Structure of Joint Stock Corporation in Japan

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Overview

Japanese law provides for essentially six (6) types of business entities, most of which are analogous to business entities in the United States.

1. *Kabushiki Kaisha* (Joint Stock Corporation)

In character and structure, the joint stock corporation closely resembles the United States corporation. Like a corporation, it is governed by directors and officers, has perpetual life, and its shareholders' liability limited to invested capital.

Establishment of a joint stock corporation requires submission of notarized articles of incorporation listing the specific business purpose of the entity, a share subscription certificate signed by each shareholder, a bank certificate evidencing custody of the full subscription amount of all subscribed shares, minutes of the initial meeting, and designation of directors officers representative directors and statutory auditors. Upon registration, the name, number of issued shares, authorized capital, and the names of corporate officers and representative directors are entered on the registration record. A registration tax based on the amount of paid-in capital is imposed on all entities.

Legal authority for the management of a joint stock corporation is concentrated in the board of directors. A required minimum of three (3) directors are elected by resolution or at a shareholders' meeting held in accordance with the majority and quorum requirements of the Articles of Incorporation. Each director's term of office may not exceed two (2) years.

Directors may be held personally liable to the entity for damages resulting from personal transactions with the corporation, approval of illegal distribution of profits, granting loans from the corporation to a director, acts in competition with the corporation or violation of law or the Articles of Incorporation. Directors similarly may be held personally liable to third parties for damages resulting from the director's wrongful acts or gross negligence in the performance of their duties.

Each entity must appoint at least one (1) representative director (*daihyo torishimariyaku*), who is selected by a majority of the board of directors from among its members. Each representative director is authorized by law to perform all acts on behalf of the corporation and bind it with respect to third parties without further corporate authorization. Conversely, directors without representative power may not bind the corporation with respect to third parties without express corporate authorization. However, directors with titles indicating representative power, similar to those of officers in a United States corporation are considered "apparent" representative directors and may bind the corporation with respect to third parties who are unaware of the absence of representative power and act in good faith.

Each entity must also appoint at least one (1) statutory auditor (*kansayaku*). Large corporations with paid-in capital in excess of ¥500 million or total liabilities of ¥20 billion or more must have three (3) or more statutory auditors, who form a board of statutory

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auditors. A statutory auditor must be an individual and may not be or have been a director or employee of the entity or any of its subsidiaries for five or more years. Statutory auditors are elected by a majority of shareholders for a mandatory term of three (3) years. Statutory auditors may be held liable to the entity for damages resulting from negligence and to third parties for damages resulting from wrongful conduct or gross negligence in the performance of their duties.

Large joint stock corporations must also elect an accountant auditor (*kaikei-kansanin*), who is primarily responsible for auditing the financial statements of the corporation. The accountant auditor must be a certified public accountant or a firm of certified public accountants.

2. *Yugen Kaisha* (Limited Corporation)

The limited corporation is similar to the limited liability corporation in the United States. The limited corporation is an independent legal entity, has perpetual life and investor liability limited to the amount of invested capital. Management authority is vested in directors who represent the corporation.

As with a limited liability corporation, the Articles of Incorporation of a limited corporation must include the names and addresses of each member and the number of investment units held. Depending on the terms of the Articles of Incorporation, members may receive disproportionate voting rights and economic preferences to dividends and liquidation proceeds. There may be no more than fifty (50) members of a limited corporation absent with court approval, and the transfer of investment units to a non-member must be approved by resolution of a majority of the existing members. A limited corporation must have at least one director with authority to represent the entity, to perform all acts on its behalf and to bind it with respect to third parties without further corporate authorization. The limited corporation is not required to appoint a statutory auditor.

