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TAX ON TRANSACTIONS

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# Tax on corporate transactions in Japan: overview

Masaki Noda, Daichi Iinaga and Takamasa Nishihara
Nishimura & Asahi

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## TAX AUTHORITIES

**1. What are the main authorities responsible for enforcing taxes on corporate transactions in your jurisdiction?**

### National tax

The main authority responsible for enforcing national taxes is the National Tax Agency (NTA) (*kokuzei-cho*), which is an external body of the Ministry of Finance. The NTA is responsible for assessing and collecting taxes.

The NTA has:

- One head office.
- 11 regional taxation bureaus (*kokuzei-kyoku*).
- One Okinawa regional taxation office (*Okinawa kokuzei-jimusho*).
- 524 tax offices (*zeimu-sho*).

### Local tax

The main authorities responsible for local taxes are the governors of each local government. The responsibilities of each governor are delegated to the tax department of the local government, which enforces local taxes in practice.

### *Pre-completion clearances and guidance*

**2. Is it possible to apply for tax clearances or obtain guidance from the tax authorities before completing a corporate transaction?**

Japanese tax laws do not provide a tax clearance system from the tax authority. However, in certain cases, a taxpayer can submit an enquiry before a transaction to request a written response from the NTA as to whether it will be subject to tax in accordance with NTA procedures. This advance enquiry would work as a de facto tax clearance. However, the written response from the NTA is not legally binding. A taxpayer requesting a written response must apply to the regional taxation bureau or the tax office that covers the place for tax payment. In addition, the content of the enquiry and response is published on the NTA website.

A taxpayer can also obtain informal guidance on the tax treatment of a particular transaction through informal consultation with the tax officers of the regional taxation bureaus or tax offices. This informal guidance may provide some comfort for the taxpayer, although it is also not legally binding. When requesting informal guidance, general practice is to disclose the taxpayer's identity and detailed information about the transaction.

### *Disclosure of corporate transactions*

**3. Is it necessary to disclose the existence of any corporate transactions to the tax authorities?**

### Disclosure during a transfer pricing examination

As a result of the 2016 tax reform, a corporation which has transactions with a related party (where the entire amount of those transactions during the preceding fiscal year exceeds JPY5 billion, or the amount of those transactions with regard to intangible property during the preceding fiscal year exceeds JPY300 million) must prepare "local files", which are necessary to calculate the arm's length price. The local files must be completed by the deadline for the tax return with regard to each fiscal year, and must be preserved for seven years (*Article 66-4(6), Act on Special Measures Concerning Taxation (ASMCT); Article 22-10, Ordinance for Enforcement of ASMCT*).

The local files comprise the following:

- Documents providing details of the foreign-related transactions of the corporation.
- Documents used by the corporation to calculate arm's length prices.

(*Article 22-10(1), Ordinance for Enforcement of ASMCT.*)

In addition, during a transfer pricing examination made by the tax authority, a corporation must present or submit to the examiners of the tax authority the local files (and the documents on which the local files are based) within 45 to 60 days after the examiners' request (*Article 66-4(8), ASMCT*).

If the corporation fails to present or submit the documents, the tax authority can assess taxable income using an estimation (*Article 66-4(8), ASMCT*), and can make inquiries with third parties engaged in the same kind of business as the foreign-related transaction, inspect documents of the business and require that documents be presented or submitted if needed to calculate the arm's length price (*Article 66-4(11), ASMCT*).

## MAIN TAXES ON CORPORATE TRANSACTIONS

### *Transfer taxes and notaries' fees*

**4. What are the main transfer taxes and/or notaries' fees potentially payable on corporate transactions?**

### Corporation tax

See *Question 5*.

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### Registration and licence tax

**Key characteristics.** This tax is imposed on various registrations, such as registrations, charters, patents, licences, authorisations, permissions, and so on.

**Triggering event.** This tax is imposed on a change to the real estate/aircraft/ship register concerning real estate/aircraft/ship acquisition, and on a change or an amendment to certain factors concerning a company (for example, a company's name, office, directors, amount of capital) (*see Question 7, Registration and licence tax*).

**Liable party/parties.** The acquirer is liable to pay this tax.

**Applicable rate(s).** The tax basis is the value of the real estate, which is registered in the fixed asset tax rolls, and the standard rate with regard to the acquisition of land is 2%. This rate is reduced to 1.5% if registration is made on or before 31 March 2019 (*Item 1(2)c of Annex 1 to the Registration and Licence Tax Act (RLTA), Article 7, the supplementary provision of it, and Article 72(1)(i), ASMCT*).

### Real estate acquisition tax

**Key characteristics.** This is generally imposed on real estate acquisition. As an exception, real estate acquisition tax is not imposed on the transfer of real estate that is made through a merger or demerger (*Article 73-7(ii), Local Tax Act (LTA)*).

**Triggering event.** This tax is imposed when ownership of real estate is transferred.

**Liable party/parties.** The acquirer is liable to pay this tax.

**Applicable rate(s).** The tax basis is the value of the real estate, the amount of which is primarily derived from that registered in the fixed asset tax rolls. The standard rate is 4%, which is reduced to 3% if the real estates are residential buildings or lands and they are acquired on or before 31 March 2021, under Article 11-2 of the supplementary provision of the LTA (*Article 73-15, LTA and Article 11-2, the supplementary provision of LTA*).

### Stamp duty

**Key characteristics.** Stamp duty is imposed when certain types of documents are executed. No stamp duty is imposed on documents not listed in Annex 1 to the Stamp Tax Act, such as share purchase agreements.

**Triggering event.** This tax is imposed on a variety of documents, which include:

- Real estate transfer agreements (the level of tax per document can be up to JPY480,000) (*Article 91(2), ASMCT*).
- Business transfer agreements (the level of tax per document can be up to JPY600,000) (*Annex 1 to the Stamp Tax Act*).
- Share certificates (the level of tax per document can be up to JPY20,000) (*Annex 1 to the Stamp Tax Act*).
- Merger agreements and demerger agreements (the level of tax per document is JPY40,000) (*Annex 1 to the Stamp Tax Act*).

**Liable party/parties.** The person or entity that executes the documents must pay stamp duty.

**Applicable rate(s).** See above, *Triggering event*.

## *Corporate and capital gains taxes*

### 5. What are the main corporate and/or capital gains taxes potentially payable on corporate transactions?

The main corporate taxes that a corporation's income on corporate transactions is potentially subject to are:

- National corporation tax.
- Local inhabitants' tax.
- Local enterprise tax.

