Doing Business in JAPAN
Doing Business in Japan

2018
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Foreword


The purpose of this publication is to provide a practical guide to the legal framework within which business is conducted in Japan. Japan has been and continues to be a world financial center with a highly active economy. Having a population of more than 120 million and the third highest global GDP makes Japan attractive to investors from all over the world.

Doing Business in Japan has been written by lawyers from our various specialist practice and industry groups. In this guide, we discuss various aspects key to doing business in Japan, including:

- Japan’s commercial laws;
- forms of business organization in Japan;
- the regulatory framework and compliance requirements affecting businesses in Japan; and
- Japan’s tax system as it applies to corporate and commercial activities.

Baker & McKenzie (Gaikokuho Joint Enterprise) is a Japanese member firm of Baker & McKenzie International, a global law firm with a network of 77 offices in 46 jurisdictions. Since being established in 1972, the Tokyo office has represented numerous foreign investors and multinational corporations in their business endeavors in Japan.

Our office is one of the largest international law firms in Tokyo with around 170 legal professionals engaged in a wide variety of areas of legal practice, including Corporate & Securities, Antitrust/Competition, Environment, Labor, Insolvency & Reorganization, Dispute Resolution/Compliance & Investigation, Banking & Finance, Capital Markets, Real Estate, Intellectual Property, Major Projects and Tax/Transfer Pricing. We also have specialists in a number of industry-focused fields such as Pharmaceutical, Automotive, Information Technology and Energy & Infrastructure.

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We hope that you find this guide a useful and practical resource. We look forward to working with you.

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Political & Legal Background

System of Government

There are two main levels of government in Japan: (1) national; and (2) prefectural. Under the Constitution of Japan, national legislative power is vested in the Diet. The Diet consists of two Houses: (1) the House of Representatives, and (2) the House of Councilors.

The current Constitution adopts the Parliamentary Cabinet system, under which the existence of the Cabinet, including the election of the Prime Minister, is dependent on parliamentary confidence in the Cabinet.

The prefectural assemblies of the 47 administrative prefectures have the power to govern and enact laws at a prefectural level. At the local level, there is a system of city, town and village municipal assemblies.

Aside from a short period from 2009 to 2012 during which the Democratic Party was in power, the Liberal Democratic Party has been in power since the 1950s and is the governing party in the second Abe administration. One of the Liberal Democratic Party’s goals is to amend the Constitution of Japan, which has not been revised since its promulgation in 1946.

Sources of Law

Japan is a civil law country, governed by laws passed by the Parliament and interpreted by the courts. The modern Japanese court and legal system was established at the beginning of the Meiji Era (1868-1912), modeled after the German and French legal systems of that time. After the Second World War, a major reform of the legal system took place in Japan with many of the revised laws modeled after American law. Today, the Japanese legal system remains a hybrid of the continental European system and the Anglo-American system.

The law-making process in Japan is outlined below:

(1) **Drafting of a legislative bill.** The relevant ministry with jurisdiction over the content of a bill draws up the first draft of a legislative bill. On the basis of this first draft, consultations take place with the other relevant ministries. If necessary, the draft bill is also referred to advisory councils or to public hearings. Upon due internal consultation, the legislative bill is considered ready and the ministry in charge formats the draft in the proper statutory form.

(2) **Examination by the Cabinet Legislation Bureau (the “Bureau”).** All legislative bills introduced by the Cabinet are examined by the Bureau before being brought before a Cabinet meeting. The Bureau examines the bill from all angles, both legally and technically. Once the preliminary examination is completed, the minister in charge of the legislative bill requests the Prime Minister to hold a Cabinet meeting regarding the submission of the bill to the Diet.

(3) **Cabinet decision to submit the bill to the Diet.** If the Cabinet decides in favor of submitting the bill without objection, the Prime Minister submits the bill to the Diet (either to the House of Representatives or to the House of Councilors). The administrative work related to the submission to the Diet of a bill introduced by the Cabinet is conducted by the Cabinet Secretariat.

(4) **Examination by the Diet.** When a legislative bill is submitted to either the House of Representatives or the House of Councilors, the leader of the House refers the bill to an appropriate committee. The committee then conducts an examination of the bill. The examination mainly follows a question-and-answer format during which the committee
Asks questions about the bill and the minister-in-charge responds to these questions. When the committee completes its questioning and deliberation, a vote is taken on whether or not to approve the bill. When the committee finishes its examination, deliberation continues at a plenary session of the House concerned. When the legislative bill is passed by the House to which it was first submitted, it is sent to the other House (the “Second House”). The same procedure is then followed by the Second House.

(5) **Enactment of new law.** Except as otherwise provided by the Constitution, a legislative bill becomes a law when it is passed by both the House of Representatives and the House of Councillors. As a matter of formality, the leader of the Second House then submits the new law to the Emperor for approval.

(6) **Promulgation of the new law.** The newly enacted law must be promulgated within 30 days from the date of its submission to the Emperor. Promulgation is by way of publication in the official gazette to ensure that a newly enacted law becomes widely known to the public. A law must be promulgated before it actually takes effect. Laws usually stipulate when they come into effect. When a law is promulgated, it is given a serial number and signed by both the state minister responsible for the law and the Prime Minister.

**Court System**

The Constitution of Japan provides that all judicial power in Japan is vested in the Supreme Court and in such lower courts as are established by law. The *Court Organization Law* establishes the following five types of courts in Japan, listed in order of judicial authority from the highest to the lowest:

1. **Supreme Court;**
2. **High Courts** (including the Intellectual Property High Court, which is a special division of the Tokyo High Court);
3. **District Courts;**
4. **Family Courts;** and
5. **Summary Courts.**

The respective courts have their own jurisdictions as provided by law. Each court renders a judgment independently and the decision of a superior court binds the courts below in respect of the case concerned. In contrast to common law jurisdictions, the doctrine of precedent (*i.e.*, the *stare decisis* principle) does not apply in Japan.

**Court Procedures**

**Civil Procedures – Developments**

To accommodate the increasing number and complexity of civil cases in Japan, some new practices have been developed in the area of civil procedure under the *Code of Civil Procedure*. Enacted in 1996, the *Code of Civil Procedure* has resulted in a reduction of the time needed for the disposition of cases.

In Japan, evidence is usually provided by way of statements or affidavits prepared by witnesses in advance. There is no “deposition” or discovery procedure available for the discovery of documents by parties to litigation before a matter is heard. However, amendments to the *Code of Civil Procedure* have adopted certain preliminary procedures for the collection of evidence. For example, prior to filing a lawsuit, a party may inquire in writing of a counterparty about matters which are clearly necessary to prove the allegations of the lawsuit. The court may, at this preliminary stage, upon a motion of a party and after hearing the views of the other party, make a request for the provision of a document or for government offices or other bodies to conduct an...
investigation. Document production from an adversary or third party by any other means must be handled at the oral argument stage. At that stage, the court may, upon a motion of a party, issue an order to produce documents in respect of which an obligation to produce is provided under the Code of Civil Procedure.

In civil suits, judges usually encourage the parties to a dispute to reach an amicable settlement prior to the court pronouncing judgment. Judges may also act as mediators and may make suggestions as to the content of a settlement agreement. An agreement reached through such court-sponsored mediation is registered with the court and is an enforceable contract.

The Japanese court system currently does not have jury trials for civil cases.

**Criminal Procedures – Developments**

There have also been developments in procedures for criminal cases in Japan. For example, a new law came into force in 2009 which provides for a system of lay judges, or “citizen judges” ("Saiban-in") in serious criminal cases. Under this law, Saiban-in selected from the public participate in trial proceedings and sentencing for serious criminal cases, together with three professional judges. Saiban-in proceedings are conducted for serious crimes such as homicide, robbery causing death or injury, arson of inhabited buildings and kidnapping for ransom.

The Saiban-in system is similar to the collaborative court system adopted in Germany (Schoffengericht) and France in that lay judges and professional judges form a panel to hear a matter. However, unlike the German and French systems, Saiban-in will only be engaged in fact finding and sentencing, while questions of law are left to the exclusive authority of judges. The Saiban-in system is also similar to the jury system adopted in the United States and other countries as both Saiban-in and juries are randomly selected from among people listed in the electoral register. They differ, however, in that under the Saiban-in system, Saiban-in form a panel with professional judges to make decisions together both on the issue of guilt and on the appropriate sentence to impose. Therefore, the Saiban-in system is quite unique to Japan as it differs from both the collaborative court system and the jury system used in other jurisdictions.

**International Arbitration and Mediation**

Besides using the Japanese court system, parties may agree to resolve commercial disputes by arbitration. In 2004, modern arbitration legislation (the Arbitration Law) took effect that is in line with UNCITRAL’s Model Law on International Commercial Arbitration. At the same time, Japan also modernized the rules of its main arbitral institution, the Japan Commercial Arbitration Association (JCAA). In 2014, updated JCAA rules became effective that include, among other things, provisions on consolidation, emergency arbitration, and powers of the arbitral tribunal to order interim measures.

Japan acceded to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) in 1961. Consistent with the New York Convention, under the Arbitration Law an arbitral award shall have the same effect as a final and conclusive judgment unless certain, limited grounds for refusing recognition and enforcement are present. These grounds include the invalidity of the arbitration agreement, significant lapses in due process, or public policy violations. Japanese courts, however, have made clear that public policy cannot be used as a “backdoor” means of bringing a challenge on the merits. Unlike in some jurisdictions, in Japan there is no power to appeal an arbitral award on the basis of an error of law or fact.

In addition to its arbitration rules, the JCAA introduced rules in 2009 to provide for third-party mediation of international commercial disputes. Another mediation institution, the Japan International Mediation Centre-Kyoto, is scheduled to open in 2018 and be based at Doshisha University.
Business Entity Forms and Structures

Introduction

There are a number of different forms of business entity and structure available to foreign companies contemplating doing business in Japan. The most commonly used are:

1. a joint-stock company, known in Japan as a “Kabushiki Kaisha” and commonly referred to as a “KK”;
2. a limited liability company, known in Japan as a “Gōdō Kaisha” and commonly referred to as a “GK”;
3. a branch office;
4. a representative office; and
5. general, limited and silent partnerships.

A key question for foreign companies contemplating doing business in Japan is what form of business operation is most appropriate for their objectives. In considering this question, foreign companies should take into account multiple factors, including tax implications, ease of setting up and maintaining local operations, contemplated business and investment scales, and levels of commitment in commercial activities in Japan.

The Baker McKenzie publication “Setting up Operations in Japan” provides further information by way of comparison, and considers the pros and cons of the most commonly used structures for doing business in Japan.

Joint-Stock Company (Kabushiki Kaisha)

Incorporation

A joint-stock company, which is referred to in Japanese as a “Kabushiki Kaisha” and is commonly abbreviated to “KK,” is the most commonly used form chosen by larger, more established companies for doing business in Japan. A KK is similar to a US close corporation or, when listed on a stock exchange, is akin to a US public corporation. It is also similar to the German AG corporate form.

