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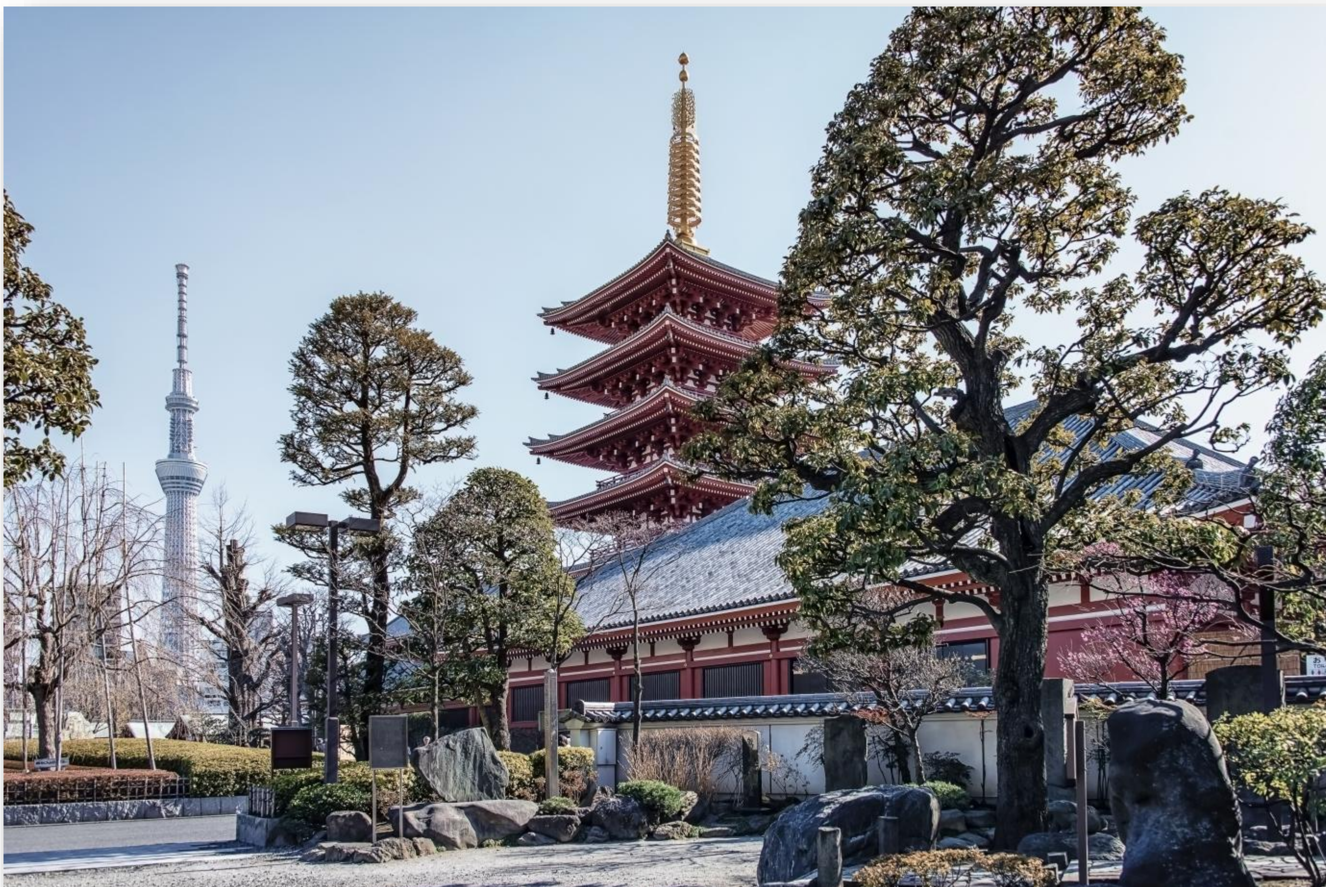

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ESTABLISHING A BUSINESS ENTITY IN JAPAN

ILN CORPORATE GROUP

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ESTABLISHING A BUSINESS ENTITY IN JAPAN

1. Types of Business Entities

1.1 Description of the types of entities available in each jurisdiction through which to conduct business --- Business entities available for doing business in Japan

1.1.1 Introduction

Business formats available for foreign investors to do business in Japan include two types of companies and a branch. Below, please find a brief overview of these formats.

1.1.2 Companies

The most frequently used format of a company in Japan is a joint-stock company (in Japanese, "Kabushiki Kaisha"; commonly abbreviated as "KK"). Recently, the format of a limited liability company has also been used ("Godo Kaisha"; "GK"). In these companies, shareholders' liability is limited to their capital contributions.