Local inhabitants' tax and local enterprise tax are imposed by each local government in accordance with the LTA and ordinances established by each local government, and therefore vary to some extent. In 2008, the government created a new local corporation special tax (*chihou-houjin-tokubetu-zei*) as an interim step in exchange for reducing the local enterprise tax.

### National corporation tax

This is imposed on the taxable income (*shotoku*) of domestic corporations, foreign corporations and other entities treated as corporations for Japanese tax purposes. Foreign corporations and other foreign entities are only liable to pay corporation tax on income from sources in Japan. Domestic corporations are liable to pay taxes on all taxable income from domestic and foreign sources.

A corporation's taxable income for each accounting period is generally calculated by subtracting deductible expenses from gross income. For deductible expenses, a company that consecutively files blue returns (*aoiro-shinkoku*) and incurs tax losses can, in principle, carry forward such losses to deduct from future taxable profits for up to the following ten years. However, note that losses incurred in fiscal years ending on or before 31 March 2008 can be deductible only for the following seven years, and losses incurred in fiscal years commencing between 4 April 2008 and 31 March 2018 can be deductible for the following nine years. Due to the 2016 tax reform, a ceiling on the deductible amount for companies other than small or medium-sized companies will be:

- Reduced to 60% of the taxable income for the fiscal year commencing between 1 April 2016 and 31 March 2017.
- Reduced to 55% of the taxable income for the fiscal year commencing between 1 April 2017 and 31 March 2018.
- Further reduced to 50% for the fiscal year commencing on or after 1 April 2018.

The normal statutory corporation tax rate is 23.4% for the fiscal year commencing between 1 April 2016 and 31 March 2018, and is 23.2% for a fiscal year commencing on or after 1 April 2018. A reduced rate of 15% applies to the first JPY8 million of taxable income earned by small or medium-sized companies, which are companies with a stated capital of JPY100 million or less.

### Local inhabitants' tax

The local inhabitants' tax consists of:

- Tax on a per capita basis, generally based on the capital amount of a corporation and the number of employees, which ranges from JPY70,000 to JPY3.8 million per year.
- Tax on a corporation tax basis, generally based on the amount of corporation tax.

The tax rate is generally 12.9% (the prefectural rate is 3.2%, and the municipal rate is 9.7%) for fiscal years commencing between 1 October 2014 and 30 September 2019, and is reduced to 7.0% (the prefectural rate is 1.0% and the municipal rate is 6.0%) for fiscal years commencing on or after 1 October 2019. Some prefectures, however, impose a slightly higher rate (for example, the tax rate



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applied to a corporation with its head office in the 23 special wards (*tokubetsu-ku*) of Tokyo ranges from 12.9% to 16.3% for fiscal years commencing between 1 October 2014 and 30 September 2019, and is reduced to 7% to 10.4% for fiscal years commencing on or after 1 October 2019).

### Local enterprise tax

The rates and calculation of local enterprise taxes generally differ depending on whether the stated capital amount of a corporation is over JPY100 million or not (*Article 72-2(1)(i), LTA*).

If the stated capital amount is over JPY100 million, local enterprise tax is imposed based on:

- A value added factor on the amount of the added value. The tax rate is generally 1.2%, but some prefectures impose a slightly higher rate (for example, the tax applied to a corporation with its head office in one of the 23 special wards (*tokubetsu-ku*) of Tokyo is 1.26%).
- A capital factor on the stated capital amount. The tax rate is generally 0.5%, but some prefectures impose a slightly higher rate (for example, the tax applied to a corporation with its head office in one of the 23 special wards (*tokubetsu-ku*) of Tokyo is 0.525%).
- An income factor on the taxable income. The progressive tax rate is generally from 0.3% to 0.7% for the fiscal years commencing on or before 30 September 2019, and from 0.4% to 1.0% for the fiscal years commencing on and after 1 October 2019, but some prefectures impose a slightly higher rate (for example, the tax rate applied to a corporation with its head office in one of the 23 special wards (*tokubetsu-ku*) of Tokyo is subject to a progressive rate from 0.395% to 0.88% for the fiscal years commencing on or before 30 September 2019, and has not been decided for the fiscal years commencing on and after 1 October 2019).

If the stated capital amount of a corporation is JPY100 million or less, local enterprise tax is only imposed under the income factor, at a progressive tax rate from 3.4% to 6.7%. However, some prefectures impose a slightly higher progressive tax rate (for example, a corporation with its head office in one of the 23 special wards (*tokubetsu-ku*) of Tokyo is subject to a progressive tax rate from 3.65% to 7.18%).

In addition, insurance companies, electrical suppliers and gas suppliers calculate this tax based on their income (*Article 72-2(1)(ii), LTA*).

### Local corporation special tax

In 2008, the Japanese government created a local corporation special tax in exchange for reducing the local enterprise tax, to redress the tax income gap between local governments and redistribute tax income among local governments. Local corporation special tax is applicable only for fiscal years commencing on or before 30 September 2019 and will be abolished from 1 October 2019 in exchange for the increase in the local enterprise tax. The amount of the local corporation special tax is generally:

- For fiscal years commencing between 1 April 2016 and 30 September 2019, 414.2% of the income factor tax amount of the local enterprise tax, if the stated capital amount of a corporation is over JPY100 million.
- 43.2% of the amount of the local enterprise tax, for other corporations.

(*Article 9, Act on Interim Measures Concerning the Local Corporation Special Tax.*)

### Special corporate enterprise tax

As a result of the 2019 tax reform, the special corporate enterprise tax was introduced, in exchange for reducing the local enterprise tax, and is applicable for the fiscal years commencing on and after 1 October 2019. The special corporate enterprise tax will be collected by the national government and reallocated to each local government (prefecture), to balance the tax revenue sources among local governments. If the stated capital amount is over JPY100 million, the special corporate enterprise tax is 260% of the general income factor tax amount of the local enterprise tax (*Article 7(i), Act on Special Corporate Enterprise Tax and Special Corporate Business Transfer Tax*).

### Local corporation tax

This tax was introduced for fiscal years commencing on or after 1 October 2014. The tax base is the base corporation tax liability (corporation tax liability before taking income/foreign tax credits, and so on into account) for each taxable fiscal year and the tax rate is 4.4% for the fiscal years commencing between 1 October 2014 and 30 September 2019, and 10.3% for the fiscal years commencing on or after 1 October 2019.

