



MERGERS AND ACQUISITIONS



Taxation of Cross-Border
Mergers and Acquisitions

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TAX

Japan

Introduction

This chapter provides some insight into tax issues that need to be considered when an acquisition is contemplated in Japan.

Recent Developments

One of the most important developments in the Japanese tax legislation since the last edition of this book is the introduction of a foreign dividend exclusion (FDE) regime which came into effect on 1 April 2009.

Prior to this, Japanese-resident companies were taxed on dividends received from foreign subsidiaries at the prevailing corporate tax rate (which could be up to 41 percent). Double taxation was mitigated by an indirect foreign tax credit (FTC) for foreign corporate tax imposed on the earnings of the subsidiaries and a direct FTC for foreign withholding tax (WHT) imposed on dividends. The nature of the system was such that tax planning was often not a priority for Japanese-owned foreign subsidiaries, as any tax saving was effectively lost on repatriation of the profits to Japan. This is no longer the case. Tax savings in foreign jurisdictions may now result in a permanent tax saving for the group.

Under the new FDE regime, 95 percent of dividend income from qualifying foreign subsidiaries shall be excluded from taxable income (the remaining 5 percent is deemed to be expenses incurred in relation to the shareholding and is not excluded). A qualifying foreign subsidiary is a foreign company with at least 25 percent of its outstanding shares held directly by a Japanese company, continuously for six months or longer, as at the date on which the obligation to pay the dividends is fixed. Where a tax treaty between Japan and the country of residence of the foreign subsidiary has a reduced holding threshold for indirect FTCs, which shall be used to determine whether a company is a foreign subsidiary for the purposes of the FDE regime.

The new regime has been introduced to encourage repatriation of overseas earnings to bolster the Japanese economy, and could have a considerable impact on Japanese corporations in various ways, including their investment activities.

Asset Purchase or Share Purchase

The following sections discuss issues that need to be considered from a Japanese tax perspective when a purchase of either assets or shares is contemplated. A summary of the advantages and disadvantages of each alternative is provided at the end of this chapter.

Purchase of Assets

In an asset deal, the selling entity will realize a gain or loss in the amount of the difference between the sale price and the tax book value of the assets sold, and the assets will have a new base cost in the purchaser's hands.

Purchase Price

For tax purposes, in an asset deal the purchase price should be allocated amongst individual assets based on their respective market values. In the case of a purchase of a business, the excess of the purchase price over the total of the values allocated to each individual asset would be treated as goodwill for tax purposes, while any excess of the total of values of the individual assets over the purchase price would constitute negative goodwill for tax purposes.

Goodwill

For tax purposes, goodwill recognized in a purchase of business should be amortized over five years (20 percent of the base cost annually) and the amortization should be treated as deductible. In the case of negative goodwill, it should also be amortized over five years (20 percent of the base cost annually), and the amortization should be treated as taxable. Unlike the depreciation of tangible assets or the amortization of intangible assets explained later in the chapter, the amortization of goodwill or negative goodwill recognized in a purchase of business for tax purposes is not affected by the accounting treatment.

Depreciation

In general, a company may select either the straight-line method or the declining-balance method to compute the depreciation of each class of tangible assets. The default depreciation method for most assets is the declining-balance method, while for buildings and certain leased assets, the straight-line method must be

used. Intangible assets must also be amortized using the straight-line method.

The depreciation and amortization allowable for tax purposes will be computed in accordance with the statutory useful lives of the assets provided in the Ministry of Finance Ordinance in principle. For second-hand assets, shorter useful lives could be applied.

The depreciation or amortization must be recorded in the statutory books of account to claim a tax deduction. The amount of depreciation or amortization in excess of the allowable limit for tax purposes must be added back to the profits in calculating taxable income. If the book depreciation or amortization amount is less than the allowable amount for tax purposes, no adjustment is required, and the asset effectively gains an extension of its useful life for tax purposes.

Tax Attributes

Tax losses and other tax attributes are not transferred to the purchaser in an asset deal.

Value-Added Tax (VAT)

Japanese consumption tax, similar to VAT, is levied on a sale or lease of an asset in Japan, and a supply of service in Japan. The current rate of consumption tax is 5 percent, but a number of transactions are specifically excluded, such as the sale of land or securities, etc. A sale of business in Japan is treated as a sale of individual assets for consumption tax purposes and, therefore, should be subject to consumption tax, depending on the type of asset transferred. A sale of goodwill in Japan is a taxable transaction for consumption tax purposes.

Transfer Taxes

Stamp duty is levied on a business transfer agreement. The amount of stamp duty is determined according to the value stated in the agreement and the maximum amount of stamp duty is JPY 600,000.

If real estate is transferred in a business transfer, registration tax and real estate acquisition tax are levied. These taxes are subject to a number of temporary reductions and reliefs, and the tax rates could differ depending on the type of acquiring entity (such as trust, special purpose vehicle, etc.). When the acquiring entity is an ordinary corporation, registration tax is levied at 2 percent of the appraisal value of the property in principle, but for land, the tax rate is reduced to 1 percent until 31 March 2011, 1.3 percent until 31 March 2012, and 1.5 percent until 31 March 2013. Real estate acquisition tax is levied at 4 percent of the appraisal

value of the property in principle, but for land and residential buildings, the tax rate is reduced to 3 percent until 31 March 2012. Furthermore, for certain types of land (such as sites for building and residence), the tax base is reduced by 50 percent until 31 March 2012.

Purchase of Shares

In a share purchase, the purchaser does not achieve a step-up of the base cost of the target company's underlying assets.