As pre-existing “shelf” companies are generally not available in Japan, it is usually necessary to incorporate a new KK in order to establish a subsidiary in Japan. The process of incorporation takes about four weeks following finalization of the KK’s profile.

The Companies Act, which replaced the corporate section of the Commercial Code when it came into effect in Japan in May 2006, relaxed several restrictions in determining corporate structures and incorporation procedures. For example, while a KK must have at least one “incorporator” (hokkinin) during the incorporation process, this incorporator is no longer required to be a resident of Japan.

As regards corporate structures, a KK must have at least one shareholder to whom at least one share must be issued. A shareholder of a KK is generally not liable for the debts and other obligations of the company.

While the establishment of a KK is generally viewed as a relatively substantial commitment to the Japanese marketplace, a key reason for the popularity of this form among foreign companies is that the parent foreign company is not directly liable for the legal obligations of the Japanese subsidiary aside from in exceptional circumstances. Further, the maximum liability of the foreign parent company is generally the amount invested in the Japanese subsidiary and it is not
necessary to provide Japanese authorities with information concerning the operations and profits of the parent foreign company upon the establishment of a KK.

The business affairs of a KK are overseen by one or more directors (individually, or collectively if the KK decides to have a board of directors). Under the Companies Act, it is possible for a closed KK (i.e., one that restricts the transfer of shares in the Articles of Incorporation) to appoint only one director and, if only one director is appointed, said director automatically serves as a representative director. In addition, where a KK does not have a board of directors, appointing a company auditor is optional.

The Ministry of Justice recently issued a formal notice abolishing the long-standing practice of requiring a KK to appoint at least one representative director resident in Japan, so a KK can now be established and maintained without any individual officers being resident in Japan.

**Capital**

The Companies Act abolished the previous requirement of a minimum share capital of ¥10,000,000 for the incorporation of a KK. It is now possible for a KK to incorporate with capital of only one yen. However, a KK must have net assets of at least ¥3,000,000 before it may distribute profits to shareholders.

A share capital contribution may be made in the form of assets in lieu of cash if this option is provided for in the Articles of Incorporation. The Companies Act also relaxed the requirements relating to "investments-in-kind" to a limited extent. Under the Companies Act, inspection by a court-appointed inspector is not required for "investments-in-kind" if:

1. the assets to be contributed do not exceed ¥5,000,000 in value, if so provided in the Articles of Incorporation;
2. the asset is a security with a market price, and the value of the security does not exceed the market price of the security, if so provided in the Articles of Incorporation; or
3. the value to be contributed has been certified as a proper price by a professional such as a certified public accountant or an auditing company, if so provided in the Articles of Incorporation.

**Corporate Maintenance and Filings**

A KK is required to hold an annual general meeting ("AGM") within three months of the end of its business year to approve the financial statements for the preceding business period. Extracts of the approved financial statements must be published in the Official Gazette (Kampō), a daily newspaper or via an Internet announcement (if that method is provided for in the Articles of Incorporation).

Minutes of AGMs or other shareholder or board meetings must be filed with the Legal Affairs Bureau if any resolution is passed regarding a change in one of the company's registered matters (such as its directors, auditors, head office address, corporate name and capital amount).

**Limited Liability Company (Gōdō Kaisha)**

A limited liability company (LLC) in Japan, referred to in Japanese as a "Gōdō Kaisha" and commonly abbreviated as "GK," is modelled on the US LLC. The Companies Act made significant changes as regards business entity forms and introduced this new "hybrid entity," which combines the features of a company and a partnership. For example, a GK functions like a partnership internally, but the members' liability is limited.
A GK is exempt from a number of procedural requirements, such as the authorization of its Articles of Incorporation by a notary public. This makes it possible to incorporate a GK slightly more quickly than a KK; about three weeks are required to incorporate a GK after its profile is determined. It also costs less to incorporate a GK than a KK. For example, while the registration and license tax for a GK are the same as those for a KK (0.7% of the capital amount), the minimum tax amount for a GK is ¥60,000, whereas it is ¥150,000 for a KK. The fact that it is not necessary to have the Articles of Incorporation authorized by a notary public also saves approximately ¥50,000 in costs.

It is possible to incorporate a GK with just one investor, described as a “member” (shain). Each partner has the right to manage the GK, but “executive members” (gyōmu-shikkō shain) may be appointed to operate and manage the GK if this option is provided for in the Articles of Incorporation. An executive member owes fiduciary duties to the GK, similar to those that directors owe to a KK. There is no stated minimum number of executive members and no term of appointment for the executive members of a GK under the Companies Act. It is possible for a legal entity (i.e., a corporation, including a foreign company) to become an executive member, provided that the legal entity appoints an individual, referred to as the “executive manager” (shokumu-shikkō sha), to represent it.

Although not specifically stipulated in the Companies Act, it is possible for a foreign company to be the sole member of a GK. In this case, it is necessary for the foreign company to appoint an individual as the executive manager to represent it. The executive manager representing the foreign company does not need to be a Japanese national or a resident of Japan. The executive manager owes fiduciary duties to the GK similar to those that a director would owe a KK.

Under the Companies Act, there is no minimum capital requirement upon the incorporation of a GK. Accordingly, it is possible to incorporate a GK with just one yen. It is possible for members to contribute cash or other in-kind property to the GK in exchange for membership interests, but it is not possible to provide non-property consideration, such as labor and other services. Unlike the situation with a KK, there is no established system requiring the examination of in-kind contributions by a court-appointed inspector for a GK.

The GK is becoming a popular vehicle for conducting business in Japan due to its potentially much simpler governance and maintenance requirements, as discussed above. The GK is also utilized as a form of special purpose vehicle (SPV), especially in securitization and other large investment projects.

The Baker McKenzie publication “Commercial Real Estate Transactions in Japan” provides information regarding other SPV forms, such as Tokutei Mokuteki Kaisha (TMK) entities as well as silent partnerships (tokumei kumiai), which are widely used for real estate investments.

Branch Office

A foreign company intending to engage in “continuous transactions” in Japan must register as a foreign company with the Legal Affairs Bureau in either of the following two situations:

1. where the foreign company establishes a business office in Japan; or
2. where a foreign company does not establish its own business office but is simply represented by an individual residing in Japan (whose address is deemed to be the foreign company’s local place of business in Japan).

The procedures for registering a foreign company are relatively simple. The foreign company must appoint an individual representative who is a resident of Japan and provide written notice of the appointment to the individual. Within three weeks of receiving the notice, the representative in Japan is required to register the foreign company with the Legal Affairs Bureau by submitting an application together with certain required attachments. One of these attachments is an
affidavit that must be notarized by a notary public in the foreign company’s home country. The affidavit must state:

1. the existence of the foreign company;
2. the authority of the representative in Japan; and
3. the legal nature of the foreign company.

Where a foreign company has not established a business office in Japan and is represented by an individual, the registered personal residential address of the representative in Japan is deemed to be the foreign company’s place of business in Japan for the purposes of commercial registration.

In both cases, a branch is merely an extension of the foreign parent company and is not a separate legal entity. Therefore, there is no minimum capital requirement in relation to the registration of the foreign company in Japan. If the foreign parent company is equivalent to a KK, the registered foreign company is required to publish its balance sheet or a summary of its balance sheet on an annual basis in the Official Gazette (Kampō), a daily newspaper or via an Internet announcement. In addition, the branch representative must file an affidavit with the Legal Affairs Bureau when there is a change in any of the company’s registered matters.

Please note, however, that the Companies Act prohibits foreign companies from entering into continuing transactions through a branch in Japan if the branch constitutes the principal office of the foreign company or if the sole purpose of the foreign company is to carry on business in Japan.

A company incorporated outside Japan but headquartered in Japan, or that exists solely for the purpose of doing business in Japan, is referred to in the Companies Act as a “pseudo-foreign company.” In this regard, the Companies Act makes a representative of a “pseudo-foreign company” in Japan personally liable for the obligations of the company under any continuing transactions entered into with third parties in Japan.

However, a circular (tsūtatsu) issued by the Ministry of Justice by way of clarification explains that, generally, the provision poses little risk for companies or groups that have substantial operations outside Japan and/or to the extent that the foreign company would be governed outside Japan.

Representative Office

A foreign company proposing to enter the Japanese market may initially wish to enter the market in a very limited capacity in order to first investigate the opportunities and possibilities. If the extent of the activities in Japan is limited to “non-commercial” liaison activities, the appropriate structure in which to operate may be a representative office.

The activities of a representative office must be limited to activities which are conducted:

1. on behalf of the head office of the foreign company; and
2. not in the direct pursuit of profit, such as information gathering, market research and advertising.

The establishment of a representative office in Japan is procedurally simple, without any formal registration or reporting requirements. There are no annual or other meeting requirements.
However, as a representative office is not formally recognized under the *Companies Act*, the following problems may arise if the foreign company is not registered with the Legal Affairs Bureau in Japan:

1. the individual representative in Japan will be personally liable for all debts and obligations of the representative office;
2. the representative office itself will not be able to enforce rights against third parties; and
3. various commercial establishments, especially banks, may be reluctant to deal with a representative office which has not been registered, or may refuse to recognize its existence.

A foreign company intending to set up a representative office in Japan must proceed with extreme caution to ensure that the office's activities do not go beyond those which permit tax-exempt status in Japan. As the distinction is not always easily drawn, it is recommended that professional advice be sought prior to setting up a representative office to ensure that tax-exempt status is obtained. Our Tax Department is available to assist if you require further advice in this regard.

**Partnerships**

There are basically three forms of partnership available under Japanese law:

1. general or voluntary partnerships;
2. limited partnerships; and
3. silent partnerships.

**General Partnerships**

The *Civil Code of Japan* provides for the concept of a general or “voluntary” partnership (*nin-i kumiai*), which is similar to a US-style general partnership. In a general partnership, the partners conduct partnership business jointly and share profits and losses *pro rata* to their respective contributions, unless otherwise agreed among the partners. Each of the partners will have unlimited liability for the obligations of the partnership *pro rata* to their respective contributions unless otherwise agreed among the partners. Each partner will also own a portion of the partnership assets.

General partnerships are not commonly used by either domestic companies or foreign companies in forming business structures in Japan. One of the disadvantages from a foreign company’s perspective is that the conduct of business activities in Japan on behalf of the partnership by any member may result in all partners, including foreign partners, being deemed as having a Japanese “permanent establishment” for taxation purposes.

**Limited Partnerships**

There are two main types of limited partnerships in Japan: (1) Limited Partnerships for Investment; and (2) Limited Liability Partnerships.