### Effective tax rate

The effective tax rate on taxable income for a Japanese corporation is generally about 29.97% for fiscal years commencing between 1 April 2016 and 31 March 2018, and about 29.74% for fiscal years commencing on and after 1 April 2018 (the rate is a little different in some prefectures).

### Tax treaties and domestic law

The Japanese government has entered into tax treaties and conventions with many countries. When a tax treaty is applied to a transaction and there are differences between the tax treaty and the domestic law, the tax treaty generally prevails. Tax treaties vary from country to country and stipulate many exemptions, reduced tax rates and requirements that may apply.

## *Value added and sales taxes*

### 6. What are the main value added and/or sales taxes potentially payable on corporate transactions?

### Consumption tax

**Key characteristics.** Consumption tax is similar to value added tax, as it is calculated by offsetting the amount of consumption tax on taxable purchases (and other certain amounts) from the amount of consumption tax on taxable sales (*Article 30, Consumption Tax Act*).

**Triggering event.** Consumption tax is imposed on taxable transactions, which generally include:

- The transfer or lease of assets or services that are provided as a business in Japan for consideration (domestic transactions) (*Article 4(1), Consumption Tax Act*).
- Import transactions (*Article 4(2), Consumption Tax Act*).

This chapter focuses on domestic transactions.

The transfer or lease of assets located in Japan is generally deemed to be made in Japan. However, consumption tax is not imposed on certain transactions, including the (*Article 6(1), Annex 1, Consumption Tax Act*):

- Transfer or lease of land.
- Transfer of securities, equity interests, loans and other similar financial instruments.

**Liable party/parties.** Residents, domestic corporations, non-residents and foreign corporations are liable to pay consumption tax, if the relevant transaction is a domestic transaction (*Article 5(1), Consumption Tax Act*).



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**Applicable rate(s).** The rate of consumption tax is generally 8%, which comprises 6.3% national tax and 1.7% local tax (*Article 29, Consumption Tax Act* and *Article 72-83, LTA*). As a result of the 2015 tax reform, this rate was due to be raised to 10% (7.8% national tax and 2.2% local tax) on 1 October 2019.

In addition, as a result of the 2016 tax reform, a lower consumption tax rate (8%) on certain goods (for example, foods and newspapers) was due to be introduced on and after 1 October 2019.

**Cross-border services via telecommunications.** Under the current Consumption Tax Act, consumption tax is not imposed on services that are provided to clients outside of Japan via telecommunications, because these transactions are considered to be neither domestic nor imports under the Consumption Tax Act. However, these transactions (including transactions that are categorised as giving authorisation to a person to exploit copyrighted works) on or after 1 October 2015 will be taxable when the recipient of the services is located in Japan.

## *Other taxes on corporate transactions*

### 7. Are any other taxes potentially payable on corporate transactions?

#### Registration and licence tax

When a corporation changes or amends registered matters, it must apply to alter or amend the registered matters with the relevant local legal affairs bureau, which triggers registration and licence taxes. A corporation that increases its stated capital must pay 0.7% registration and licence tax on the increased amount of stated capital (*Item 24(1)d-h of Annex 1 to the RLTA*). This rate may be reduced for a capital increase by merger.

## *Taxes applicable to foreign companies*

### 8. In what circumstances will the taxes identified in*Question 4* to *Question 7* be applicable to foreign companies (in other words, what "presence" is required to give rise to tax liability)?

#### Corporation tax

**Source rules.** Foreign companies are only liable to pay corporation tax and income tax on income from sources in Japan (domestic-source income) (*kokunai-gensen shotoku*), which is set out in the Income Tax Act (ITA) and the Corporation Tax Act (CTA) (*Article 161, ITA and Article 138, CTA*). Dividends paid by Japanese corporations to foreign corporations are deemed to be domestic-source income and are subject to withholding tax.

Income tax and corporate tax will be imposed on income attributable to a permanent establishment (PE).

**Taxation by self-assessment.** The scope of a foreign company's taxable income varies depending on whether it has a PE in Japan and accordingly the type of PE (*Articles 141 and 138, CTA*). For a foreign company that has branch offices, factories or any other fixed places for conducting business in Japan, all domestic-source income is subject to corporation taxes.Specific rules apply to other foreign companies, for example those involved in construction work in Japan for more than one year and those with a foreign company that has an agent in Japan authorised to conclude a contract on its behalf (excluding an independent agent).

Capital gains from the following transfers of certain shares held by a foreign company are subject to corporation taxes under certain conditions, even if the foreign company does not have a PE in Japan:

- The transfer of more than 2% (or 5%, if the shares are listed) of the shares in a corporation that derives 50% or more of the value of its gross assets directly or indirectly from real estate (including related rights on real estate) situated in Japan.
- The transfer of shares, that consists of 5% or more of the outstanding shares in a domestic corporation, by a foreign company, where the foreign company owns 25% or more of the domestic corporation's shares at any time during the taxable year of the transfer or during the two preceding years.

**Withholding tax.** Most domestic-source income paid to a foreign company is subject to withholding tax. The rate is generally 20.42%, but is 10.21% for certain income, or 15.315% for interest on Japanese national government bonds, local government bonds, bonds issued by a domestic corporation, bonds issued by a foreign corporation attributed to a business in Japan, and other certain domestic-source income (*Articles 212(1), 213(1) and 161, ITA, and Article 28, ASMRGEJE*).

A foreign company with a PE in Japan may be exempt from withholding tax on certain types of income if it obtains a certificate from the relevant authorities and provides a copy of this certificate to the payer of the income (*Article 214, ITA*).

#### Registration and licence tax

Registration and licence tax relating to transfer of real estate (*see Question 4*) applies to foreign companies, irrespective of whether they have a PE in Japan. Registration and licence tax relating to other corporate transactions (*see Question 7*) does not generally apply to foreign companies.

#### Real estate acquisition tax

Real estate acquisition tax (*see Question 4*) applies to foreign companies, irrespective of whether they have a PE in Japan.

#### Stamp duty

Stamp duty (*see Question 4*) applies to foreign companies if the relevant agreements or documents are executed in Japan, irrespective of whether they have a PE in Japan.

#### Consumption tax

Consumption tax (*see Question 6*) applies to foreign companies if they conduct a transaction subject to consumption tax, regardless of whether they have a PE in Japan.

