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SETTING-UP BUSINESS IN JAPAN

Japan continues to attract the interest of foreign investors, wishing to establish or expand their own business presence in this market. Japanese corporate law provides for a broad variety of legal types of investment, the most prevalent of which are described in this newsletter. These include the representative office (cf. I.), the branch (cf. II.), the joint stock corporation (cf. III.) and the limited liability company (cf. IV.), with the stock corporation being the preferred choice for foreign investors wishing to establish a wholly owned subsidiary in Japan.

I. Representative Office

1. Overview

A representative office is usually established if no active business operation is intended by the investor and activities will be limited to market surveillance and collection or exchange of information.

A representative office legally qualifies as an overseas office of the foreign company. Because a representative office is principally regarded as a non-taxable entity, it is not permitted to engage in (taxable) business activities such as sales, services, contract negotiations, or similar activities.

2. Formation

a) A representative office can be established without any particular registration requirements under Japanese law. In practice, the establishment of the representative office is done by appointing a chief representative as the head of the representative office and specifying the business location of the representative office. However, if the chief representative is a foreigner, he will need to obtain a visa. To this end, it is necessary to prove the legal and physical existence of the representative office's premises in Japan, typically by submitting a copy of the office lease agreement to the immigration authority. In addition to the lease agreement, the visa application requires submitting (in English or Japanese) certain personal data of the chief representative together with the following documents and information regarding the foreign company:

- Brief description of the planned activities in Japan;
- Assignment letter and employment agreement for the designated chief representative;
- Latest available financial statements;
- Company brochure;
- Certified copy of the commercial registry excerpt.

b) A bank account can be opened after the chief representative has received his visa and by submitting the following documents:

- Office lease agreement;
- Company brochure;
- Resident permit;
- Passport.

c) A representative office is entitled to employ staff, provided the usual labor law, tax and social insurance notifications and filing requirements are observed (cf. III. 2. c) below). Legally, all contractual relationships are entered into with the foreign company (or the chief representative personally) as the representative office does not constitute a separate legal entity. Foreign employees assigned to the representative office in Japan also need to obtain a visa prior to entering Japan.

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3. Taxation

A representative office in principle is regarded as a nontaxable entity, provided it does not engage in any sales activities. The following activities are generally permitted under Japanese tax law:

- Purchase and storage of assets;
- Renting premises for purposes other than sales activities;
- Market surveys and research;
- Advertising;
- Maintaining a bank account.

As long as the representative office is acting within the limited scope of the permitted activities, it is not subject to Japanese corporate income tax. Any activities outside the defined scope risk, however, that the representative office will be regarded as a so called permanent establishment ("PE") under Japanese tax laws and consequently will be subject to Japanese taxation with the deemed profits attributable to the PE.

II. Branch

1. Overview

A foreign company establishing a branch in Japan must be registered with the local Japanese Legal Affairs Bureau. Consequently, the foreign company bears full responsibility for the operations of the branch. In addition, the paid-in capital of the foreign company will form the basis for the legal and accounting treatment of the branch in Japan. This is particularly relevant for large companies and financial service institutions.

2. Formation

a) In order to establish a branch, the foreign company has to appoint at least one legal representative, who must reside in Japan. The representative of the branch does not have to be the actual manager of the branch, but the representative will be regarded as the person legally entitled to conduct the business of the foreign company in Japan.

b) To register with the competent local Legal Affairs Bureau, an affidavit, including information of the foreign company, such as the company name, the business purpose, the names of the representative director(s), the establishment date, etc., needs to be prepared and signed by the representative(s) of the foreign company. The signature on the affidavit must be certified by a notary public of the signatory's home country. Alternatively, the affidavit can be prepared by the branch representative in Japan, setting forth the required information.

After the establishment of the branch, notification obligations to the Bank of Japan, the Labor Standards Inspection Office, Social Insurance Office, and the local as well as the national tax authorities are to be observed.

3. Taxation

Even though the branch is not an independent legal entity, it is treated as a corporation under Japanese tax laws. As such the branch is subject to corporate tax on its Japanese source income.