1. **Limited Partnerships for Investment.** Limited Partnerships for Investment (“Investment LPS” or “*Tōshi Jigyō Yūgensekinin Kumiai*” in Japanese) are established under the *Limited Partnership Act for Investment* (“Investment LPS Act”). The Investment LPS Act was enacted in 1998 and is designed specifically to promote venture capital and private equity investment.

   The Investment LPS has several key features in common with a general or voluntary partnership under the *Civil Code*. For example, in an Investment LPS:
the partnership assets are co-owned by all the partners; and
the Investment LPS has no distinct legal personality and is transparent for tax purposes.

However, there are also the following key differences:
the Investment LPS may have one or more general partners, each jointly and severally liable for all debts of the partnership;
the limited partners of an Investment LPS are liable only to the extent of their contributions;
the Investment LPS is subject to commercial registration requirements under the Commercial Registration Act and changes in matters registered with the Legal Affairs Bureau must be promptly reported; and
the Investment LPS partners’ rights are “deemed securities” (minashi yūkashōken) and as such are subject to certain disclosure requirements and other requirements for the protection of investors under the Financial Instruments and Exchange Act.

(2) Limited Liability Partnerships. The Limited Liability Partnership (“LLP”) was established under the Limited Liability Partnership Act (“LLP Act”). The LLP Act came into effect in August 2005. The LLP, or Yūgen Sekinin Jigyō Kumiai as it is known in Japanese, was introduced as an exception to the rules governing general partnerships (nin-i kumiai).

The LLP was introduced to revitalize Japan’s economy by offering a more flexible business structure aimed at promoting R&D and business in the IT and finance sectors. An LLP enjoys limited liability in the sense that the LLP partners are liable only to the extent of their capital contributions to the partnership. The LLP also enjoys autonomy, as it may distribute proceeds on a pro rata basis to members regardless of their contributions and freely determine the governance structure.

However, the LLP Act does not permit members of an LLP to entrust the entire operation of the business to designated members. In other words, every member of the LLP has to participate in the management of its business.

The LLP is also exempt from entity-level income tax, making it a true pass-through entity for tax purposes.

The LLP is subject to commercial registration requirements under the Commercial Registration Act and changes in matters registered with the Legal Affairs Bureau must be promptly reported.

Silent Partnerships

The Commercial Code of Japan provides for another form of partnership, referred to as a silent partnership (tokumei kumiai). A silent partnership is not an “entity” as such, but is a specialized business structure that is useful in only a very limited number of situations.

In a silent partnership, one or more silent partners enter into an investment agreement with a person, referred to as an “entrepreneur,” under which the silent partners provide funds to the entrepreneur in exchange for the entrepreneur’s promise to distribute to the silent partners a specified share of the profits and losses arising from the partnership business, provided that there is no contrary provision in the silent partnership contract.
Previously, there had been certain tax advantages involving silent partnerships that made this business structure popular with foreign investors. This was especially the case when a foreign company was keen on investing in a particular Japanese business but had no intention of having a role in the management or administration of the business. The tax advantages were relevant where the applicable tax treaty contained an “other income” clause under which the income derived from a silent partnership was subject only to taxation in the home country (i.e., outside Japan). However, the Japanese tax authorities have recently begun aggressively challenging silent partnership arrangements that rely on this type of tax treaty by re-characterizing silent partnerships as general partnerships.

The distinction between a silent partnership and a general partnership is important for Japanese tax purposes. The partners in a general partnership conduct partnership business jointly. They are subject to Japanese income tax due to it being classified as a permanent establishment, the withholding tax being payable in advance on any distribution (the withholding tax may be credited at a later stage). However, in the case of a silent partnership, a silent partner simply makes an investment and the partnership business is conducted solely by the entrepreneur. The partners in a silent partnership are subject to a flat rate withholding tax under Japanese domestic tax law on their distributions from the silent partnership, unless exempted under a tax treaty.

In practice, the distinction between a general and silent partnership may be difficult to make, but the following factors are relevant, although not conclusive:

1. the silent partner has no right to manage or administer the business of the entrepreneur;
2. the assets of the silent partnership are owned solely by the entrepreneur; and
3. the liability of a silent partner will be determined by an obligation under the silent partnership agreement to make additional funds available to the entrepreneur.

The tax treatment of the profits of non-resident silent partners is quite complex and must be considered within the context of the applicable tax treaty. It is recommended that professional advice be sought prior to establishing a silent partnership, particularly if it is for tax-related purposes. Our Tax Department is available to assist you in this regard.
**Common Investment Strategies for Japan**

There are a number of different methods of investing in Japan. Four of the most common investment strategies for foreign companies entering the Japanese market are set out below.

**Wholly-owned Subsidiary**

The most common investment strategy for foreign companies entering the Japanese market is to establish a subsidiary, typically a KK company, in Japan. However, the establishment of GK companies not only as holding companies, but also as operating entities, has recently become increasingly common. Japanese subsidiaries of foreign companies are generally wholly owned by their foreign parent companies, directly or indirectly.

**Joint Venture Company**

A foreign company may wish to set up joint ventures with one or more local business partners for various reasons, operational or otherwise. Many foreign companies may find joint ventures to be attractive, particularly in circumstances where the success of the business is reliant on efficient distribution, sales contacts, manufacturing and technology support to be provided by local partners in Japan. A foreign investor in a joint venture company must carefully consider the key issues in establishing a joint venture, including equity participation and board representation, especially in light of the possibility of a future deadlock situation.

If the joint venture vehicle is a KK company, the foreign investor must ensure that its shareholding provides the level of influence over the management and operation of the company sought by the investor. For example, pursuant to the default rules which apply under the Companies Act, if the shareholding consists of a majority of all outstanding shares, the foreign investor will have control over decisions concerning basic company matters, such as the appointment of directors and statutory auditors and the distribution of any surplus. If the shareholding is two-thirds or more of all outstanding shares, the foreign investor will have control over decisions concerning matters of fundamental company policy, such as amendments to the Articles of Incorporation, reorganization of the company (including a merger, corporate spin-off or share exchange), or liquidation of the company.

It is also possible for the joint venture vehicle’s Articles of Incorporation to provide rules that are different from the default rules under the Companies Act. In this way, the Articles of Incorporation can be tailored to meet the joint venture partners’ specific requirements in relation to their investments in the company.

If a GK company is selected as the joint venture vehicle, the Companies Act also allows for a more flexible corporate governance structure.

A joint venture company can be created by:

1. the incorporation of a new company together with one or more Japanese business partners; or

2. the subscription for new shares or the purchase of existing shares in an already existing company.

In each case, the contribution can be made in cash or other types of consideration, such as business assets. Foreign investors are generally permitted to purchase the shares of existing Japanese companies, subject to certain notification requirements.
Investment in a Listed Company

If the target company is listed on a stock exchange in Japan, the foreign company intending to acquire shares in said listed company should determine whether the takeover regulations are triggered by the proposed acquisition. For example, an acquisition of shares (other than on an ordinary auction market) resulting in ownership exceeding one-third of the voting rights of a Japanese listed company is subject to the mandatory takeover bid requirements unless one of the limited exemptions apply. Certain transactions involving a smaller portion of shares may also be subject to the mandatory takeover bid regulations depending on the circumstances. Please contact our office or consult our complimentary memorandum on “Takeover Bids in Japan” for more information in this regard.

When considering an investment in a listed company in Japan, a foreign company should also be aware of the insider trading regulations and the substantial shareholding reporting regulations applicable to the trading of listed stock. A foreign company which directly or indirectly owns a majority of the voting rights of a Japanese listed company is also subject to disclosure requirements under the Japanese securities regulations.

Market Entry by Acquisition of a Company or Business Assets

A foreign investor may wish to enter the Japanese market by acquiring: (1) an existing Japanese company; or (2) the assets of an existing Japanese business, either directly or through a subsidiary.

As is the case with most jurisdictions, it is generally easier in terms of legal procedure to acquire shares in an existing Japanese company than to acquire business assets from a Japanese company. A foreign investor should, however, carefully review whether a share acquisition is the preferable option after considering factors such as the relevant tax implications and the potential liabilities associated with the legal entity to be acquired.

The principal reason why an asset purchase may be preferred to a share acquisition is flexibility in determining the assets and liabilities to be acquired. In the case of an asset purchase, a foreign company may selectively acquire business assets that it will need in order to enter into the Japanese market in accordance with its specific investment plan, rather than acquiring the target assets as a whole as a going concern.

If a foreign company directly acquires business assets, it will be considered to be engaging in business in Japan after the acquisition of the business. Accordingly, the foreign company will need to register as a foreign corporation in Japan upon acquiring the business from the Japanese seller. The business office in Japan will be treated as a “branch office” for the purposes of the Companies Act. Alternatively, if the foreign corporation purchases Japanese assets through a Japanese company, a board or shareholders’ resolution may be required at the Japanese company level.

Under the new Companies Act, the “post-incorporation asset acquisition” (jigo setsuritsu) rules have been significantly relaxed and a court-appointed inspector is no longer required to value the assets proposed to be acquired in an asset acquisition.
Foreign Investment Laws

Overview and Key Definitions

Foreign investment in Japanese companies is mainly regulated by the *Foreign Exchange and Foreign Trade Act*. Certain reporting or approval requirements may apply to “direct inward investments” in Japan by a “foreign investor,” depending on:

1. the jurisdiction in which the investor is located (i.e., whether it is an approved country or not); or
2. the industry in which the target company or business operates (i.e., whether the industry in question is regulated or unregulated).

A “foreign investor” is defined as one of the following persons or entities:

1. an individual who is a non-resident;
2. a legal entity or other entity which is established under foreign law or which has its principal office in a foreign country;
3. a Japanese company of which 50% or more of the voting rights are held directly or indirectly by (1) or (2) above; or
4. a Japanese legal entity or other entity, a majority of whose: (i) officers, being directors or persons holding similar positions; or (ii) officers having the power of representation, are non-resident individuals.

Therefore, making a foreign investment through a Japanese subsidiary is also subject to the “direct inward investment” regulations.

A “non-resident” is defined as an individual or legal entity which is not a resident. A “resident” is defined as an individual who has an address or domicile in Japan or a legal entity which has its principal office in Japan.

Share Acquisitions – General Case

Where the foreign investor is located in a recognized jurisdiction or the target company is engaged in business which is not in a “regulated industry,” the foreign investor is required to file an after-the-fact report with the Minister of Finance (“MOF”) and any other relevant Minister through the Bank of Japan (“BOJ”) no later than the 15th of the month following the month in which the acquisition was made where:

- the seller is a Japanese company and, as a result of the acquisition, the investor and any related companies hold 10% or more of the issued shares in the aggregate in a non-listed company; or
- as a result of the acquisition, the investor and any related companies hold 10% or more of the issued shares in the aggregate in a listed company.

The filing of this report is generally regarded as a mere formality and does not require extensive disclosure of information.