## DIVIDENDS

### 9. Is there a requirement to withhold tax on dividends or other distributions?

Dividends or any other form of distribution (including capital repayments or part of the consideration for a share buyback (*see Question 30*)), paid by one Japanese corporation to another Japanese corporation, are subject to withholding tax. The standard rate is 20.42%, which was reduced to 15.315% if shares in the distribution payer are listed on a stock exchange. Individual shareholders who have less than 3% of the shares of a distribution company can also enjoy the reduced tax rate of 20.315%, which consists of 15.315% national tax and 5% local tax (*Article 212(3) and Article 213(2)(ii), ITA; Article 28, ASMRGEJE; Article 9-3, ASMCT* and *Article 33(2)*). As an exception, dividends-in-kind paid between Japanese corporations within a 100% Group (*see Question 11*) are not subject to withholding tax (*Articles 212(3), 174(ii) and 24(1), ITA*).

For the taxation on dividends paid to foreign companies, see *Question 8*.



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## SHARE ACQUISITIONS AND DISPOSALS

### *Taxes potentially payable*

**10. What taxes are potentially payable on a share acquisition/share disposal?**

**Corporation tax**

Corporation tax is generally imposed on capital gains or losses from the disposal of shares (*see Question 5*).

**Stamp duty and consumption tax**

These do not apply to a share acquisition or share disposal (*see Question 4 and Question 6*).

### *Exemptions and reliefs*

**11. Are any exemptions or reliefs available to the liable party?**

**Qualified reorganisations**

Taxation on share acquisitions and disposals that are made through a merger, demerger, share exchange (*kabushiki-kokan*), share transfer (*kabushiki-iten*) or capital contribution-in-kind can be deferred, if they satisfy certain requirements (*see Question 21, Question 24 and Question 27*).

**Group taxation regime**

A group taxation regime, which was introduced in 2010, applies to Japanese corporations in a 100% Group. A 100% Group is a group comprised of corporations having a 100% control relationship. A 100% control relationship is either:

- A relationship in which a person or entity holds directly or indirectly all of the outstanding shares in a corporation.
- A relationship between corporations where all of the outstanding shares in the corporations are held by the same person or entity.

If a Japanese corporation transfers certain assets (excluding an asset whose book value is less than JPY10 million) to another Japanese corporation that is within the same 100% Group, recognition of capital gains or losses are deferred until certain trigger events occur such as re-transfer, depreciation, or revaluation of the transferred assets, or dissociation of the transferee corporation (*Article 61-13, CTA, Article 122-14(1), Order for Enforcement thereto*).

### *Tax advantages/disadvantages for the buyer*

**12. Please set out the tax advantages and disadvantages of a share acquisition for the buyer.**

**Advantages**

The tax position of the target company (target), which may be directly or indirectly advantageous to the acquirer, is not changed by the acquisition of the target's shares. For example:

- The unrealised gain or loss in the target is not realised at target level.
- Net operating losses, losses carried forward and built-in losses on target assets remain in the target.

The following taxes do not apply to a share acquisition (*see Question 4 and Question 6*):

- Registration and licence tax.
- Real estate acquisition tax.
- Stamp duty.
- Consumption tax.

**Disadvantages**

The disadvantages include the following:

- The target cannot step up the tax basis of its assets on the acquisition of the shares in the target.
- The buyer may not recognise goodwill with regard to the acquisition of the shares. As a result, the amortisation cost may not be deductible from the buyer's taxable income (unlike the tax treatment of a merger where it is deductible).

### *Tax advantages/disadvantages for the seller*

**13. Please set out the tax advantages and disadvantages of a share disposal for the seller.**

**Advantages**

The advantages include the following:

- The seller can deduct the amount it paid for the shares as a transfer cost from the amount of consideration it receives when selling the shares.
- Separate withholding tax applies on a capital gain by an individual shareholder, at a lower rate.
- Registration and licence tax, real estate acquisition tax, stamp duty and consumption tax, which would otherwise negatively affect the purchase price, do not apply to a share disposal (*see Question 4 and Question 6*).

**Disadvantages**

The disadvantages include the following:

- Net operating losses, losses carried forward and built-in losses relating to target assets are not available for the seller.
- The seller cannot avoid taxation of capital gains or losses unless it uses a share exchange (*kabushiki-kokan*) or share transfer (*kabushiki-iten*) that satisfies certain requirements (*see Question 26 and Question 27*).

### *Transaction structures to minimise the tax burden*

**14. What transaction structures (if any) are commonly used to minimise the tax burden?**

**Qualified share exchange and share transfer**

See *Question 11, Question 13, Question 26*and*Question 27.*

**Dividend payment before transfer (dividend received deduction)**

The full amount of a dividend (after deducting interest expenses relating to debt used to acquire the subject shares) received by a corporation that continuously owns more than 1/3 of the outstanding shares in the corporation paying the dividend, in general, during the period from the day after the base date of the previous dividend payment to base date of the dividend payment to the owner, is exempt from the corporate tax base of the receiving corporation.

20% of a dividend amount (without deducting interest expenses relating to debt used to acquire the subject shares) received by a corporation that owns 5% or less on the base day of the dividend payment to the owner is exempt from the corporate tax base of the receiving corporation.



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Half of a dividend amount (without deducting interest expenses relating to debt used to acquire the subject shares) received by a corporation other than set out above is exempt from the corporate tax base of the receiving corporation (*Article 23, CTA*).

For a dividend paid between 100% Group corporations, the amount of the dividend is entirely excluded from its taxable income.

Paying excess cash in the target to the seller as dividends before selling the target's shares reduces the market value of the shares. Therefore, this can reduce the total amount of tax paid on the whole transaction.

## ASSET ACQUISITIONS AND DISPOSALS

***Taxes potentially payable***

### 15. What taxes are potentially payable on an asset acquisition/asset disposal?

#### Corporation tax

Corporation tax is imposed on the seller of an asset relating to a capital gain from the sale (*see Question 5*).

#### Registration and licence tax

Registration and licence tax is imposed on a real estate buyer on a change in the real estate register (*see Question 4*).

#### Real estate acquisition tax

Real estate acquisition tax is imposed on a real estate buyer. The tax base is the assessed value of the real estate (*see Question 4*).

#### Stamp duty

Stamp duty is imposed on certain types of asset transfer agreements, including real estate transfer agreements and business transfer agreements (*see Question 4*).

#### Consumption tax

Consumption tax applies to a transfer of assets (*see Question 6*).