(1) Joint-stock Company

Conventionally, a joint-stock company ("KK") is used for larger businesses which raise funds widely from many investors and delegate the management of the company to directors who are considered professionals retained by the shareholders (i.e., there is a separation of management and ownership). Under the recently enacted Companies Act, smaller companies have been allowed to simplify their corporate governance systems. For instance, for companies whose shares may not be freely sold, a Board of Directors system is not compulsory (a single director may execute the business operations of the company). Having said that, a KK is more suitable for an enterprise held by a large number of shareholders; in order to protect their interests, strict corporate governance systems have been set forth in the Companies Act (see also Section 4.1.1 below).

(2) Limited Liability Company

A limited liability company ("GK") is a recently introduced form of a company which is managed by the investors themselves. Unlike a KK, a GK is not designed based on the principle of separation of management and ownership; as such, generally, a GK is more suitable for smaller companies. In the case of a GK, corporate governance systems are relatively less stringent. For instance, public notice of financial statements is not required. As there are no restrictions on large scaled investors which choose the GK format, recently, some Japan subsidiaries of giant multinational companies (e.g., Google, Amazon, etc.) have been structured as a GK. Having said that, a GK is more suitable for an enterprise held by a small number of members (owners), who themselves execute the business of the company (see also Section 4.1.2 below).

1.1.3 Branch

A branch is a business format that can be established relatively simply. A branch does not have its own legal personality and is deemed to be encompassed within the legal personality of the foreign company. As such, the foreign company is ultimately responsible for all debts and credits generated by the branch.

2. Matters to be considered when choosing a particular business entity type

2.1 Liabilities

Both a KK and a GK are separate legal entities from their parent companies, and the parent companies do not directly bear the liabilities of their subsidiaries in Japan. On the other hand, branches are not separate legal entities from their foreign companies, and as such the foreign company is directly responsible for the liabilities of its branch.

2.2 Residency requirement

Since 2015, neither a representative director of a KK nor a representative member of a GK are required to be a resident of Japan. In contrast, in the case of a branch, at least one of the representatives in Japan is still required to be a resident of Japan.

2.3 Taxes

It is generally considered that there is no significant difference regarding taxation applicable to a company and a branch. The income of companies established in Japan is, as a rule, subject to Japanese taxation regardless of where it was generated. Currently, for taxation purposes, branches are deemed to be an independent business entity and the taxation for a Japanese branch is calculated on the assumption that the branch is an organization independent from the foreign company. As a result, a company (a KK and a GK) and a branch are subject to essentially similar income taxes.

Please note that while a GK has some similarity to a partnership, in Japan, pass-through taxation does not apply to a GK. On the other hand, it is said that in some foreign jurisdictions, a Japanese GK is treated as an entity to which pass-through taxation is applicable, and foreign companies in such jurisdictions tend to determine that a GK is a more preferable format as a subsidiary in Japan (in light of the relative tax impact in the home country). For more detailed or specific tax information, it is advisable to consult with an international tax specialist.

2.4 Summary

Among the business formats available in Japan, a KK has been most frequently chosen by investors. One of the reasons is said to be that a KK is the most conventional business format in Japan. As a KK is suitable for a company that has numerous shareholders (the corporate governance systems for a KK are more stringent in order to protect the interests of these shareholders, see Section 4.1.1 below), founding investors who would like to raise funds from many additional investors tend to choose a KK. Also, as a GK may not become a listed company, investors who plan to have the company go public on the stock exchange would not choose a GK. A KK is also preferred by smaller businesses, as a KK has conventionally been considered to be perceived as having higher social credibility.

On the other hand, if the investors are not interested in mass fundraising or in becoming publicly listed, a GK is also a viable option. Considering that the corporate governance systems that a GK is required to comply with are simpler (e.g., a Board of Directors system is not required even where a GK has a large amount of assets), a GK could be a better option for a foreign parent company. Typically, a foreign parent company becomes the sole member of its subsidiary GK so that it can directly control it.

Especially, if the foreign parent company is located in a jurisdiction where its home country's tax regulations treat a Japanese subsidiary GK as an entity for which pass-through tax treatment is applicable, such a foreign parent company would benefit from choosing a GK (see Section 2.3 above).

While a branch can be established relatively easily, a company format is more frequently chosen by foreign investors. One of the reasons behind this seems to be that a branch is not a separate entity, and the foreign parent company is directly responsible for the branch's liabilities. Also, it is sometimes said that a company format (a KK or GK) tends to be perceived as showing the foreign parent company's stronger commitment to Japan market, and as such any domestic Japanese parties transacting with the subsidiary company would feel more easily able to rely on them (compared to a branch).

