to calculate the stamp tax obligation, unless the covered agreement is subject to a fixed stamp tax obligation (in which case, the fix stamp tax amount would apply). For example, if the purchase price in a business transfer agreement is increased, such differential from the prior purchase price would be used to calculate the stamp tax amount based on the progressive tax rate schedule for a business transfer agreement. On the other hand, a flat stamp tax of JPY40,000 per each original would apply if the purchase price in a merger agreement is increased because a merger agreement

Stephen D. Bohrer

Foreign Law Partner
03-5562-8648
s_bohrer@jurists.co.jp

Michito Kitamura

Partner
03-5562-9853
m_kitamura@jurists.co.jp

is subject to a fixed stamp tax payment regardless of the agreement's consideration amount.

If an amendment to a covered agreement involves either a decrease to its consideration amount or a material change to a provision other than an increase to the covered agreement's consideration amount, then (i) if the methodology to calculate the stamp tax for such covered agreement is based on a progressive tax rate schedule, then a stamp tax payment of JPY200 would apply to each original version of the amendment to such covered agreement, or (ii) if the methodology to calculate the stamp tax on such covered agreement is a fixed amount, then a stamp tax payment equal to such fixed amount would apply to each original version of the amendment to such covered agreement. For example, if a change is made to the effective date of a business transfer agreement (which would be considered a material amendment because a change to the effective date in a business transfer agreement is stipulated as being material under the *Commissioner's Directive on Interpretation of the Stamp Tax Act*), then a JPY200 stamp tax would be payable on each original version of such amendment agreement, while a JPY40,000 stamp tax would be payable on each original version of an amendment to a merger agreement that covers a material change to a non-monetary provision.

No stamp tax payment obligation would arise in connection with the execution of an amendment agreement that does not involve a material change to the covered agreement.

How many times must a stamp tax be paid on the same covered agreement? Are copies of covered agreements taxed?

A stamp tax should be affixed to each original version of a covered agreement. For example, if Company A, Company B and Company C enter into an intellectual property transfer agreement that is subject to a stamp tax and each party wants to maintain an original version of the agreement, then three stamp tax payments would arise (one on each original version of the intellectual property transfer agreement maintained by Company A, Company B and Company C). Under Japan's Stamp Tax Act, the payment of the applicable stamp tax is a joint and several obligation of each signatory to a covered agreement. Typically, the parties divide the stamp tax amount equally between them, unless the covered agreement is a one-way service agreement (in which case, the service provider often will pay the stamp tax) or the covered agreement is a loan related agreement (in which case, the borrower often will pay the stamp tax).

A copy of a covered agreement generally is not subject to a stamp tax so long as the copy is not intended to serve as an original version of the covered agreement. For example, copies of a covered agreement maintained in an office file would not require the payment of a stamp tax on such copies. On the other hand, a stamp tax payment obligation generally cannot be avoided by simply undertaking a "virtual" signing or similar process (e.g., the parties separately execute the covered agreement, convert their respective executed signature page counterparts into an electronic format, and then exchange by email the executed signature page counterparts with the intent to subsequently collate the signature page counterparts into a fully executed "original" binding version of the covered agreement maintained by each party). The necessity of having to pay a stamp tax under the foregoing signing process is especially clear if the covered agreement contains a boilerplate provision stipulating that "signatures transmitted by fax, by email or any other electronic means intended to preserve the original graphic and pictorial appearance of this agreement shall have the same effect as physical delivery of the paper document bearing an original signature."

As explained immediately below, however, there are scenarios where a "virtual" signing over a covered agreement is not subject to a stamp tax.

Are there circumstances when a stamp tax for a covered agreement is not payable?

A stamp tax arises upon the execution in Japan of an original covered agreement.

A contract is not considered executed in Japan if the last person to sign the covered agreement is not physically located in Japan at the time of such signing. For example, if Japan Co and US Co enter into a construction agreement and Japan Co first executes the covered agreement and subsequently the representative of US Co executing the covered agreement is outside of Japan when he/she signs, then a stamp tax would not be payable for such covered agreement. The parties should maintain sufficient records to demonstrate that the covered agreement was concluded outside of Japan (i.e., US Co was the last party to sign the construction agreement and the representative of US Co signing the construction agreement was not in Japan at such signing time). For instance, the parties could include on the signature page of the covered agreement the time and location of each party executing the covered agreement, or the parties could maintain email correspondence that demonstrates the appropriate signing sequence of the covered agreement.

Where are stamps purchased?

Stamps can be purchased at most local post offices, large financial institutions in Japan, and almost all immigration bureaus in Japan.

What are the legal consequences if a stamp tax is not paid?

Failure to pay a stamp tax for a covered agreement can lead to the delinquent person being required to pay the applicable stamp tax, plus a penalty amount equal to two times the stamp tax payment amount. If a party voluntarily discloses its payment delinquency to the applicable tax bureau before the tax authority commences its tax examination on stamp tax payment compliance, then such person would be required to pay the applicable stamp tax plus a penalty amount equal to only 10% of the stamp tax. For example, a party failing to pay a stamp tax covering a merger agreement would be required to pay a penalty equal to JPY44,000 (i.e., the stamp tax of JPY40,000, plus 10% of JPY40,0000 as the penalty amount) if such party voluntarily discloses its payment delinquency to the applicable tax bureau before the tax authority commences its tax examination on stamp tax payment compliance.

The failure to pay a stamp tax does not impact or jeopardize the validity of the covered agreement, and such failure does not prevent a party from enforcing the covered agreement in a Japanese court.

* * * *

As the Japanese government continues to seek ways to balance its budget, it is conceivable that Japan's arcane stamp tax regime could be revitalized and its coverage expanded as a convenient way to generate tax revenues from the Japanese business community. Should this occur and rates significantly increase, then many in Japan will undoubtedly long for the days when all that was needed to *seal* a deal (*pardon the pun*) was a simple handshake.

Nishimura & Asahi
Ark Mori Building, 1-12-32 Akasaka, Minato-ku, Tokyo 107-6029, JAPAN
Phone:81-3-5562-8500 Fax:81-3-5561-9711 URL:http://www.jurists.co.jp/en/

Annex A
<u>Sample Stamp Tax Rates</u>

Document Type	Stamp Tax Rate	
	Minimum	**Maximum**
	(*depending on consideration value of the document, unless a fixed stamp tax applies*)	
Real property transfer agreement	JPY200	JPY480,000
Intellectual property transfer agreement	JPY200	JPY600,000
Loan agreement	JPY200	JPY600,000
Letter of credit	JPY200	
Consulting/service agreement (*ukeoi keiyaku*)	JPY200	JPY600,000
Construction agreement	JPY200	JPY480,000
Promissory note	JPY200	JPY200,000
Stock share certificate	JPY200	JPY20,000
Merger agreement / demerger agreement	JPY40,000	
Asset purchase or business transfer agreement	JPY200	JPY600,000
Articles of incorporation (original only)	JPY40,000	
Master purchase agreement, franchise agreement, distribution agreement and other "continuous" contracts	JPY4,000	
Cross-receipt	JPY200	

Further stamp tax levy details can be found at: https://www.nta.go.jp/shiraberu/zeiho-kaishaku/shitsugi/inshi/01.htm