Under the *Foreign Exchange and Foreign Trade Act*, with certain exceptions, foreign investors are not required to file any notification or report in case of acquisitions of shares in non-listed companies from other foreign investors or acquisitions of less than 10% of shares in non-listed companies from Japanese seller. Also, acquisitions of less than 10% of shares in listed companies are not subject to any filing or notification requirement. However, acquisitions of 5%
or more shares in listed companies are subject to the large shareholding reporting requirements under the *Financial Instruments and Exchange Act*.

### Share Acquisitions – Exceptional Cases

Where the foreign investor is located in a jurisdiction which is not included in the MOF’s list of designated jurisdictions or the target company is engaged in business in a “regulated industry,” the foreign investor will be required upon the purchase of any shares in a non-listed company from a Japanese seller or, in aggregate with the shares held by the foreign investor’s related companies, 10% or more shares in a listed company to file a notification with the MOF and any other relevant Minister via the BOJ *prior* to the acquisition.

The term “regulated industry” is rather broad and includes industries regulated:

1. *for national security reasons* (*e.g.*, the armament, aircraft, satellite, nuclear and related industries);
2. *for reasons of public order* (*e.g.*, the electricity, gas, heat supply, telecommunications, broadcasting, water, railroad and passenger transport industries);
3. *for public safety reasons* (*e.g.*, the biological product and security industries); and
4. *for reasons otherwise in the national interest* (*e.g.*, the agriculture, fisheries, petroleum, leather goods, air transport and maritime transport industries).

Once prior notification has been given, there is a 30 day waiting period during which the foreign investor may not execute the acquisition. In most cases, this waiting period may be shortened to two weeks. However, the waiting period may be further shortened to five business days in the following cases:

1. *greenfield investments* involving the establishment of or acquisition of new shares in a wholly-owned Japanese subsidiary;
2. *rollover investments* where a foreign investor resubmits notification within six months of the submission of a prior notification which was not executed; or
3. *passive investments* where a foreign investor declares in the prior notification that it will maintain a passive investment in the company in which the foreign investor will invest.

The foreign investor is also required to submit an execution report with the MOF and any other relevant Minister via the BOJ no later than 30 days after the acquisition.

### Asset Acquisitions

If a non-resident acquires assets directly from a Japanese vendor, the acquisition will be subject to certain reporting requirements under the *Foreign Exchange and Foreign Trade Act*. The reporting requirements differ depending on the particular asset involved. For example, subject to certain limited exceptions, a non-resident must report an acquisition of real property located within Japan — which is categorized as a “capital transaction” — to the MOF via the BOJ within 20 days after the acquisition.

Personal property, other than gold bullion, is generally exempt from these requirements.

### Foreign Ownership Restrictions

Thresholds have been established with respect to foreign ownership in certain industries. These rules vary for individual companies within these industries and should be checked at the time an acquisition is contemplated. Major industries to which these rules apply include the following:
(1) **Telecommunications:** Foreign investors are permitted to acquire 100% of the shares of all Japanese telecommunications companies except for Nippon Telegraph and Telephone East Corporation (NTT-East), Nippon Telegraph and Telephone West Corporation (NTT-West), and Nippon Telegraph and Telephone Corporation (NTT, the holding company of NTT-East and NTT-West). Less than one-third of all of the voting rights in NTT may be foreign owned and NTT-East and NTT-West are required to be owned by NTT;

(2) **Airlines:** Foreign investors are permitted to acquire a maximum of 33.3% of all voting rights in Japanese airline companies; and

(3) **Broadcasting:** Foreign investors are permitted to acquire less than 20% of all voting rights in general broadcasting and communications companies and other similar companies. The regulations relating to broadcasting companies — such as cable, satellite and similar companies — are technical and fluctuate more than other regulations. It is wise to confirm these restrictions prior to making any substantial acquisition in such entities.

Foreign individuals and companies may still invest in the above companies beyond the maximum levels detailed above. However, they will not be able to be registered as shareholders and will therefore not be afforded the usual rights given to shareholders (e.g., voting rights and dividend rights).

**Currency and Exchange Control**

One of the stated aims of the *Foreign Exchange and Foreign Trade Act* is to subject foreign exchange and foreign trade to the minimum necessary controls and regulation. In keeping with this aim, capital flows relevant to mergers and acquisitions in Japan are largely free of government controls. However, cash payments of more than ¥30,000,000 into or out of Japan must be reported to the MOF. This reporting obligation falls on residents only. In practice, however, the Japanese bank involved in the transaction will usually prepare and file a report on its customer’s behalf.

The repatriation of profits by branch and dividends by subsidiary is unrestricted in Japan.
Taxation in Japan

Introduction

There are two main levels of taxation in Japan: (1) national taxes; and (2) local taxes (i.e., prefectural and municipal taxes).

The main taxes imposed in Japan are described below.

National Taxes

Corporations Tax

In Japan, the national Corporations Tax is generally computed at a rate of 23.4%\(^1\) on all earnings. However, for small corporations capitalized at ¥100,000,000 or less, the first ¥8,000,000 of income is subject to tax at a rate of 15%.\(^2\) When local taxes are also taken into account with the national corporate income tax, the average effective corporate tax rate for a company located in the Tokyo Metropolitan area, reflecting the deductibility of local enterprise tax (see below), is 33.80% if the standard local tax rate applies or 34.81% if the higher local tax rate applies. The local tax rate may vary slightly depending on the prefecture.

Different effective tax rates apply to companies with more than ¥100,000,000 of stated capital. Such companies are subject to the “factor-based enterprise tax,” which is based not only on income but also other value-added factors. Where the “factor-based enterprise tax” applies, the average effective tax rate would be 30.86% for a company located in the Tokyo Metropolitan area. The local tax rate may vary slightly depending on the prefecture. Our Tax Department can provide greater detail on the calculation of these rates, if required.

Both companies and branches are taxed on their net incomes (i.e., income after the deduction of necessary and ordinary expenses incurred in the course of business), but the scope of their taxable incomes is different. Companies are subject to corporate taxation on their worldwide income and a foreign tax credit is available if certain conditions are met, while branches are generally subject to tax only on their Japanese source income. The foreign tax credit is also applicable to certain foreign source income attributable to branches.

Royalties or interest payments are generally deductible as business expenses when made between parent companies and their subsidiaries, provided that the amounts are commensurate with an arm’s length transaction.\(^3\) In the case of branches, these payments are also deductible as business expenses when made between a head office and a branch, unless different treatments exist under tax treaties for the avoidance of double taxation. In order to justify a transaction by showing that it was carried out on an arm’s length basis, it is necessary to prepare and maintain proper documentation which provides a substantive basis for the payments.

Income tax withheld on interest, dividends and redemption premiums that the corporation has received during the accounting year is creditable with respect to national corporate income tax in Japan. However, a tax credit is not granted to foreign corporations having no place of business in Japan for income tax withheld on income not subject to national corporate income tax.

Both companies and branches must pay their national corporate income tax liabilities and file national corporate income tax returns with the National Tax Agency within two months after the fiscal year-end. With regard to the national corporate income tax return and the local corporate inhabitants tax and local enterprise tax return, a one-month extension (in the case of branches, a

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\(^1\) A 23.2% tax rate will apply starting in the fiscal year beginning on or after 1 April 2018.
\(^2\) A 19% tax rate will apply starting in the fiscal year beginning on or after 1 April 2019.
\(^3\) The payment of royalties or interest to foreign companies is subject to Japanese withholding tax. While the domestic tax rate for these payments is 20.42%, the rate may be reduced by virtue of the operation of any applicable tax treaty.
two-month extension) may be allowed if the companies or branches duly file an application for an extension with the National Tax Agency.

**Tax on Nonresident Companies**

Nonresident companies (“foreign corporations”) are subject to national corporate income tax and/or withholding income tax on income derived from sources within Japan (together with offshore income attributable to branches, if any). Income treated as being derived from sources within Japan, unless otherwise stipulated in tax treaties for the avoidance of double taxation, includes the following:

- income from business conducted in Japan or from the utilization, holding, sale or disposal of assets situated in Japan and other income sources within Japan;
- income from businesses that consist primarily of providing personal services performed in Japan; and
- dividends or distributions of surpluses and profits from securities investment trusts, excluding bond investment trusts, received from domestic corporations.

A distribution received by a nonresident partner of a *nin-ii kumiai* (“NK,” a partnership under the Japanese *Civil Code*) is subject to a 20.42% withholding tax in addition to the corporate tax filing requirement. However, withholding taxation is not applicable if the nonresident has a permanent establishment in Japan despite limiting its involvement in the NK’s business activities to the NK investment. If the NK transfers a Japanese company’s shares, capital gains taxation is calculated based on the NK’s membership portion as long as the non-resident partner does not have a permanent establishment in Japan. Our Tax Department can provide further details, if required.

**Personal Income Tax**

Individual resident taxpayers must generally pay income tax on the total income earned during the calendar year concerned. Generally, income tax rates are progressive, ranging from 5.105% to 45.945%. A local inhabitants tax is also imposed at a rate of 10% regardless of the amount of taxable income. With regard to the tax rates for individual resident taxpayers, please see the following table:

<table>
<thead>
<tr>
<th>Income bracket (in ¥)</th>
<th>Individual income tax rate</th>
<th>Individual prefecture and municipal inhabitants tax rate</th>
<th>Total tax rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 to 1,950,000</td>
<td>5.105%</td>
<td>10%</td>
<td>15.105%</td>
</tr>
<tr>
<td>1,950,001 to 3,300,000</td>
<td>10.21%</td>
<td>10%</td>
<td>20.21%</td>
</tr>
<tr>
<td>3,300,001 to 6,950,000</td>
<td>20.42%</td>
<td>10%</td>
<td>30.42%</td>
</tr>
<tr>
<td>6,950,001 to 9,000,000</td>
<td>23.483%</td>
<td>10%</td>
<td>33.483%</td>
</tr>
<tr>
<td>9,000,001 to 18,000,000</td>
<td>33.693%</td>
<td>10%</td>
<td>43.693%</td>
</tr>
<tr>
<td>18,000,001 to 40,000,000</td>
<td>40.84%</td>
<td>10%</td>
<td>50.84%</td>
</tr>
<tr>
<td>40,000,001 and above</td>
<td>45.945%</td>
<td>10%</td>
<td>55.945%</td>
</tr>
</tbody>
</table>

Certain income, such as retirement income, designated interest income, dividend income and capital gains on listed shares, is taxed separately.
An individual who has a domicile in Japan or who has resided in Japan continuously for more than one year ("resident") must pay income tax on all of his or her income from both within and outside Japan.

A resident who has not resided in Japan for five years cumulatively out of the last ten years ("non-permanent resident") is subject to tax only on the total income derived from sources within Japan and on income from other sources paid in Japan or remitted to Japan from abroad.

An individual other than a resident ("nonresident") must pay income tax on income derived from sources within Japan. Most of the income earned by nonresidents is normally subject to a flat withholding tax (e.g., 20.42%), but the rate may be reduced by virtue of the operation of any applicable tax treaty.