***Exemptions and reliefs***

### 16. Are any exemptions or reliefs available to the liable party?

#### Qualified reorganisations

Taxation on asset acquisitions and disposals made through a merger, demerger, share exchange (*kabushiki-kokan*), share transfer (*kabushiki-iten*) or capital contribution-in-kind may be exempted if they satisfy certain requirements (*see Question 21, Question 24* and *Question 27*).

#### Group taxation regime

Taxation on acquisitions and disposals of certain assets made between 100% Group corporations is deferred (*see Question 11*).

Real estate acquisition tax is not imposed on a transfer of real estate made by merger or demerger (*see Question 4*).

***Tax advantages/disadvantages for the buyer***

### 17. Please set out the tax advantages and disadvantages of an asset acquisition for the buyer.

#### Advantages

The advantages include the following:

- The tax base of the transferred asset may be stepped up.
- Goodwill recognised by a buyer can be amortised and the amortisation cost is deductible from the buyer's taxable income.

#### Disadvantages

The disadvantages include the following:

- The buyer cannot inherit net operating losses and losses carried forward from the seller in an asset acquisition.
- Registration and licence tax, real estate acquisition tax, stamp duty and consumption tax can apply to an asset acquisition.

***Tax advantages/disadvantages for the seller***

### 18. Please set out the tax advantages and disadvantages of an asset disposal for the seller.

#### Advantages

The advantages include the following:

- An unrealised loss on the transferred asset is realised.
- Net operating losses and losses carried forward are available to offset capital gains arising from an asset disposal.

#### Disadvantages

The disadvantages include the following:

- An unrealised gain on the transferred asset is realised.
- Registration and licence tax, real estate acquisition tax, stamp duty and consumption tax, which negatively affect the purchase price, can apply to an asset disposal (*see Question 4*).

***Transaction structures to minimise the tax burden***

### 19. What transaction structures (if any) are commonly used to minimise the tax burden?

#### Qualified reorganisations or group taxation regime

Tax qualified transactions can be used, and it is especially common to seek them in transactions where the seller or target has large built-in gains on the transferred asset (*see Question 16, Question 21, Question 24 and Question 27*).

## LEGAL MERGERS

***Taxes potentially payable***

### 20. What taxes are potentially payable on a legal merger?

A legal merger is generally treated in two steps for tax purposes as follows:

- **Step A.** A target is deemed to transfer all of its assets and liabilities to an acquiring company (acquirer). The acquirer is deemed to pay cash or transfer its assets (for example, its shares) to the target, as consideration for the assets and liabilities transferred from the target.
- **Step B.** The target is deemed to distribute cash or assets received as consideration from the acquirer to its shareholders (target shareholders) immediately after receiving them. The target shareholders are deemed to transfer their shares to the target in exchange for the money or assets distributed by the target.

It is assumed that the shareholders of both companies in the legal merger are corporations.

There are tax consequences at corporate and shareholder level.



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### Taxation at corporate level

**Corporation tax.** The target must recognise capital gains or losses on the assets transferred in Step A (whereas the target is not subject to taxes in Step B), unless the requirements for a qualified merger (defined in *Question 21*) are satisfied. Corporation tax is not generally levied on the acquirer for the acquisition in Step A, unless the consideration from the acquirer to the target consists of assets other than the acquirer's shares.

**Registration and licence tax/stamp duty.** Registration and licence tax may be imposed and the acquirer is liable to pay it (*see Question 4 and Question 7*). Stamp duty is also levied on a merger agreement (*see Question 4*).

**Other taxes.** Consumption tax is not levied on the transfer of the target's assets in a legal merger (*Article 2(1)(iv), Order for Enforcement of the Consumption Tax Act*). Real estate acquisition tax is not levied on the transfer of real estate in a legal merger (*see Question 4*).

### Taxation at shareholder level

**Corporation tax.** A certain part of the fair market value of the consideration that each of the target shareholders receives from the target in Step B is generally deemed to be a dividend (*Article 24, CTA*), unless the requirements of a qualified merger (defined in *Question 21*) are satisfied. The remaining amount is deemed to be consideration for the transfer of shares in the target, which results in a capital gain or loss for the target shareholder (*Article 61-2, CTA*), unless certain requirements (*see Question 21*) are satisfied.

The deemed dividend for each target shareholder is equal to the amount of the fair market value of the acquirer's shares that are received by each of the target shareholders, less an amount roughly equivalent to the total capital and capital reserves of the target multiplied by the percentage of target shares held by the shareholder (the precise formula is set out in the CTA).

## *Exemptions and reliefs*

### 21. Are any exemptions or reliefs available to the liable party?

### Qualified merger: taxation at corporate level

In a merger that satisfies certain requirements set out below (qualified merger), the target is deemed to transfer all of its assets and liabilities to the acquirer at book value and, simultaneously, the acquirer receives them at book value, which results in a deferral of the recognition of capital gains or losses (*Article 62-2, CTA*).

The requirements for a transaction to qualify as a qualified merger vary depending on the capital relationship between the target and the acquirer. This capital relationship is classified into three categories:

- A 100% relationship.
- A less than 100% but more than 50% relationship.
- A 50% or less relationship.

(*Article 2, Item 12-8, CTA.*)

The requirements to qualify generally become more stringent the lower the level of the capital relationship. The requirements for a qualified merger are as follows:

- **100% relationship.** The target or the acquirer must own directly or indirectly all the shares issued by the other party, or all of the shares of both the target and the acquirer must be directly or indirectly owned by the same individual or the same company (100% relationship).
- The only requirement, which is that the consideration from the acquirer must solely consist of shares of the acquirer or shares in the acquirer's wholly owning parent company that directly or indirectly owns all its shares (parent company), applies if the acquirer does not have 2/3 or more of the target shares.
- **Relationship of less than 100% but more than 50%.** The target or the acquirer owns directly or indirectly less than 100% but more than 50% of the shares of the other party, or less than 100% but more than 50% of the shares of both the target and the acquirer are directly or indirectly owned by the same individual or the same company. The requirements are as follows:
  - the same requirement for a 100% relationship (*see above, Qualified merger: taxation at corporate level*);
  - about 80% of the target employees will continue to engage in the business of the acquirer (including its wholly-owned subsidiaries) after the merger;
  - the principal target business (or a target business, if it has several) will continue to be conducted by the acquirer (including its wholly-owned subsidiaries).
- **50% or less relationship.** Where the target and the acquirer do not have a 100% relationship or a less than 100% but more than 50% relationship, a merger to jointly conduct a business may still be treated as a qualified merger if all the following requirements are met:
  - the same requirements for a less than 100% but more than 50% relationship (*see above, Qualified merger: taxation at corporate level: Relationship of less than 100% but more than 50%*);
  - a mutual connection between the principal target business and any business of the acquirer (not limited to its principal business);
  - either: the sales amount, number of employees, capital amount or other similar characteristics of the target's principal business or a related business of the acquirer is no more than about five times greater than the size of that of the other; or at least one of the senior directors or equivalent in the target and in the acquirer before the merger is respectively expected to be appointed as a senior director or equivalent of the acquirer after the merger:
  - the target shareholders who are expected to hold shares of the acquirer (or the parent company) after the transaction must hold at least 80% of the shares of the target before the transaction. This requirement does not apply if no one has a 50% or more relationship with the target immediately prior to the merger.