Moreover, corporate inhabitant tax (all companies regarded in Japan are subject to a tax on their status of inhabitancy) is levied on the branch, with the basis of calculation being the stated share capital of the parent company. In some cases, this may render the establishment of a branch unattractive.

III. Kabushiki Kaisha

The joint-stock corporation or kabushiki kaisha (KK) is by far the most popular type of investment vehicle used by foreign companies in Japan. The KK is also the most widely established corporate form for local companies in Japan and enjoys a high acceptance in the business world. Due to its flexible legal structure and the limitation of liability, the KK is usually the preferred vehicle when investing in Japan.

1. Overview

The KK is an independent legal entity in which the liability of the shareholders is limited to the amount of their capital investment. The Japanese Company Act offers the set-up of several types of stock corporations as further illustrated in the enclosed table (cf. back page), which can be distinguished mainly by (i) the amount of the capital and (ii) their legal status as private or public corporations. A KK is regarded as a "large" corporation if it has a stated share capital of at least JPY 500 million or JPY 20 billion in liabilities. A "private" corporation has a stipulation in its articles of incorporation which subjects the transfer of shares to the approval of the shareholders' meeting or the board of directors, whereas a "public" corporation has no such restriction for at least one class of shares.

2. Formation

a) In order to establish a KK, foreign investors usually appoint a Japanese resident promoter who can handle the entire incorporation process by subscribing to at least one share. If the promoter subscribes to only one share and the investor to the remaining shares to be issued, a special establishment bank account needs to be set up for the transfer of the capital to Japan. Alternatively, the promoter may subscribe to all shares to be issued, allowing the transfer of the capital through a personal bank account of the promoter in Japan. While the shares held by the promoter are transferred in context of the establishment procedure to the foreign investor, paying the capital of the KK through the personal bank account of the promoter may not be in line with internal compliance requirements of the investor and bears the risk of misappropriation.

Alternatively, foreign investors can prepare an affidavit based on the corporate information of the foreign company, accompanied by an original excerpt from the commercial register which must be translated into Japanese. The signature on the affidavit must be certified by a notary public of the signatory's home country. The advantage in choosing a promoter residing in Japan lies mainly in the absence of the requirement to submit the parent company's documents and affidavits together with Japanese translations to the competent Legal Affairs Bureau, which saves time and reduces costs.

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The articles of incorporation have to be notarized by a Japanese notary public, after which a constituent general shareholders' meeting must be held to appoint the directors and statutory auditors. After a recent change of the registration practice in Japan, now all directors of a KK may reside outside of Japan.

b) Although there is no minimum capitalization requirement under the Japanese Company Act (theoretically allowing a "one-yen company"), the law prohibits dividend distribution if the company's net assets amount to less than JPY 3 million. Upon incorporation, the payment of share capital for the subscription of shares must be made from an account held by the foreign investor because Japanese law does not accept transfers from third parties on behalf of the investor.

c) In accordance with the Foreign Exchange Act the company's incorporation must be notified to the Bank of Japan by the 15th day of the following month during which the company was registered with the commercial registry. The company must also notify the competent Japanese national and local tax authorities after the company's incorporation without delay. All companies in Japan must file certified copies of their commercial registration with the Labour Standard Inspection Office, the Public Employment Security Office, and the Social Insurance Office in order to employ local staff. Joining the Japanese National Health Insurance, Employees' Pension Insurance, and Workers' Compensation and Unemployment Insurance is, in principle, mandatory for locally employed staff.

3. Taxation

A KK is subject to national corporation tax, local enterprise tax, and inhabitant tax. Further, the KK has to pay a 0.7% registration tax on its registered share capital. This does not apply to payments made to the capital reserve, which may account for up to 50% of the cash contribution to be paid at the time of the company establishment or at a subsequent capital increase. In principle, withholding tax is imposed on dividends to the parent company. This tax is reduced or not applied under double taxation treaties with various countries upon application to the competent tax authority in Japan. In addition, independent from its business income a corporation with a paid-in capital exceeding JPY 100 million is subject to enterprise tax depending on the size of its assets (this may also apply to the taxation of a branch).