Income tax is paid upon the filing of an income tax return by 15 March of the year following the calendar year in which the individual’s income was earned. However, Japan has also adopted a comprehensive system of withholding of taxes on income with the intention of minimizing the number of returns that must be filed. Indeed, most Japanese individual taxes currently are collected by way of this withholding tax mechanism. In general, the following taxpayers (including expatriates) who satisfy any one of the following tests are required to file tax returns:

1. those whose salary income exceeds ¥20,000,000;
2. those whose income other than their salary exceeds ¥200,000;
3. those who receive employment income from two or more sources and the total amount of earnings from employment not subject to withholding tax and any other income, other than employment income, exceeds ¥200,000; or
4. those who have received all or a portion of their remuneration from overseas.

The income tax return (or reports from the employer in the event that no return has to be filed) also serves as a basis for the calculation of the local inhabitants tax. The local inhabitants tax is paid in one of two ways:

1. payment in installments, whereby the local inhabitants tax is paid in four equal installments in June, August, October and January, following the year in which the income arose with regard to salary income not paid in Japan and other income at the election of the taxpayer; or
2. collection by withholding by the employer in 12 equal amounts commencing in June of the year following the year in which the income arose, if the taxpayer’s salary is paid in Japan. In this case, the taxpayer can elect to have inhabitants taxes imposed on income other than his or her salary to be collected by withholding such taxes. As a result, the payment of inhabitants tax attributable to income in a particular calendar year will be delayed substantially after the end of said year.

Japan introduced a so-called “exit tax” in the 2015 Japanese tax legislation that is applicable to certain departures from Japan on or after 1 July 2015, with only limited exceptional treatment available for foreigners, such as expatriates who reside Japan due to intracompany transfers. The exit tax is imposed on any individual that:

1. is a Japan resident, or whose principal place of residence (jusho), or whose temporary place of residence (kyosho) has been Japan for a period exceeding five out of the last ten years prior to expatriation; and
2. has taxable (securities-type) assets with a combined value of at least ¥100,000,000.
The law considers the following types of assets when determining whether the ¥100,000,000 threshold has been met:

(i) certain securities, as defined under the Income Tax Law, and any interest held in a silent partnership contract;

(ii) unsettled credit transactions or when-issued transactions; and

(iii) unsettled derivatives.

Real estate, bank deposits, insurance policies and loan receivables are excluded from taxable assets for exit tax purposes.

If an individual is subject to exit tax, they must pay tax on the deemed gain realized at their applicable individual income tax rate. The specific rate at which tax will be owed depends on the tax category of the income realized. Japan’s individual income tax is composed of several income categories with varying rates. For example, a capital gain arising on a transfer of listed or non-listed shares is generally subject to tax at a flat rate of 15.315%. A suspension on exit tax may be available for temporary departures from Japan, if certain conditions are met.

Consumption Tax

Consumption tax is an indirect tax similar to the value-added tax (i.e., VAT) in EU countries. The overall total current consumption tax rate is a flat 8%\(^4\), which includes a 1.7% Local Consumption Tax.

Consumption tax is imposed on the transfer or lease of assets in Japan and services in Japan offered by enterprises. In general, consumption tax is ultimately borne by consumers.

A number of transactions are exempt from consumption tax, including:

- the sale and lease of land;
- the sale of securities, such as national government bonds, corporate bonds and stocks;
- money lending and other financial transactions; and
- housing rent.

There are two types of consumption taxpayers: (1) a voluntary consumption taxpayer; and (2) a mandatory consumption taxpayer.

(1) Voluntary consumption taxpayer. A voluntary consumption taxpayer is a business enterprise other than a mandatory consumption taxpayer.

(2) Mandatory consumption taxpayer. A mandatory consumption taxpayer is a business enterprise that falls under any of following categories:

   (i) a business enterprise which has more than ¥10,000,000 in sales subject to Japanese consumption tax for the “base period” (two years preceding the current fiscal year, if any);

   (ii) a business enterprise which does not have a base period (i.e., a corporation that is less than two years old) if the stated capital of said enterprise is ¥10,000,000 or more;

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\(^4\) 10% on or after 1 October 2019.
(iii) A business enterprise which does not have ¥10,000,000 or more of taxable sales in the relevant base period, but has more than ¥10,000,000 of taxable sales in the first six months of the preceding taxable year; or

(iv) A business enterprise which does not have a base period (i.e., a corporation that is less than two years old), and is controlled by a person with more than ¥500,000,000 of taxable sales in the relevant base period.

An individual consumption taxpayer must pay consumption tax liabilities and file a consumption tax return by 31 March of the year following the calendar year in which the individual’s income was earned.

A corporation consumption taxpayer must pay consumption tax liabilities and file a consumption tax return within two months after the fiscal year-end (a one-month extension is not allowed for a national corporate income tax return).

Under the 2015 Japanese tax legislation, effective from 1 October 2015, certain “digital” services provided by a service provider located outside Japan are subject to Japanese consumption tax if the recipient of the service is located in Japan. Under the Japanese Consumption Tax Law Basic Circular, a foreign service provider which provides certain “digital” services to recipients located in Japan may be treated as a foreign digital service provider even if it has no permanent establishment in Japan.

Two types of digital services provided by digital service providers located outside Japan exist for Japanese consumption tax purposes: (a) so-called B2B (business-to-business) digital services; and (b) so-called B2C (business-to-consumer) digital services. Under the Japanese Consumption Tax Law, B2B digital services are defined as, “the provision of digital services by a foreign service provider to recipients normally limited to business enterprises, considering the nature of the service, the terms and conditions, and other factors relating to the provision of the services.” B2C digital services are defined as services other than B2B digital services.

In the case of B2B digital services, Japanese consumption tax is to be collected by way of a so-called “reverse charge” mechanism. Under the reverse charge mechanism, the recipient of the service located in Japan — not the foreign service provider — is required to file a Japanese consumption tax return and to acknowledge the Japanese consumption tax liabilities with the Japanese tax authorities. Please note that while the foreign service provider is not required to pay Japanese consumption tax, it is required to provide notice to the recipients of the services located in Japan that the transaction is subject to the reverse charge.

In contrast, in the case of B2C digital services, the foreign service provider is required to file a Japanese consumption tax return and pay Japanese consumption tax liabilities to the Japanese tax authorities where the foreign service provider is categorized as a mandatory Japanese consumption taxpayer.

Transfer pricing

Japan has adopted transfer pricing rules that apply to calculation of the taxable net income of branches and corporations. Under these rules, arm’s length prices shall generally be applied in calculating the applicable national corporate income tax in the event that a Japanese corporation has conducted a transaction with a related foreign entity for an amount that was not an arm’s length price. The National Tax Agency has issued revised Transfer Pricing Guidelines. Please consult our Tax Department should you require specific advice in this regard.

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5 For example, the sale of e-books, the provision of music streaming services, the provision of internet advertising services or the provision of services regarding preservation of electronic data in the cloud by a foreign service provider.
Payroll taxes and Social Security

Japan has mandatory social insurance programs, such as a health insurance program, a pension insurance program and a labor insurance program. The employee’s portion of the premiums for these programs is paid by means of a payroll deduction, but employers are also required to pay the employer portion of the premiums for these programs.

Local Taxes

In Japan, local public entities consist of: (1) municipalities (cities, towns and villages), which are primary, basic local organizations; and (2) prefectures, which are larger units but secondary local organizations. There are 47 prefectures and over 3,000 municipalities.

Taxes levied at the prefectural level in Japan, including: Prefectural Inhabitants Tax; Prefectural Enterprise Tax; Local Consumption Tax; Real Property Acquisition Tax; Tobacco Tax; Golf Course Utilization Tax; Automobile Tax; and Automobile Acquisition Tax.

Taxes levied at the municipal level in Japan include the following: Municipal Inhabitants Tax; and Municipal Property Tax.

When Inhabitants Tax (imposed both at the prefectural and municipal levels) and Enterprise Tax are taken into account, together with national taxes, the average effective corporate tax rate in Japan for a company located in the Tokyo Metropolitan area is 33.80% if the standard local tax rate applies or 34.81% if the higher local tax rate applies. Where the “factor-based enterprise tax” mentioned below applies, the effective tax rate would be 30.86% for a company located in the Tokyo Metropolitan area. The local tax rate may vary slightly in either case depending on the prefecture.

Enterprise Tax

Enterprise tax is further subdivided into two components: (1) enterprise tax; and (2) special local corporation tax.

Both companies and branches must pay enterprise tax liabilities and file enterprise tax returns with the relevant Prefectural Tax Offices within two months after the fiscal year-end. With regard to the enterprise tax return, a one-month extension (in the case of branches, a two-month extension) is allowed if a company or branch files an application for an extension with the Prefectural Tax Office.

The amount of enterprise tax and special local corporation tax paid in prior years may be deducted when computing taxable income for the purpose of calculating national corporate tax and enterprise tax for the current year.

(1) Enterprise Tax

The current maximum enterprise tax rate in the Tokyo metropolitan area is 6.7%⁶ of taxable income in Japan. The rate may vary slightly in other areas of Japan. For example, the rate is higher in larger cities in Japan.

Corporations with stated capital of more than ¥100,000,000 are subject to taxation under the “factor-based enterprise tax system” in addition to the existing income-based tax system. The factor-based enterprise tax system refers to an enterprise tax which is based on certain factors and which is payable even if the taxable income of the corporate taxpayer is zero. Corporations which have a stated capital of ¥100,000,000 or less are still subject to the existing enterprise tax levied on income as described above.

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⁶ For companies with an annual income of more than ¥25,000,000 or a stated capital of more than ¥100,000,000, the rate is 7.18%.
Corporate enterprise tax is assessed according to the total of the “income-based levy” and the “factor-based levy.” Factor-based enterprise tax is also applicable to a foreign corporation if it has a permanent establishment in Japan, such as a branch office. To determine whether the capital threshold of more than ¥100,000,000 has been reached by the foreign corporation, its stated capital amount in the relevant foreign currency is converted to Japanese yen based on the foreign exchange rate applicable on the last day of the relevant fiscal year.

In relation to the income-based levy, an “income allocation portion” is computed at an effective rate of 0.88% of the taxable profits in accordance with the income-based tax system. In relation to the factor-based levy, the “capital allocation portion” is computed by multiplying the corporation’s “amount of stated capital and capital surplus” by 0.525%. The “value-added allocation portion” (i.e., compensation and salaries, net interest and net rent paid) is computed by multiplying the value-added amount by 1.26%.

