

## **Joint Statement Regarding Article 821 of the Proposed Corporation Law**

The following is a joint statement by the American Chamber of Commerce in Japan (ACCJ), Australia New Zealand Chamber of Commerce in Japan (ANZCCJ) and European Business Council (EBC):

### **Background**

Article 821 of the proposed Corporation Law will have a massive negative impact on foreign companies doing, or seeking to do, business in Japan. This problem could have been avoided had the Article been drafted based on sufficient consultation with affected ministries and industries. The contents of Article 821 are completely different from the version that was submitted for public comment in October 2003. Most firms became aware of the amended contents of Article 821 only after it passed the House of Representatives and just before the bill was submitted to the House of Councilors. Among the problems that will be created by Article 821 are the following:

#### **1. The economic impact of introducing Article 821 into the Corporation Law is immense.**

Article 821 affects not only foreign financial services firms (especially securities and asset management firms) but also firms in industries such as pharmaceuticals, consumer goods, trading companies, project management, law as well as companies owning property in Japan. In only a few days after being advised of the issue, more than 100 firms have informed our associations that they may be required to reincorporate and **suffer significant financial losses and business disruption** as a consequence of the new law. The actual number of affected firms is doubtless, substantially larger than those that have come forward so far.

#### **2. Article 821 will have a negative economic impact on companies that are longstanding good corporate citizens in Japan.**

Existing tax losses for Japan branches that have been carried forward will be lost and irrecoverable. There is significant potential tax exposure due to goodwill recognition and foreign exchange gain recognition on home office cash injections. Transaction taxes, including consumption tax would be required on the transfer of real estate and other assets. Potential tax exposure for some affected U.S. and European companies will reach into the hundreds of millions of dollars. Valuation losses would crystallize and require funding. All staff contracts would have to be renewed and pension schemes would have to be revised; employees wishing to retire and receive retirement payments may be eligible to do so. Contracts would have to be renegotiated and entered into again. Companies would also be forced to change product packaging, obtain new licenses, change IT systems and transfer employees to new entities. These changes would be extraordinarily expensive and disruptive to the ongoing operations of the business.

Even ignoring the tax consequences to affected companies, the cost of transitioning even a small or medium-size business to a kabushiki kaisha structure is estimated by some foreign companies to be at US\$ 5-10 million,

including administrative costs and registration fees. Packaging changes alone at one potentially affected company could reach \$5 million. Therefore, at a minimum, the economic cost of adopting Article 821, if only 100 firms were required to incorporate, would likely be several billion U.S. dollars.

### **3. Article 821 would discourage Foreign Direct Investment in Japan.**

Article 821's implementation imposes an undue burden on many foreign companies that have been operating responsibly in the Japanese market, thereby seriously weakening the Prime Minister's stated goal of doubling foreign investment by 2008 as well as the Financial Services Agency's objective of helping Japan become a "Highly-Advanced Financial Services Country."

A branch of a foreign company is typically a preferred legal entity form for new investors given the simplicity of setting up a branch and the flexibility to carry tax losses (most new businesses incur losses in their first few years of operation) into their overseas parent. It is important to note that carrying tax losses overseas into the parent does not result in lowering the entity's tax burden in Japan. The foreign branches in Japan are taxed at the same rate as other incorporated Japanese entities such as a KK or YK.

### **4. Japan's legal and administrative infrastructure is completely unequipped to deal with the potential flood of reincorporations.**

Most companies affected by this legislation are licensed and regulated entities. In addition to local government branches needing to handle reincorporation procedures, various government ministries would be required to re-license the affected companies. For companies seeking to reincorporate through a business transfer to a new kabushiki kaisha, a court-appointed appraiser would need to value the assets. There are not enough qualified appraisers in Japan to handle this task for the number of potentially affected companies.

### **5. Article 821 raises serious concerns regarding Japan's compliance with its GATS commitments.**

Article XVI:2(e) of GATS prohibits restrictions on the type of legal entity by which foreign companies may operate in a given country. While there is an exception in the financial services area for prudential limitations, that is not an issue in this case. To restrict the use of the branch form of entry into Japan, as Article 821 does, raises serious questions about the Article's validity under GATS.

### **Summary**

The Ministry of Justice claims that Article 821 was intended to clarify existing ambiguities in the Japanese Commercial Code and case law precedent. However, Article 821 ignores and reaches beyond decades of existing practice. Article 821 casts into doubt the legal and corporate structure by which foreign companies have operated in Japan for more than 50 years. This will create serious confusion for businesses in numerous industries, their employees, customers, and regulators with NO ADDED BENEFIT TO THE JAPANESE GOVERNMENT, JAPANESE CITIZENS OR THE COMPANIES THEMSELVES.