### Qualified merger: taxation at shareholder level

If the merger qualifies as a qualified merger, the target shareholders do not need to recognise deemed dividends (*Article 24(1)(i), CTA*).

If the consideration paid for the merger consists solely of the acquirer's shares or the shares of the parent company, the consideration amount of the shares transferred by the target shareholder is deemed to be their book value, regardless of whether the merger qualifies as a qualified merger. This results in a deferral of the recognition of capital gains or losses for the target shareholders (*Article 61-2(2), CTA*).

### Group taxation regime

Recognition of capital gains or losses on certain assets is deferred for mergers between members of a 100% Group regardless of whether or not the merger is a qualified merger (*see Question 11*).



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### *Transaction structures to minimise the tax burden*

**22. What transaction structures (if any) are commonly used to minimise the tax burden?**

**Qualified merger**

If the target has a lot of properties with built-in gains, it is common to seek a qualified merger to defer recognising capital gains. In many cases the acquirer purchases the majority of the target's shares before the merger in order to be sure that it meets the requirements for a qualified merger.

**Non-qualified merger**

If the target has a lot of properties with built-in losses, it is common to seek a non-qualified merger (a legal merger that does not meet the requirements of a qualified merger), to realise capital losses.

## JOINT VENTURES

### *Taxes potentially payable*

**23. What taxes are potentially payable on establishing a joint venture company (JVC)?**

The following two methods are commonly used to contribute assets to a joint venture company.

**Demerger**

In a demerger under the Companies Act, the assets and liabilities of a contributor's business are assumed by a newly established company in an incorporation-type demerger (*shinsetsu-bunkatsu*), or an existing company in an absorption-type demerger (*kyusyu-bunkatsu*). The company typically issues its shares to the contributor in exchange for the assets and liabilities transferred. From a tax perspective, there are two types of demerger:

- Spin-off-type demergers (*bunsya-gata-bunkatsu*).
- Separation-type demergers (*bunkatsu-gata-bunkatsu*).

In a separation-type demerger, consideration for the transferred assets and liabilities is immediately distributed to the contributor's shareholders once the contributor receives it. In a spin-off-type demerger, the consideration is not distributed to the contributor's shareholders. Since it is common to use a spin-off-type demerger to establish a joint venture company, we will first focus on the tax consequences of spin-off-type demergers, which include:

- **Corporation tax.** Capital gains or losses on assets that are transferred by the contributor are recognised for calculating its taxable income (*Article 62(1), CTA*) (*see Question 5*), unless the demerger satisfies requirements similar to those for a qualified merger (qualified demerger) (*see Question 21*). Taxes are only levied on the contributor, provided that the consideration consists solely of the contributed company's shares.
- **Registration and licence tax/stamp duty.** Registration and licence tax may be payable by the contributed company (*see Question 4 and Question 7*). Stamp duty is also levied on a demerger agreement (*see Question 4*).
- **Other taxes.** Consumption tax is not levied in a demerger (*see Question 20*). Real estate acquisition tax is not levied on the transfer of real estate in a demerger, under certain circumstances (*see Question 4*).

Conversely, as a result of the introduction of the spin-off taxation rules, a separation-type demerger for a business spin-off qualifies as a qualified demerger under all of the following conditions:

- **Consideration.** Only the shares in the contributed company are distributed to the shareholders of the contributor.
- **Non-control relationship.** The contributor is not controlled by any person before the demerger and the contributed company is not expected to be controlled by any person after the demerger.
- **Major assets and liabilities transfer.** The major assets and liabilities of the demerged business of the contributor are transferred to the contributed company by the demerger.
- **Employees transfer.** About 80% of the employees in the demerged business of the contributor will continue to engage in the contributed company's business (including its wholly-owned subsidiaries) after the demerger.
- **Business continuation.** The demerged business of the contributor will continue to be conducted by the contributed company (including its wholly-owned subsidiaries).
- **Director's continuation.** At least one of the senior directors or the equivalent in the contributor is expected to be appointed as a senior director (or equivalent) of the contributed company after the demerger.

**Contribution in-kind**

A contribution in-kind is treated as a transfer of assets from the contributor to a contributed company in exchange for shares in the contributed company for tax purposes.

**Corporation tax.** Corporation tax is levied on capital gains or losses from a transfer of assets in a contribution in-kind (*Article 22(2), CTA*), unless the contribution in-kind satisfies certain requirements similar to those for a qualified merger or a qualified demerger (qualified contribution in-kind) (*see Question 5 and Question 21*).

**Other taxes.** Real estate acquisition tax is not levied on the transfer of real estate in a contribution in-kind, under certain circumstances (*see Question 4*). On the other hand, unlike a legal merger or demerger, consumption tax is levied on the transfer of certain assets in a contribution in-kind (*see Question 6 and Question 21*). Registration and licence tax and stamp duty are also generally levied (*see Question 4 and Question 7*).

### *Exemptions and reliefs*

**24. Are any exemptions or reliefs available to the liable party?**

**Qualified demerger or contribution in-kind**

Recognition of capital gains or losses from the transfer of assets in a demerger or contribution in-kind is deferred if the demerger or contribution in-kind satisfies the requirements of a qualified demerger or qualified contribution in-kind (*Articles 2, Items 12-11 to 12-14, 62-2, 62-3 and 62-4, CTA*) (*see Question 23*).

**Group taxation regime**

Recognition of capital gains or losses from a transfer of certain assets between Japanese companies in a 100% Group is deferred until certain events occur including, among others, re-transfer, depreciation or revaluation of transferred assets (*see Question 11*).