(2) Special Local Corporation Tax

A special local corporation tax taxpayer is also an enterprise tax taxpayer. The taxable base of the special local corporation tax is the business tax income component liability. The rates are shown below:

| Taxpayers subject to taxation under the “factor-based enterprise tax system” (i.e., those with more than ¥100,000,000 in share capital) | 414.2% |
| Taxpayers not subject to taxation under the “factor-based enterprise tax system” | 43.2% |

Inhabitants Tax

Inhabitants tax is further subdivided into two components: (1) a corporate tax levy; and (2) a per capita levy.

Both companies and branches must pay inhabitants tax liabilities and file inhabitants tax returns with the relevant Prefectural Tax Offices and Municipal Offices within two months after the fiscal year-end. With regard to the inhabitants tax return, a one-month extension (in the case of branches, a two-month extension) is allowed if a company or branch files an application for an extension with the Prefectural Tax Office and the Municipal Office.

(1) **Corporate Tax Levy.** The maximum rate may not exceed 16.3% of the national corporate income tax imposed.

(2) **Per Capita Levy.** The “per capita” levy payable is calculated based on:

(i) the total amount of stated capital and capital surplus of the company; and

(ii) the number of employees employed by the company.

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7 In the case of a foreign corporation, the capital allocation portion is calculated based on the share capital and capital surplus corresponding to the Japanese business which is statutorily computed rateably by using the number of employees in Japan.

8 Prefectural and municipal corporate inhabitants tax corporate levy rates in the Tokyo Metropolitan area are as follows:

| (A) Prefectural corporate inhabitants tax rate | 3.2% (4.2%) | Total inhabitants tax rate | 12.9% (16.3%) |
| (B) Municipal corporate inhabitants tax rate | 9.7% (12.1%) |

The rates in brackets (i.e., 105% of the standard rates) are applied to corporations in the Tokyo Metropolitan Area with more than ¥100,000,000 in shareholder equity or annual national corporate income tax of more than ¥10,000,000.
With regard to a foreign corporation registered as a branch in Japan, the “per capita” levy payable is calculated based on:

(i) the total amount of stated capital and capital surplus of the foreign “head office” corporation; and

(ii) the number of employees employed in Japan by the foreign “head office” corporation.

A minimum “per capita” inhabitants tax levy of ¥70,000 per year is payable irrespective of whether the “head office” of the foreign corporation or the registered office in Japan has any income. For example, a Delaware corporation which has: (i) capital of only US$1; (ii) no employees in the US; and (iii) no taxable income in Japan, but is registered as a foreign corporation in Japan, is still liable to pay at least ¥70,000 per year by way of inhabitants tax. The maximum per capita levy is ¥3,800,000 per year.
Intellectual Property

Protection of Intellectual Property in Japan

To keep up with significant developments in relevant technologies, changes in socio-economic backgrounds and international movements, Japan has continuously revised its intellectual property laws. Like other developed countries, Japan has enacted various laws to protect various forms of intellectual property, including:

1. the *Patent Act*, which governs the registration and protection of patents;
2. the *Utility Model Act*, which governs utility models;
3. the *Trademark Act*, which governs trademarks;
4. the *Design Act*, which governs designs; and
5. the *Copyright Act*, which governs copyright.

Each of the above is discussed briefly below. A more comprehensive overview of Japanese intellectual property law is set out in our “Intellectual Property Guide,” which is available upon request.

Patents and Utility Models in Japan

The Japanese patent registration system under the *Patent Act* is designed to give inventors, or their assignees, the right to apply for the granting of patent rights for their inventions.

The Japanese intellectual property system also provides for the protection of utility models by allowing the registration of “devices” under the *Utility Model Act*. An idea that does not qualify for protection as an “invention” under the *Patent Act* because it is not a highly advanced creation may still be eligible for registration as a “device” under the *Utility Model Act*.

The registration procedures for patents and utility models are similar. In order to protect these rights in Japan, it is necessary to file an application with the Japan Patent Office and obtain registration. Once registered, and provided the annual fees are paid for each successive year, the patent right remains valid for up to 20 years from the date of filing of the application. Utility models receive protection for up to 10 years from the filing date.

Trademarks in Japan

Trademarks are protected primarily by registration with the Japan Patent Office under the provisions of the *Trademark Act*. This law defines a “trademark” as a character, letter, figure, sign, three-dimensional configuration, color or any combination of these, a sound and anything else designated by governmental order. Amendments made to the *Trademark Act* in 2015 added sounds, motions, positions, holograms and colors to the definition of a trademark.

Under the *Trademark Act*, if a person uses a trademark in Japan without intending to engage in unfair competition prior to another party’s filing of an application to register the same or a similar trademark, and if by such use the trademark becomes a well known source indicator for the prior user, the prior user may continue using the trademark even if the applicant succeeds in registering the trademark. However, this right applies only if the prior user or its successor in business uses the trademark continuously.

In Japan, the application filing date determines trademark right priority, assuming that the trademark is ultimately registrable. Due to this “first-to-file” rule, it is generally recommended that registration be promptly applied for even for trademarks still in the planning stages.
A trademark can be registered in Japan by filing a trademark registration application with the Japan Patent Office designating the goods or services for which the trademark is to be used. Japan adopted the international classification system in 1992. An applicant may designate goods or services belonging to more than one class in a single application for registration.

The owner of a registered trademark is entitled to the exclusive use of the trademark on designated goods for 10 years from the registration date. The trademark owner may renew the registration for additional 10 year terms by filing a simplified application with the Japan Patent Office.

In addition to the legislation noted above, the Unfair Competition Prevention Act provides protection for well-known and famous names, trademarks or other “indications” even if they are not registered, as well as protection for technical or business information that is treated as a trade secret. It also prohibits the sale of “imitation” goods and the provision of false information to customers of competitors.

Designs in Japan

Designs may be protected by registration with the Japan Patent Office under the Design Act. Under this law a “design” is defined as a shape, pattern or color, or any combination thereof, of an article (including a part of an article) which creates a distinctive aesthetic impression.

Design registration in Japan is obtained by filing an application for a design with the Japan Patent Office. In order to register a design for which an application is filed, the design must meet certain substantive requirements in addition to certain formality requirements. For example, the design must be industrially applicable, novel, creative, not contrary to morality or public order and not liable to create confusion with an article pertaining to another party’s business.

After a design registration is issued, the Japan Patent Office will publish it in the Official Design Gazette.

A design registration remains valid for up to 20 years from the registration date, provided that the appropriate annual fee is paid.

Copyright in Japan

The law protecting copyright is the Copyright Act. As Japan is a civil law country, no common law copyright action exists. The administrative body charged with enforcing the Copyright Act is the Agency for Cultural Affairs, which is part of the Ministry of Education.

In Japan, copyright arises upon the creation of copyrightable work, without any need for registration. However, the Copyright Act permits registration with the Agency for Cultural Affairs of a true name, the date of first publication or first disclosure and the assignment or establishment of a pledge. While insufficient to confer ownership upon the person filing for registration alone, the registration creates a presumption that the person who has registered his or her true name is the author of the work that is the subject of the registration, and that the date recorded is the date of first publication, broadcast, recitation or performance. Registration is also necessary to perfect a pledge or assignment against third parties.

Various types of works, including computer software and databases, are protected under the Copyright Act. The Copyright Act recognizes the right of public transmission and the right to make copyrighted works transmittable. Accordingly, the act of uploading an unauthorized copy of a copyrighted work on an internet website or the exchange of an unauthorized copy of a copyrighted work constitutes copyright infringement. Additionally, the downloading of unauthorized copies of movies or music with the knowledge that it is an unauthorized copy constitutes copyright infringement.
The Copyright Act has recently been amended to promote the use of works of authorship through the internet by expanding the scope of the limitation on copyright with regard to internet search services.

Under the amended Copyright Act, internet search service providers can reproduce works of authorship to the extent necessary as long as the requirements prescribed by the Copyright Act are satisfied.

Other Intellectual Property Protections in Japan

Japan also provides protection for other intellectual property rights. For example:

- semiconductor chip designs are protected under The Act Concerning the Circuit Layout of a Semiconductor Integrated Circuit; and
- plant varieties are protected under the Seeds and Seedlings Act.

Japan has also acceded to international treaties and conventions, the most important of which are:

- the Paris Convention for the Protection of Industrial Property;
- the Berne Convention for the Protection of Literary and Artistic Works;
- the Patent Cooperation Treaty;
- the Trademark Law Treaty;
- the Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks;
- the World Intellectual Property Organization Copyright Treaty;
- the World Intellectual Property Organization Performances and Phonograms Treaty;
- the Convention Establishing the World Intellectual Property Organization; and
- the Agreement on Trade-Related Aspects of Intellectual Property Rights (“TRIPS”).

Enforcement of Intellectual Property Rights in Japan

The Japanese legal system offers several ways of enforcing intellectual property rights and of pursuing legal remedies for the infringement of intellectual property rights.

Injunctive Relief

The Patent Act and other intellectual property legislation in Japan provide for injunctive relief. In Japan, it is usually easier to obtain injunctive relief for intellectual property infringement than to recover damages for such infringement. However, an accelerated proceeding for a provisional disposition — similar to a temporary injunction — which is then accompanied by a regular suit seeking a final injunction, may take almost as long as the regular suit itself.

A provisional disposition action also requires the posting of a security bond that in most cases is very large.

Therefore, in certain cases in which the relative urgency of a matter does not justify the additional costs involved in seeking a provisional disposition or damages, the plaintiff may wish to forego these remedies and seek only a final injunction in a regular suit.

Damages
Besides injunctive relief, damages can be recovered under the general tort provisions of the *Civil Code of Japan* if the actionable conduct was intentional or negligent.

**Criminal Sanctions**

Criminal proceedings may also be commenced against an infringer in Japan which may result in imprisonment and/or the levying of a fine.

**Customs Filings**

Filing an application with Japanese customs to prohibit the import of infringing products is one of the most practical and effective measures to prevent counterfeiting activities in Japan. Once the application is accepted by the Japanese customs authorities, they begin monitoring goods being imported into Japan that may infringe the applicant's rights as set out in the application.
Labor Laws

Sources of Employment and Labor Law

Employment and labor laws in Japan are sourced from the Japanese Constitution, statutes and court precedents. Provisions from collective bargaining agreements, work rules and individual employment contracts together constitute the terms and conditions of an employment contract. Customs and established practices may also be regarded as a part of an employment contract.

Mandatory requirements for employers and employees, as well as the minimum working conditions, are established by statute. Any provision in a labor collective agreement, work rules or individual employment contract that is in conflict with these mandatory requirements will be deemed void and unenforceable.

The main statutes relevant to employment and labor law in Japan are:

- the Civil Code;
- the Labor Contract Act; and

Statutes related to social and labor insurance are also relevant, because social insurance (i.e., welfare annuity insurance, health insurance and nursing care insurance) and labor insurance (i.e., employment insurance and workers’ accident compensation insurance) are mandatory in Japan.

The application and interpretation of these statutes is based on Japanese court precedents and administrative guidelines issued by the relevant administrative authorities, including the Ministry of Health, Labor and Welfare, the Labor Standards Inspection Office and the Labor Bureau.