3. *Gomei Gaisha* (Unlimited Commercial Partnership Corporation)

The unlimited commercial partnership corporation is similar to the general partnership in the United States. All partners are jointly and severally liable for the obligations of the partnership. However, unlike a general partnership, the unlimited commercial partnership corporation is a separate legal entity for all purposes including corporate income tax purposes. Corporations may not be partners of the unlimited commercial partnership corporation. Each partner has the right and duty to manage the affairs of the partnership corporation unless otherwise provided in the articles. Each partner has the authority to represent and to bind the partnership to third parties. All partners are jointly and severally liable for all liabilities of the partnership corporation in excess of its assets. A partner may be removed from the partnership corporation upon (i) the consent of all partners, (ii) death of the partner, (iii) declaration of bankruptcy, (iv) adjudication of incompetence, and (v) expulsion by court order or by a majority vote of the other partners for any of the following reasons: (1) competition with the partnership or becoming an officer of a competing company, (2) commission of a dishonest or unauthorized act in the administration of the partnership affairs wherein the representation of the partnership and (3) failure to perform an important duty. A withdrawn or removed partner will remain liable for all partnership obligations for a period of two (2) years. Upon dissolution, the partners remain liable for obligations of the partnership corporation for a period of five (5) years.

4. *Goshi Kaisha* (Limited Commercial Partnership Corporation)

The limited commercial partnership corporation is similar to an unlimited commercial partnership corporation except that there are partners of both unlimited and limited liability, similar to a United States limited partnership. The liability of limited partners in a limited commercial partnership corporation cannot exceed the amount of their partnership contributions. Again, the limited commercial partnership corporation is a separate legal entity for taxation purposes, and therefore does not enjoy the pass-through treatment available to partnership entities in the United States.

A limited partner of a limited commercial partnership corporation may not bind the partnership corporation with respect to third parties who are induced to believe that the limited partner had the authority to represent the partnership and who act in good faith. Is such cases, the limited partner is considered liable to the extent of a general partner.

5. *Kumiai* (Civil Code Association)

A Civil Code association is in many ways similar to an American partnership or joint venture. For Japanese tax purposes, profits and losses flow through the members in proportion to their interests. The association itself does not file a tax return, nor is the association recognized as a corporation under the Commercial Code. Rights to profits and liability for obligations and losses accrue to members in proportion to their respective contributions unless otherwise provided in the association agreement.

6. *Tokumei Kumiai* (Undisclosed Association)

An undisclosed association is an arrangement whereby an individual or entity undertakes a business activity on behalf of one or more undisclosed partner who will receive or bear a portion of the ultimate gain or loss in the business activity. Technically, each undisclosed partner has a separate contract with the entity and there is no contractual relationship among the undisclosed partners. Business is conducted entirely on the account of the establishing entity, and the income and expenses of the business do not flow through to the undisclosed partners. Rather, the undisclosed partners merely report for tax purposes their portion of the ultimate gain or loss as agreed by contract. For Japanese legal purposes, only the establishing entity is considered to be conducting the business, and such entity owns all assets and is liable for all liabilities of the business, although the partnership contracts may provide for the undisclosed partners to bear a portion of such liabilities.

9. <u>Acquisition of Business Entity in Japan</u>

In general, all acquisitions by foreign investors of shares in closely held Japanese companies are considered "direct investments" subject to a requirement of ex post facto notification in the name of the party to the transaction resident in Japan under the Foreign Exchange Control Law (Law No. 65, December 18, 1979). Similarly, ex post facto notification is required for the establishment of branch offices of foreign companies or the substantial alteration of their business activities. Ex post facto notification is also required for provision of industrial property rights, know-how or other rights to technology including licenses to a Japanese party. Loans of specified amounts by foreign parties are also subject to the ex post facto notification requirement.

Prior notification is required for "direct investments," including licenses of technology, which concern national security related interests or foreign acquisition of shares of Japanese companies which are engaged in (i) agricultural forestry and marine products; (ii) petroleum industries including exploration, production, refining and sales; (iii) leather and leather products manufacturing; and (iv) mining. In addition, there are eighteen (18) business categories including railways, civil aviation, banking, insurance, broadcasting and utilities which are regulated through a process of licensing on a case-by-case basis. Loans of extremely large amounts by foreign parties are also subject to prior notification. Foreign corporate shareholders of Japanese corporations are required under the Anti-Monopoly Law to file an annual report with the JFTC with respect to shares held directly or through affiliates. Certain restrictions are placed on the holding of shares of Japanese corporations by foreign and domestic financial institutions including banks, trust companies and securities firms. In general, these institutions may not hold more than five percent (5%) of the outstanding shares of any Japanese corporation. Insurance companies may hold not more than ten percent (10%) of such shares.