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### *Transaction structures to minimise the tax burden*

#### 25. What transaction structures (if any) are commonly used to minimise the tax burden?

**Qualified demerger or contribution in-kind**

If contributed property has an unrealised gain, it is common for the contributor to seek a qualified demerger or a qualified contribution in-kind.

**Non-qualified demerger or contribution in-kind**

If the contributed property has an unrealised loss, it is common for the contributor to seek a non-qualified demerger or a non-qualified contribution in-kind.

## COMPANY REORGANISATIONS

### *Taxes potentially payable*

#### 26. What taxes are potentially payable on a company reorganisation?

**General**

Legal mergers, demergers, share exchanges (*kabushiki-kokan*) and share transfers (*kabushiki-iten*) are all categorised as reorganisations (*Companies Act*).

For the tax consequences of legal mergers and demergers, see *Question 20* to*Question 24*.

**Share exchange and share transfer**

In a share exchange under the Companies Act, an existing company (A) becomes a wholly owned subsidiary of another existing company (B) by transferring, by operation of law, all the shares in A to B, in exchange for issuing or transferring shares in B to A's shareholders.

In a share transfer under the Companies Act, a company (C) becomes a wholly owned subsidiary of a newly formed parent company (D) by transferring, by operation of law, all the shares in C to D, in exchange for issuing shares in D to C's shareholders.

**Taxation at corporate level**

Although no assets are transferred from the company that becomes the wholly owned subsidiary in both cases (unless a share exchange or share transfer is categorised as a qualified share exchange or qualified share transfer (*see Question 27*), certain assets of the subsidiary must be revalued at fair market value, so that corporation tax is imposed on capital gains or losses that are deemed to arise (*Article 62-9, CTA*).

**Taxation at shareholder level**

The shareholders of the company that becomes the wholly owned subsidiary are not subject to income tax or corporation tax as long as they receive new shares in the company that becomes the parent company and so on (*Article 61-2(8)(10), CTA*) (*see Question 27*). However, since the shareholders transfer their shares and receive new shares in the company that becomes the parent company, income tax or corporation tax is imposed on the shareholder for capital gains or losses that are recognised in a share exchange or a share transfer (*Article 61-2(1), CTA*), unless certain requirements are satisfied (*see Question 27*).

### *Exemptions and reliefs*

#### 27. Are any exemptions or reliefs available to the liable party?

**Taxation at the corporate level**

In a share exchange or a share transfer that satisfies certain requirements (similar to the requirements for a qualified merger, see*Question 21*) (qualified share exchange or qualified share transfer) or is otherwise conducted in a 100% Group, the assets of the company that becomes the wholly owned subsidiary need not be revalued at fair market value. Therefore, capital gains or losses on those assets can be deferred (*Articles 62-9 and 2, Items 12-16 and 12-17, CTA*).

**Taxation at the shareholder level**

At shareholder level, recognition of capital gains or losses from the transfer of shares is deferred, regardless of whether the transaction qualifies as a qualified share exchange or qualified share transfer, if the consideration consists solely of either:

- The acquiring company's shares (for example, B or D in *Question 26*).
- The shares of the acquiring company's wholly owning parent company that directly or indirectly owns all of its shares (in the case of triangular reorganisations).

(*Article 61-2(8)(10), CTA.*)

### *Transaction structures to minimise the tax burden*

#### 28. What transaction structures (if any) are commonly used to minimise the tax burden?

**Qualified reorganisations**

It is common to use qualified reorganisations when the company that becomes a wholly owned subsidiary owns properties that have appreciated in value.

**Non-qualified reorganisations**

If a company has built-in losses, it is common to use non-qualified reorganisations.

## RESTRUCTURING AND INSOLVENCY

#### 29. What are the key tax implications of the business insolvency and restructuring procedures in your jurisdiction?

**Tax implications for the business**

In restructuring procedures such as those under the Civil Rehabilitation Act and the Corporate Reorganisation Act, a company revalues its assets at the start of the procedures and realises its gains or losses (*Articles 25 and 33, CTA*).

A company in restructuring can use its past net operating losses to offset gains from the procedures, such as income from discharge of debt or revaluation of its assets (*Article 59, CTA*).

**Tax implications for the owners**

The owner or shareholder of a company in a restructuring or insolvency can deduct as much as all of the amount of the company's shares from income, under certain requirements (*Article 33(2), CTA, Article 68(1), Order for Enforcement thereto and Corporation Tax Basic Circular (CTBC) 9-1-7, 9-1-8, 9-1-9, and 9-1-11*).



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### Tax implications for the creditors

**Bad debt loss.** Creditors can deduct the entire amount of the write-off or release of a loan under a borrower's legal insolvency procedure or reasonable out-of-court workout procedure (*CTBC 9-6-1*). Further, when it becomes clear to the creditor that the entire amount of the loan is uncollectable in light of the borrower's inability to repay and the value of the borrower's assets, the creditor can deduct the full amount of the write-off. Before such a deduction, the creditor must first dispose, and make collections based on, any collateral that secures repayment of the loan (*CTBC 9-6-2*).

A parent company is permitted to deduct the write-off or release of the loan to the subsidiary if it has to write off or release a loan to its subsidiary in connection with the winding-up or sale of the subsidiary (or a similar reason) and has a material reason to do so (such as if, for instance, the parent company may incur additional losses if it does not write-off or release the loan) (*CTBC 9-4-1*).

In these cases, the borrower is deemed to receive taxable debt-waiver income (that is, it is deemed to have received income equivalent to the debt that is released), which is taxable income. In certain cases (for example, under the Corporate Reorganisation Act), the borrower can use net operating losses that have already expired to offset this "debt-waiver" income.

**Bad debts reserve.** Japanese tax law allows creditors that credit amounts (within a certain limit) to a bad debts reserve account to deduct the credited amount that is reserved (*Article 52, CTA*). However, under the 2011 tax reform, this deduction was limited to:

- Small or medium-sized companies.
- Banks, insurance companies or other similar companies.
- Certain companies that hold certain monetary claims.

## SHARE BUYBACKS

***Taxes potentially payable***

**30. What taxes are potentially payable on a share buyback? (List them and cross-refer to*Question 4* to *Question 7* as appropriate.)**

### Corporation tax

In a share buyback, part of the received money is deemed to be dividends (*Article 24, CTA*) and the rest is deemed to be consideration for the purchased shares, which results in capital gains or losses for shareholders (*Article 61-2(1), CTA*) (*see Question 20*).