Labor Standards Act

The Labor Standards Act specifies the mandatory minimum working conditions applicable to all individuals working in Japan regardless of nationality. The Labor Standards Act regulates basic working conditions, including dismissal, wages, working hours and days off, overtime work, annual paid leave, maternity leave and work-related injury and sickness.

Even if an employee has been hired under an agreement which specifies a foreign law as the governing law, the employee may be able to claim protection under mandatory Japanese employment laws if the employee works in Japan. For example, if a foreign company hires an employee overseas, but the employee is actually required to work in Japan, the employee may demand that the minimum working conditions in the Labor Standards Act be applied even where the company and the employee did not agree in advance about the applicable law, or where another country’s law has been selected as the governing law.

Work Rules

An employer that employs ten or more employees on a continuous basis at one workplace must draw up work rules (also called “rules of employment” or shugyo kisoku) applicable to that workplace and file them with the applicable local Labor Standards Inspection Office.

The work rules are a set of rules which comprehensively provide for various matters relating to the employees' working conditions. The Labor Standards Act provides a list of specific working conditions that must be covered under the work rules, including work schedule, wages, leave and termination of employment. The implementation and amendment of the work rules must follow certain procedures prescribed by statute.
Work rules in Japan may be unilaterally amended by the employer and are, in principle, binding on both the employer and the employees as long as certain procedures are followed and have been made known to the employees. However, provisions of the work rules which are contrary to the minimum statutory requirements or which are unreasonable are not binding on employees. Work rules or amended work rules that change the employment terms and conditions in a manner that is detrimental to an individual employee are not binding on the employee unless the employee consents to them or they are “reasonable” under all of the circumstances.

The work rules must be prepared on a workplace basis and include the basic employment terms and conditions applicable to all employees working at a particular workplace. In this context, the reference to “all employees” includes non-regular employees, such as contract employees and part-time employees, as long as they work on a continuous basis.

Wages, Bonuses and Other Payments

“Wages” means any payments made by the employer to its employees as remuneration for the employees’ services, including salaries, bonuses and allowances. In principle, wages must be paid to employees: (1) in cash; (2) directly; (3) in full; and (4) at least once a month and on a fixed date.

Although wage payments should be made in cash under the Labor Standards Act, they can be paid by other methods if the employee consents. The payment of wages by bank transfer is now almost universal, although some small employers may still pay their employees in cash. The requirement to pay wages “in full” means that the employer cannot make deductions without the employee’s consent, apart from legally required or permitted deductions such as taxes and social and labor insurance contributions. This includes set-off by the employer of debt owed by the employee to the employer.

Japanese laws do not impose any specific requirements on employers concerning bonuses. The calculation and payment of bonuses to employees is done at an employer's discretion. It is, however, quite common in Japan to pay employees a fixed amount as a seasonal bonus twice a year, in summer and winter. Generally, it is difficult to cease or reduce this kind of fixed or “guaranteed” bonus.

There are also no statutory rules regarding retirement benefits, severance pay or company pensions (separate from the mandatory welfare annuity insurance scheme). Any such benefits will be voluntary benefits paid by the employer. It is quite common among Japanese employers to provide a retirement allowance. Under this type of plan, employees receive a lump sum payout when they leave the company which is calculated based on their years of service with the company and their reason for leaving the company (i.e., whether the departure from the company is voluntary or involuntary).

Working Hours and Holidays

The statutory maximum working hours are eight hours per day or 40 hours per week, excluding rest periods. Employers may have employees work beyond the statutory maximum working hours only after they have executed a labor management agreement with their employee representative or internal labor union specifying the circumstances in which overtime can be demanded and the applicable overtime hours limits. This agreement must then be filed with the Labor Standards Inspection Office.

Rest periods of at least 45 minutes for work exceeding six hours and of at least one hour for work exceeding eight hours are mandatory. If necessary, the rest period may be provided in installments during the day, but in principle the rest period should be provided to all employees simultaneously. To make other arrangements, an employer must generally enter into a labor management agreement with the employee representative or internal labor union.
In principle, an employer must provide at least one day off per week as the statutory day off. Any other days off are "employer-designated days off." Any day of the week can be designated as a day off and employers are not required to grant days off on Japanese public holidays. Work on a statutory day off will be regarded as legal "work on a day off" which is subject to an additional overtime allowance. Work on an employer-designated day off which is not a statutory day off will only be regarded as overtime if it is in excess of the 40 hour per week limit. Employers may have employees work on statutory days off only after executing a labor management agreement with the employee representative or internal labor union specifying the circumstances in which such work can be demanded and the applicable hours limits. The employer must then file this agreement with the Labor Standards Inspection Office.

Overtime Work and Work on Days Off

Any work performed beyond the statutory maximum working hours — eight hours a day or 40 hours a week — is generally referred to as "overtime work". Any work performed on a statutory day off is generally referred to as "work on days off."

An employee must be paid an overtime allowance in addition to his/her regular hourly wage for each hour or part of an hour of overtime work or work on days off. Generally, the regular hourly wage is calculated by dividing the monthly salary by the average regular working hours per month over a period of one year. The overtime allowance, which is based on a percentage of the regular hourly wage, depends on the particular category of work to which it relates. The statutory minimum rates for the various overtime allowances can be summarized as follows:

- 125% of the regular hourly wage for overtime work (and 150% for overtime work exceeding 60 hours per month, unless certain exceptions apply); and
- 135% of the regular hourly wage for work on days off.

Additionally, when an employee works between the hours of 10:00 pm and 5:00 am, the employee is entitled to an additional "late night work allowance" at the statutory minimum rate of 25% of the regular hourly wage. Accordingly, overtime work performed during late night hours will attract a total overtime allowance of 150% (125% + 25%) of the regular hourly wage. Work on days off performed during late night hours will attract a total overtime allowance of 160% (135% + 25%) of the regular hourly wage.

Any arrangement contrary to these regulations will be deemed void and unenforceable even if agreed to by an employee. An employee will be entitled to the statutory minimum allowances even if the employee has waived them in advance.

Employees in "supervisory" or "management" positions or employees handling "confidential matters" are exempt from receiving an overtime allowance but not from receiving late night work allowances. However, this exemption has been interpreted very narrowly by the Ministry of Health, Labor and Welfare and the Japanese courts. An employee in a "supervisory" or "management" position is generally defined as one who, as part of the employer’s management, has the responsibility and authority to supervise and manage other employees.

Japanese courts have generally limited the application of this exemption to high-level employees who are directly involved in the employer’s core business decisions as members of its management team. This means that the scope of the managers who can be legitimately excluded from the overtime payment requirement is quite limited.
Mandatory Social and Labor Insurance Schemes

A number of mandatory social and labor insurance programs have been implemented for the welfare of workers in Japan. Employers are required to participate in five types of insurance:

1. Welfare Annuity Insurance (Kōsei Nenkin Hoken);
2. Health Insurance (Kenko Hōken);
3. Nursing Care Insurance (Kaigo Hoken);
4. Employment Insurance (Kōyō Hoken); and
5. Workers’ Accident Compensation Insurance (Rōdōsha Saigai Hoshō Hoken).

Welfare Annuity Insurance, Health Insurance and Nursing Care Insurance are collectively referred to as “Social Insurance” (Shakai Hoken), while Employment Insurance and Workers’ Accident Compensation Insurance are collectively referred to as “Labor Insurance” (Rōdō Hoken).

Employers are required to enroll their employees in:
- the Welfare Annuity Insurance program;
- the Health Insurance program; and
- the Nursing Care Insurance program (only required for employees between the ages of 40 and 65 years old).

The premiums for these insurance schemes are calculated based on the employee’s compensation and are shared equally between the employee and the employer.

Employers are also required to participate in the Workers’ Accident Compensation Insurance and Employment Insurance programs funded and managed by the government. The premiums for Workers’ Accident Compensation Insurance and Employment Insurance are calculated based on the total compensation paid to all insured employees (including base salary, bonuses and allowances but excluding casual payments, actual reimbursable expenses, retirement allowances and leave compensation). The Worker’s Accident Compensation Insurance premium is borne entirely by the employer but the Employment Insurance premium is shared between the employee and the employer at a rate set by statute (i.e., not equally).

Employees are required to be enrolled in the above social and labor insurance schemes regardless of nationality. However, Japan has entered into Social Security Agreements with some countries that set forth provisions to avoid double payments of insurance premiums and/or aggregate insurance premiums.

Japan currently has Social Security Agreements with the following countries: Germany, the UK, South Korea, the US, Belgium, France, Canada, Australia, the Netherlands, the Czech Republic, Spain, Ireland, Brazil, Switzerland, Hungary, India and Luxemburg. With regard to the UK, South Korea and Italy, the Social Security Agreements only relate to provisions to avoid double payment of insurance premiums. Further, Japan has concluded Social Security Agreements with Italy, the Philippines and Slovakia that have yet to come into effect.

Tax Considerations

An employee’s income is subject to two different types of withholding tax:

1. national income tax (withholding income tax); and
2. local tax (inhabitants tax).
A newly established entity must file with the regional taxation bureau within one month after its establishment date. This filing is usually handled as a matter of course together with several other tax notifications upon the establishment of a company. Thereafter, the employer will have to file annually with the local and regional taxation bureaus and pay the tax which it withholds from employees’ salaries for national income tax (i.e., withholding income tax) and local tax (i.e., inhabitants tax).

Termination of Employment

When an employer dismisses an employee, it is required to give at least 30 days' notice or payment in lieu thereof. An employer may dismiss an employee without notice or payment in lieu thereof only for very serious misconduct by the employee and upon obtaining the prior approval of the Labor Standards Inspection Office.

An employer must have an objectively justifiable and reasonable cause to legitimately dismiss an employee (a “justifiable cause”). Dismissal without a justifiable cause is considered to be an “abuse of the right of dismissal” and will be considered illegal and void. This means that an at-will employment arrangement cannot be validly implemented in Japan, even if the employee agrees to it.

Dismissal is prohibited during a period of statutory leave for medical treatment with respect to a work-related injury or sickness and for 30 days thereafter, or during maternity leave and for 30 days thereafter. Dismissal of a female employee during her pregnancy and for one year after she has given birth will be void unless the employer proves that the dismissal was not related to her pregnancy, giving birth or her application for or the taking of maternity leave, or for any other reason relating to her pregnancy or giving birth.

Where an employee wishes to resign, he/she is in principle required to give the employer at least two weeks' notice. An employee is free to resign at any time unless the employee is employed under a fixed-term contract that does not specifically reserve the employee’s right to resign during the term.

Trade Unions

In Japan, an employee can join a labor union and may seek to be represented by the union, whether it is an enterprise union organized within the employer or an external union, at any time before, or even after, receiving a notice of dismissal. Union representation forces the employer to bargain with the union in good faith over decisions related to the union member’s employment and termination.