3. Steps and Timing to Establish

3.1 Brief overview of steps to incorporate/constitute each

3.1.1 Joint-stock company (KK)

To incorporate a joint-stock company (kabushiki kaisha, "KK"), (i) incorporators prepare the Articles of Incorporation of the company (Art. 26, Companies Act), (ii) incorporators have the Articles of Incorporation notarized by a notary public (Art. 30), (iii) incorporators each pay an incorporator's contribution with respect to the shares for which the incorporator has subscribed (Art. 34), (iv) incorporators elect the officers (such as directors) of the company (Art. 38), and (v) a director applies for the registration of incorporation with the Legal Affairs Bureau. When the registration of incorporation is completed, a joint stock company (KK) is legally formed (Art. 49).

3.1.2 Limited Liability company (GK)

To incorporate a limited liability company (godo kaisha, "GK"), (i) incorporators prepare the Articles of Incorporation of the company (Art. 575, Companies Act; this is analogous to the procedures for the formation of a KK, but in the case of a GK, notarization of the Articles of Incorporation is not required),

(ii) incorporators pay contributions (Art. 578), and (iii) a member of the GK applies for the registration of incorporation with the Legal Affairs Bureau. When the registration of incorporation is completed, a limited liability company (GK) is legally formed (Art. 579).

3.1.3 Branch

Foreign companies doing business continuously in Japan must appoint and register the representative in Japan (Art. 817 & 818, Companies Act). If the foreign company chooses to set up a physical office in Japan, the address of such an office also needs to be registered. In addition, the foreign company needs to register the matters that are required to be registered for whichever type of Japanese corporation is most similar to the foreign company, e.g., if the foreign company is similar to a Japanese joint-stock company, then the name of the representative director, the address of the main office, the business purposes, etc., of the foreign company need to be registered.

4. Governance, Regulation, and Ongoing Maintenance

4.1 Brief summary of corporate governance systems of each type

4.1.1 Joint-stock Company ("KK")

The primary corporate organs of a joint-stock company ("KK") are a shareholders meeting and director(s), i.e., all KKs must have a shareholders meeting and director(s). Aside from these organs, under the recently enacted Companies Act, the types of corporate organs a company must have differ significantly depending on (i) whether the company falls under a "large" company or not, and (ii) whether the company falls under a "public" company or not. Under the Companies Act, a "large" company means a company with capital of JPY 500 million or more, or total liabilities of JPY 20 billion or more (Art. 2(vi)). A "public" company means a company the Articles of Incorporation of which do not require the approval of the company for acquisitions of the company's shares (Art. 2(v)). These variations are summarized in the below table.

	Large companies		Non-large companies	
	Public companies	Non-public companies	Public companies	Non-public companies
Board of Directors* *consisting of 3 or more directors	Mandatory	Optional (with some exceptions)	Mandatory	Optional (with some exceptions)
Number of Directors	3 or more	1 or more	3 or more	1 or more
Representative Director	Mandatory	Optional	Mandatory	Optional
Statutory Auditor	3 or more	1 or more	1 or more	Optional (with some exceptions)
Board of Auditors* *consisting of 3 or more Statutory Auditors	Mandatory	Optional	Optional	Optional
Accounting Auditor	Mandatory	Mandatory	Optional	Optional
Accounting Advisor	Optional	Optional	Optional	Mandatory, if the company has a Board of Directors but has no Statutory Auditor

*In addition to the above structures, a 'company with a committee system' is also available, but here we focus on the traditional organizational structures.

As indicated in the above table, if a joint-stock company ("KK") has JPY 500 million or more capital (i.e., a "large" company), and its shares are freely transferable (without the company's approval, i.e., a "public" company), then the KK must have a Board of Directors consisting of 3 or more Directors and must appoint 3 or more Statutory Auditors who constitute a Board of Auditors. In contrast, in the case of a non-large and non-public KK, it is permissible to appoint just one Director (a Board of Directors is not mandatory, and a Statutory Auditor is not mandatory, either).

An Accounting Advisor is either a Certified Public Accountant or audit firm, or a certified public tax accountant or tax accountant corporation (Art. 333, Companies Act), whereas a Statutory Auditor need not be any such certified professional. In the case of an Accounting Auditor (which is mandatory for "large" companies), it is either a public certified accountant or audit firm (Art. 337).

4.1.2 Limited Liability Company ("GK")

The members of a limited liability company ("GK") themselves execute the business of the GK, unless otherwise provided for in the Articles of Incorporation (Art. 590, Companies Act). As mentioned above, unlike a KK (where the management of the company is entrusted to the Directors), in the case of a GK, the members (i.e., the owners who invested in the GK) themselves manage the company.

Additionally, a GK, in its Articles of Incorporation, may designate the specific member(s) who execute the business of the GK, and if there are two or more members who execute the business of the GK, the business of the company is determined by a majority of the members who execute the business (unless otherwise provided for in the Articles of Incorporation) (Art. 591). In cases where corporations (i.e., non-natural persons) act as members who execute the business, such corporations must appoint natural person(s) to perform the duties of members who execute such business and notify other members of the names and addresses of such natural person (Art. 598). A member who executes the business of the GK, in principle, has the authority to represent the GK. Provided, however, that a GK may also appoint specific members to represent the GK from among the members who execute the business (Art. 599).