***Exemptions and reliefs***

**31. Are any exemptions or reliefs available to the liable party?**

### Dividend received deduction

Dividend received deduction (*see Question 14*) also applies to a deemed dividend in a share buyback, including, for the avoidance of doubt, when conducted by a Japanese corporation from another Japanese corporation in the same 100% Group.

***Transaction structures to minimise the tax burden***

**32. What transaction structures (if any) are commonly used to minimise the tax burden?**

It is unlikely that there is a specific structure that would minimise the tax burden triggered by a share buyback. However, in practice, the parties in a share buyback should carefully confirm whether they meet the requirements of a dividend received deduction beforehand.

## PRIVATE EQUITY FINANCED TRANSACTIONS: MBOS

***Taxes potentially payable***

**33. What taxes are potentially payable on a management buyout (MBO)?**

There are complex methods available to bring about an MBO and their tax consequences differ depending on each method.

One of the most common methods to bring about an MBO is as follows:

- The management buys a controlling stake in the target through a tender offer.
- After this, the management can squeeze out the remaining minority shareholders without their consent using the Demand for Shares Cash-Out procedure (*kabushiki-tou uriwatashi seikyu*) if the management can acquire 90% or more of the target's voting rights. It is not necessary to hold a shareholders' meeting at the target company under the Demand for Shares Cash-Out procedure.
- On the other hand, if the management cannot acquire 90% of the target's voting rights, it is possible to squeeze out the minority shareholders using the Consolidation of Shares method (*kabushiki heigou*). Under the Consolidation of Shares method, the target must hold its shareholders' meeting and the shareholders, including the management, resolve, with more than two-thirds of the voting rights present at the shareholders' meeting, to consolidate the target's shares by a ratio which results in:
  - the shares held by the management becoming one or more shares; and
  - the shares held by the minority shareholders becoming less than one (a fraction).
- The fraction must be sold so that the management can squeeze out the minority shareholders by buying, or allowing the target to buy, the fraction.

### Taxation at corporate level (target)

**Corporation tax.** Built-in-gains or built-in-losses on assets held by the target are not realised for tax purposes in a qualified stock exchange and so on (*kabushiki-kokan-tou*) (a Demand for Shares Cash-Out method, a Consolidation of Shares method, a merger, or a stock exchange, which satisfies requirements similar to those for a qualified stock exchange between the companies in a relationship of less than 100% but more than 50%). On the other hand, when the management uses a non-qualified stock exchange and so on to squeeze out the minority shareholders for cash instead, the target must recognise capital gains or losses, which are subject to corporation tax (*see Taxes potentially payable and Exemptions and reliefs*).

### Taxation at shareholder level (management that conducts an MBO)

**Corporation tax and individual income tax.** Capital gains or losses are not recognised by management that conducts an MBO in a qualified stock exchange and so on (*kabushiki-kokan-tou*). On the other hand, in a non-qualified stock exchange and so on, corporation tax or individual tax is imposed on the managements' income depending on whether the management is a corporation or an individual.



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### Taxation at shareholder level (minority shareholders)

**Corporation tax and individual income tax.** In any of the methods or schemes mentioned above, the minority shareholders squeezed out by cash must recognise capital gains or losses, and corporation tax or individual tax is imposed on their income depending on whether they are corporations or individuals.

***Exemptions and reliefs***

**34. Are any exemptions or reliefs available to the liable party?**

Management that conducts an MBO and its target can receive tax deferral treatment on capital gains or losses through a qualified stock exchange and so on (*kabushiki-kokan-tou*). In other words, by using a qualified stock exchange and so on (*kabushiki-kokan-tou*) to squeeze out the minority shareholders, the target is not required to recognise capital gains or losses.

***Transaction structures to minimise the tax burden***

**35. What transaction structures (if any) are commonly used to minimise the tax burden?**

### Scheme of class shares subject to a call

This depends on the actual situation, that is, on whether parties want to defer capital gains or realise capital losses. To defer capital gains or losses, the most common MBO method described in *Question 33* can be used for now (*see Question 33, Taxation at corporate level (target)*).

### Scheme of cash merger or cash stock exchange

If a party seeks to realise capital gains or losses, the management should buy a controlling stake in the target through a tender offer and a subsequent non-qualified stock exchange and so on to squeeze out the minority shareholders for cash (*see Question 33*).

## REFORM

**36. Please summarise any proposals for reform that will impact on the taxation of corporate transactions.**

The 2019 tax reform bill (2019 Tax Reform Proposals) was proposed by the Japanese government in February 2019. The purposes of the reforms included ensuring the Japanese economy's virtuous economic cycle, developing local public organisations continuously, preventing international tax avoidance, and others. The reforms include:

- Easing conditions for a qualified reorganisation (for example, when the consideration consists of the shares of the ultimate wholly owning parent company (that is, the indirect owner) in a merger, demerger, or share exchange (*kabushiki-kokan*), the requirement for consideration is satisfied).
- Introducing the special corporate enterprise tax, and reducing the corporate enterprise tax rates (although the total corporate enterprise tax rates will basically remain unchanged).
- Introducing the discount cash flow (DCF) method as a new transfer pricing method for calculating intangible transactions without comparables.
- Enabling the tax authority to correct the transfer price of transactions involving hard to value intangibles (HTVIs) if estimates used by the taxpayer to calculate the arm's length price differ from the tax office's determination by more than 20%.

# Practical Law **Contributor details**


**Masaki Noda**

Nishimura & Asahi

T +81 3 6250 6422
F +81 3 6250 7200
E m_noda@jurists.co.jp
W www.jurists.co.jp/en

**Professional qualifications.** Attorney-at-law, Japan, 2002; Attorney-at-law, New York, 2010

**Areas of practice.** M&A; corporate international transactions; tax advice.

**Daichi Iinaga**

Nishimura & Asahi

T +81 3 6250 6747
F +81 3 6250 7200
E d_iinaga@jurists.co.jp
W www.jurists.co.jp/en

**Professional qualifications.** Japan, 2014

**Areas of practice.** Tax law; corporate; M&A.




Sensitivity: Confidential

**Takamasa Nishihara**

Nishimura & Asahi

T +81 3 6250 6200
F +81 3 6250 7200
E t_nishihara@jurists.co.jp
W www.jurists.co.jp/en

**Professional qualifications.** Japan, 2017

**Areas of practice.** Tax law; corporate; M&A.



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