A majority of employees is not needed for collective bargaining representation in Japan. A collective labor agreement with a labor union applies only to union members. However, if 75% or more of the employees are members of the labor union, the agreement, in principle, applies to all of the employees.
Antimonopoly Act

Overview

The aim of the Act on the Prohibition of Private Monopolization and Maintenance of Fair Trade (the “Antimonopoly Act”) is to promote free and fair competition in Japan. The following four measures aim to achieve this goal:

(a) the prohibition of cartels;
(b) the prohibition of private monopolies;
(c) the prohibition of unfair trade practices; and
(d) the control of business combinations.

The enforcement agency of the Antimonopoly Act is the Fair Trade Commission (“FTC”). The FTC is an independent administrative commission consisting of a chairman and four commissioners. Although the FTC is a part of the Prime Minister’s Office, its decisions are made independently.

Prohibition of Cartels

The phrase “unreasonable restraint of trade” is used in the Antimonopoly Act to describe a cartel situation. Two basic requirements must be met for conduct to be determined to be an “unreasonable restraint of trade”:

(a) an explicit or tacit agreement must exist among enterprises as to the mutual restriction of their business activities. These may be related to price fixing, quantity restriction or some other types of restriction such as a territorial restriction; and

(b) the cartel or “unreasonable restraint of trade” must also have a “substantial impact” on the relevant market.

Private Monopolization

Private monopolization is defined in the Antimonopoly Act to require the following elements:

(a) where any enterprise, whether individually or in combination with other enterprises;
(b) excludes or controls the business activities of another enterprise;
(c) thereby causing, contrary to the public interest, a substantial restraint of competition in any particular field of trade.

In short, private monopolization means the abuse of the economic power of powerful enterprises to exclude or control the business activities of other enterprises. The types of practices within this category of prohibited business activity involve predatory pricing, exclusive arrangements with distributors which prevent competitors from using them, tie-ins and other restrictive practices.

Unfair Trade Practices

The term “unfair trade practices” includes a variety of conduct, some of which is not easily defined. The Antimonopoly Act lists a number of categories of unfair trade practices and the FTC is authorized to designate unfair business practices within these categories. The original activities designated by the FTC in 1982 were revised in 2010.
The main categories of unfair trade practices include:

- concerted refusal to trade;
- discriminatory pricing;
- unjustly low price sales;
- resale price restrictions;
- abuse of superior bargaining position;
- unduly discriminating against other enterprises;
- unduly inducing or coercing a competitor’s customers to deal with oneself; and
- trading on exclusive terms or restrictive terms.

The prohibition of unfair business practices is regarded to be a method of preventing private monopolization. However, in practice, the prohibition of unfair business practices has had a wider scope of operation.

Control of Business Combinations

Overview

Under the Antimonopoly Act, a pre-closing filing arises in respect of the following business transactions:

- mergers;
- asset acquisitions;
- share acquisitions;
- corporate spin-offs; and
- transfers of shares.

These filing requirements are not applicable in the case of:

(a) business combinations, such as mergers, asset acquisitions, corporate spin-offs and joint share transfers where all parties to a transaction belong to the same group; and

(b) share transactions where the share acquiring company and the share issuing company belong to the same group.

The FTC looks into the substance of a transaction to determine whether the transaction is likely to "substantially restrain competition" in any "particular field of trade." The FTC will make its determination by examining the actual circumstances of each case with reference to certain economic matters for horizontal, vertical and conglomerate transactions. The FTC must take action within the 30-day waiting period or any shortened period if it finds that the proposed transaction may "substantially restrain competition" in "any particular field of trade" or where unfair trade practices have been employed.

The “Guidelines to the Application of the Antimonopoly Act Concerning the Review of Business Combinations” published by the FTC specify the circumstances in which a proposed merger or acquisition may be regarded as substantially restraining competition in a particular market. While the guidelines are not binding on the FTC in respect of any decision made in relation to a specific
case, the FTC, in practice, follows the guidelines when conducting a review of the factual situation.

A comprehensive overview of these laws as they apply to M&A in Japan is set out in our “M&A Guide - Japan,” which is available upon request.

Mergers

Both parties to a merger must file a notification with the FTC no later than 30 days before the proposed date of the merger where the merger is between Japanese companies or foreign companies, and:

(a) the total amount of the domestic sales of the combined group of companies to which one company belongs exceeds ¥20 billion (approximately €148,000,000 or US$182,000,000); and

(b) the total amount of the domestic sales of the combined group of companies to which another related company belongs exceeds ¥5 billion (approximately €37,000,000 or US$45,500,000).

A merger between a parent company and a subsidiary, or between two or more subsidiaries of the same parent, is not subject to the foregoing prior notification requirement. The parties to a transaction that is subject to a prior notification filing are prohibited from effecting the transaction for a period of 30 days after the filing. However, the FTC has the power to shorten this waiting period.

Share Acquisitions

For share acquisitions, a pre-closing notification must be filed by the acquirer with the FTC at least 30 days prior to the closing date of the transaction:

(a) when the total amount of domestic sales of the acquiring company (whether a domestic or foreign company) and the other companies in the combined group of companies exceeds ¥20 billion (approximately €148,000,000 or US$182,000,000);

(b) when the total amount of domestic sales in Japan of the target company and its subsidiaries exceeds ¥5 billion (approximately €37,000,000 or US$45,500,000); and

(c) when, as a result of the acquisition, the aggregate percentage of the total voting shares of the target company held by the acquiring company and other companies in the combined group of companies exceeds 20% or 50%, respectively.

An acquisition of shares upon incorporation of a wholly-owned subsidiary is not subject to this reporting requirement.

Business and Asset Acquisitions

The acquiring company must file a notification with the FTC no later than 30 days before the proposed date of the acquisition where the target business or assets are owned by a Japanese company or by a foreign company, and:

(a) the total amount of domestic sales of the acquiring company (whether domestic or foreign) and the other companies in the combined group of companies exceeds ¥20 billion;

(b) in the case of an acquisition of the company’s entire business, the company’s total amount of domestic sales exceeds ¥3 billion; and
(c) in the case of an acquisition of a material part of the company’s business or all or a material part of the fixed assets the company uses in its business, the total amount of domestic sales related to the target business or fixed assets exceeds ¥3 billion.

The parties to a transaction that is subject to a prior notification filing are prohibited from effecting the transaction for a period of 30 days after the filing. However, the FTC has the power to shorten this waiting period.

An asset transfer between a parent company and a subsidiary or between two or more subsidiaries of the same parent is not subject to the foregoing prior notification requirement.

Prior Consultation with the FTC

It is recommended that the FTC be consulted prior to notification with regard to the contents of notification forms, such as “a particular field of trade.” During such consultations, the FTC will not make a determination as to the legality of the proposed business activities under the Antimonopoly Act. Voluntary pre-notification consultation with the FTC is particularly advisable in the case of business combinations, as it is frequently difficult to determine whether an intended transaction meets the criteria for review under the Antimonopoly Act. This is particularly the case when the parties involved in the transaction reasonably anticipate that the transaction may “substantially restrain competition in any particular field of trade.”

Extra-Territorial Application of the Antimonopoly Act

In the past, the FTC did not actively seek to implement the extraterritorial application of the Antimonopoly Act in cases involving foreign entities. However, with the recent tendency for transactions with foreign entities to impact Japanese markets, the FTC has gradually changed its policy towards a more active extraterritorial application of the Antimonopoly Act.

There are basically two principles involved in the application of the Antimonopoly Act to foreign transactions:

(a) the “territorial principle”; and
(b) the “effect principle.”

The “territorial principle” means that the law applies to conduct that occurs within the territory of Japan and does not apply to conduct that occurs outside Japanese territory. The “effect principle” means that the law applies to conduct that directly and substantially affects the Japanese market.

The courts of Japan and the FTC adopt the effect principle when applying the Antimonopoly Act. Accordingly, the Antimonopoly Act will apply to cartels operated outside Japanese territory that affect the Japanese market.

Administrative and Criminal Procedures

Overview

The Antimonopoly Act provides for administrative and criminal procedures as well as civil compensation by way of damages. Contravention of the penal provisions can result in imprisonment or fines, as described in more detail below.

Administrative Procedures

When evidence exists of a violation of the Antimonopoly Act, the FTC initiates an investigation. If the evidence collected is sufficient to support the initiation of administrative proceedings, the FTC usually issues a cease-and-desist order and possibly also a surcharge-payment order to the
violator after giving it notice and a chance of an opinion hearing. A person who is dissatisfied with the FTC's orders may challenge the order by initiating a lawsuit in the Tokyo District Court.

The Surcharge System

The surcharge system was introduced in Japan to discourage repeat offenses. For example, where a business is involved in a cartel, private monopoly or certain unfair business practices (i.e., concerted refusal to trade, discriminatory pricing, unjust low price sales or resale price restrictions) more than once within a 10 year period, an order is imposed on the offending party to pay an administrative surcharge. This surcharge is computed on the basis of total sales or purchases made during the period in which the conduct in question was taking place. Some examples of how the surcharge system operates are set out below.

- Where the formation of cartels or private monopolization is conducted more than once within 10 years, the surcharge is increased by half.
- Where an entity played a leading role in the formation of a cartel, the surcharge imposed on said entity is increased by half.
- Where an entity which had formed a cartel stopped one month prior to the investigation by the FTC, the surcharge is discounted by 20%.

The leniency program, which was first introduced in 2005 and then expanded in 2009, applies to surcharges imposed on entities involved in cartels. The current system provides that up to five cartel participants may seek leniency with respect to surcharge payments before dawn raids as follows:

- First applicant: 100% immunity
- Second applicant: 50% reduction
- Third applicant: 30% reduction
- Fourth applicant: 30% reduction
- Fifth applicant: 30% reduction

Even after a dawn raid, up to three applicants, but no more than five applicants in total, including pre-dawn raid applicants, will be entitled to a 30% surcharge reduction.

Criminal Penalties

Conduct that violates the Antimonopoly Act, such as the formation of cartels, is subject to criminal penalties which include the imposition of monetary fines or imprisonment.

The maximum monetary penalty which may be imposed on companies responsible for violations of the Antimonopoly provisions, aside from a surcharge-payment order, is ¥500,000,000, and for individuals, the maximum monetary penalty is ¥5,000,000. For business combinations, any person who fails to file the required pre-closing notification or who files a false notification can receive a fine of up to ¥2,000,000. The penalty for failure to file may also be imposed on the non-compliant company. A person who gives effect to transactions which are required to file a prior notification prior to the expiration of the 30 day waiting period may be fined up to ¥2,000,000. The penalty may also be imposed on the non-compliant company. The fines are enforced by the FTC through the relevant District Court.

The maximum prison sentence for individuals convicted of participation in cartels is imprisonment for five years.
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