IV. Godo Gaisha

The limited liability company or *godo gaisha* (GK) was created under the Japanese Company Act in 2005 as an alternative to the former company limited (*yugen gaisha*), which has been abolished. Similar to the so-called "small KK", it offers a legal structure particularly designed for small businesses. Although the GK is not nearly as common as the KK, a growing number of domestic and foreign companies are adopting this legal form, in particular for special purpose vehicles and similar investment structures.

1. Overview

The GK is modeled after the American limited liability company (LLC) and is a hybrid of a joint stock corporation and a partnership, combining the simplified internal structure of a partnership with limited liability for all its investors. With the unanimous consent of all its members, a GK may be converted into a KK at any time.

2. Formation

a) In order to establish a GK, an affidavit, including information of the GK to be established, such as the company name, the business purpose, the names of the representative director(s), the establishment date, etc., needs to be prepared and be signed by the representative(s) of the investors, the so-called "members". The signature on the affidavit must be certified by a notary public of the signatory's home country. Contrary to a KK, the articles of incorporation of a GK do not have to be notarized and must simply be registered together with the company's corporate seal with the competent Legal Affairs Bureau.

All members are legal representatives of the company, unless a specific member has been appointed as representative member. This representative member may either be a natural person or a corporation. If a corporation has been appointed as representative member, a manager (*shokumu shikkosha*) for the corporation's representation concerning GK matters needs to be appointed. All managers of the GK may reside outside of Japan.

b) There is no minimum capitalization requirement for a GK under the Japanese Company Act and capital contributions can be made in cash or in kind. While the latter does not, unlike for the KK, require an appraisal under court supervision, any contribution to the GK by a foreign investor may cause prenotification or post-reporting obligations to the Bank of Japan under the Foreign Exchange and Foreign Trade Law, depending on the investor's country of origin and the nature of the company's business. One of the advantages of a GK over a KK is that capital contributions may be made entirely to the capital reserve (*shihon jouyokin*) on which no 0.7% registration tax will be levied.

3. Taxation

GKs are subject to Japanese corporate income tax similar to a KK and no "pass through taxation" as in a (limited liability) partnership is available.

V. Disclaimer

The information contained in this newsletter is of general nature only and does not constitute legal advice or opinion. For any specific question on legal matters addressed in this newsletter, please contact a qualified attorney at our office. We do not provide services related to tax, accounting and social security matters and professional advice should be obtained separately in this respect.

Type of Stock Corporation(kabushiki kaisha)		Board of Directors ³	Number of Directors	Director's Term of Office	Board of Statutory Auditors ⁴	Number of Statutory Auditors ⁴	Statutory Auditor's Term of Office	External Statutory Auditor	External Auditor
Private Corporation (with limitation on transfer of all classes of shares ¹)	Small-sized	Optional	1 or more	Up to 10 years	Optional	0 or more ⁵	4 up to 10 years	Optional	Optional
	Large-sized ²	Optional	1 or more	Up to 10 years	Optional	1 or more	4 up to 10 years	Optional	Mandatory
Public Corporation (no limitation on transfer of at least one class of shares ¹)	Small-sized	Mandatory	3 or more	Up to 2 years	Optional	1 or more	4 years	Optional	Optional
	Large-sized ²	Mandatory	3 or more	Up to 2 years	Mandatory	3 or more	4 years	Mandatory	Mandatory

1 "Limitation" = the transfer of shares is subject to the approval of the shareholders' meeting or the board of directors.

2 "Large Corporations" = stock corporations with at least JPY 500 million in paid-in capital or JPY 20 billion in liabilities as of the most recent balance sheet.

3 Appointment of at least one director is mandatory. The establishment of a board of directors requires a respective provision in the articles of incorporation and the election of at least three directors. This is mandatory for corporations with no limitation on transfer of shares, i. e. "public corporations."

4 Alternatively, the company may install a "committee system" of compulsory committees, including an audit committee. In this case, the audit committee assumes the role of the (board of) statutory auditors.

5 A statutory auditor is mandatory when a board of directors is established (unless a committee system is adopted), but the statutory auditor may be replaced by an accounting counsellor in case of a private mid- or small-sized company.

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