As shown above, in a GK, when making decisions, formal meetings such as a shareholders' meeting or a Board of Directors meeting are not required to be held; thus, a GK can be said to be an entity in which quick decisions can be made.

4.1.3 Branch

A branch is not an independent legal entity; as such, the Companies Act does not provide for any specific regulations concerning the governance systems for a branch.

4.2 Requirements for local shareholding/directors

4.2.1 Local shareholding

In Japan, in principle, there are no restrictions on the nationality or citizenship of shareholders of a joint- stock company or of members of a limited liability company. As such, in principle, a company with 100% foreign shareholding or membership is permissible. Please note, however, that some industries are subject to restrictions (e.g., defense-related industries; see also Section 5.1 below).

4.2.2 Local directorship

A natural person of any nationality or citizenship can be a director of a joint-stock company ("KK"). In the case of a limited liability company ("GK"), aside from a natural person, a corporation (incorporated in any jurisdiction, in principle) can be a member of the GK. As we mentioned in Section 2.2 above, since 2015, a representative director of a KK or a representative member of a GK is no longer required to be a resident of Japan. In contrast, in the case of a branch, at least one of the representatives in Japan is still required to be a resident of Japan.

4.3 Minority shareholders' rights and protection

4.3.1 Joint stock company

In the case of a joint stock company ("KK"), there are a number of rights and protections available for minority shareholders, including the following:

(i) Shareholders' right to propose --- at a KK with a Board of Directors, shareholders having (consecutively for the preceding 6 months or more) not less than 1% of the votes of all shareholders or not less than three hundred votes of all shareholders may demand that the Directors include certain matters in the purpose(s) of a shareholders meeting (the percentage and number may be lowered by the Articles of Incorporation) (Art 303, Companies Act).

(ii) Shareholders' right to convene a shareholders' meeting shareholders having (consecutively for the preceding 6 months or more) not less than 3% of the votes of all shareholders may demand the Directors, by showing the matters which shall be the purpose(s) of the shareholders meeting and the reason of the convocation, convene a shareholders meeting, and if the Directors fail to convene the shareholders meeting in a timely manner, then these shareholders may convene a shareholders meeting with the permission of the court (Art. 297)

4.3.2 Limited liability company

In the case of a limited liability company ("GK"), no such rights or protections similar to those for a KK mentioned above are set forth in the Companies Act. Provided, however, that there are some provisions under which minority members' position or status can be protected to some degree. For instance, amendments to the Articles of Incorporation of a GK or other important changes to a GK need to be approved by all of the members, unless otherwise stipulated in the Articles of Incorporation (Art. 637). Also, in cases where the members who execute the business of the GK have been designated, other members (who do not execute the business of the GK) may investigate the status of the business and assets of the GK (Art. 592).

5. Foreign Investment, Thin Capitalization, Residency and Material Visa Restrictions

5.1 Any significant barriers to entry for an offshore party

In Japan, there are no generic restrictions for offshore parties to do business in Japan or to establish a business entity in Japan. That being said, there are exceptions to investment in certain industries (e.g., those related to national security) which are regulated.

5.2 Any capitalization obligations

In Japan, there are thin capitalization rules. Where a subsidiary company in Japan raises funds from its foreign parent company, if the tax rate in Japan is higher, the foreign parent company tends to prefer debt (i.e., loan(s) from the parent company) to equity (i.e., additional investment by the parent company), as interest on debt is tax deductible. As such, there are regulations (known as thin capitalization rules) which stipulate if the debt is more than 3 times the capital of the Japan subsidiary company, then the interest on the portion of the debt that exceeds 3 times the capital shall not be tax deductible.

5.3 Any special business or investment visa issues

A "Business Manager" visa (status of residence) is available for company directors, branch managers, and others who engage in activities to determine important matters regarding the operation of a business, the execution of a business, or the auditing of a business.

Some local governments have established special programs for encouraging foreign investors to support business startup activities. For instance, in the case of Yokohama City, if a foreign investor plans to start a business in Yokohama City and the type of business is related to innovative technology and other activities, and fulfills other requirements, the investor will be granted a "Specially Designated Activities" status of residence for a maximum period of one year; the investor then can use this maximum one year period to engage in activities to start the applied-for business. After this special one-year period, the investor who has managed the start of the business can apply for a "Business Manager" visa.

5.4 Any restrictions on remitting funds out of the jurisdictions (withholdings, etc.)

There are no particular restrictions in Japan on remitting funds out of Japan. Provided, however, a Japanese company is, in principle, required to deduct and pay withholding tax on its dividends. The tax rate is reduced if the tax treaty between the home county and Japan stipulates a reduced tax rate for dividends.