Tax Indemnities and Warranties

In a share purchase, the purchaser takes over the target company's liabilities, including contingent liabilities. In the case of negotiated acquisitions, it is usual for the purchaser to request, and the seller to provide, indemnities or warranties as to any undisclosed tax liabilities of the company to be acquired. The extent of the indemnities or warranties is a matter for negotiation. When an acquisition is made by way of a hostile takeover, it is not possible, by virtue of the nature of the acquisition, to seek warranties or indemnities.

Tax Losses

Tax losses may be carried forward for seven years in principle. For Japanese corporate tax purposes, there is no distinction between revenue and capital losses.

Restrictions could apply on the carry-forward of losses when more than 50 percent of the ownership of a company with unused tax losses changes hands. These restrictions only apply when within five years after the change of ownership, one of several specified events occurs, such as the acquired company ceases its previous business and starts a new business on a significant scale compared to the previous business scale, etc.

Japanese tax law also provides for a tax loss to be carried back for one year at the option of the taxpaying company, but this provision has been suspended since 1 April 1992 except in certain limited situations, such as dissolution, and for small corporations with share capital of JPY 100 million or less.

Crystallization of Tax Charges

If the target company belonged to a tax consolidated group, gains and losses the target company incurred and deferred relating to transfers of assets to other entities within the consolidated group will crystallize in the target company when the target company leaves the consolidated group as a consequence of the acquisition.

Pre-Sale Dividend

When the seller is a Japanese corporation, the seller may prefer to receive part of the value of its investment as a pre-sale dividend rather than sale proceeds. This is because while capital gains from the sale of shares are subject to corporate tax at approximately 41 percent, dividend income less interest expenses deemed incurred in relation to holding the shares (net dividend income) is exempt from corporate tax, provided the Japanese seller corporation has held 25 percent or more of the target company for six months or more before the dividend is declared. If these conditions are not satisfied, 50 percent of net dividend income is exempt from corporate tax.

Transfer Taxes

No stamp duty is levied on the transfer of shares. However, if the target issues share certificates for the purpose of the transfer, the issuance of the certificates will be subject to stamp duty. The amount of stamp duty varies based on the stated value of the certificate. The maximum liability per share certificate is JPY 20,000.

Tax Clearances

It is not necessary to obtain advance clearance from the tax authorities for acquisitions or disposals of shares. For very complex or unusual transactions, however, the parties may decide to seek a ruling from the tax authorities (generally a verbal ruling) to confirm the proposed tax treatment.

Choice of Acquisition Vehicle

The following vehicles may be used for an acquisition by a foreign purchaser. When establishing an ordinary domestic company (Kabushiki Kaisha or Godo Kaisha), registration tax is charged at 0.7 percent of share capital (not including capital surplus), while establishing a branch of a foreign company is generally subject to registration tax of JPY 90,000.

Local Holding Company

If the purchaser wishes to offset financing costs for the acquisition against the Japanese target company's taxable income, a Japanese holding company may be set up as an acquisition vehicle. The offsetting would be achieved either through a tax consolidation, which allows an offset of losses of one company against profits of other companies in the same group, or through a merger, which makes two entities one. The tax consolidation system in Japan is explained in Other Considerations later in the chapter. For tax implications of a merger, see the Equity section.

Foreign Parent Company

If the foreign purchaser wishes to offset the financing costs for the acquisition against its own taxable profits, the foreign purchaser may choose to acquire the Japanese target company directly. In this case, Japanese tax implications for dividends from the target company to the foreign parent company, and for capital gains to be realized when the foreign parent company disposes of the target company in the future, should be considered.

Japanese WHT is imposed on dividends paid by a Japanese non-listed company to its foreign shareholders at 20 percent under Japanese domestic law, but reduced tax rates are available under Japan's tax treaties.

Capital gains from the sale of shares in a Japanese company by a foreign corporate shareholder without a permanent establishment in Japan are subject to Japanese national corporation tax at 30 percent if:

- the foreign shareholder and its related parties owned 25 percent or more of the outstanding shares at any time during the previous three years including the year of sale, and sold 5 percent or more of the outstanding shares of the Japanese company in a specific accounting period; or
- more than 50 percent of the Japanese company's total property consists of real estate located in Japan on a fair market value basis.

Some of Japan's tax treaties exempt foreign shareholders from taxation on capital gains in Japan.

Non-Resident Intermediate Holding Company

If the foreign parent company could be subject to significant tax in Japan and/or its home country if it directly holds the Japanese target company, an intermediate holding company in another country could be used to take advantage of benefits of tax treaties. It should be noted, however, that interposing an intermediate holding company for the sole purpose of enjoying tax treaty benefits could be regarded as treaty shopping and application of the treaty could be disallowed. The Japanese government has recently been updating its tax treaties, and many now contain LOB (limitation on benefits) clauses.

Local Branch

Generally, there is no material difference in the tax treatment of a branch of a foreign corporation and a corporation organized under Japanese law. The methods for computing taxable income, tax-deductible

provisions, and reserves, the limitations on certain allowable expenses, such as entertainment expenses and donations, and the corporate income tax rates are the same for both a branch and a corporation.

However, due to the difference in corporate structure between a branch and a corporation, certain areas are treated differently, as follows:

	Japanese Branch	Japanese Corporation
Scope of taxable income	Income from sources within Japan	Worldwide income
Applicable Tax Rates		
Effective tax rate	40.69%	40.69%
Special tax on family corporations	N/A	10% – 20% of undistributed earnings
Repatriation of profit	No tax	Dividends are subject to 20% withholding tax, or a lower rate under tax treaties
Tax Credit		
Withholding tax on interest	Creditable	Creditable
Withholding tax on dividends from other Japanese corporations	Creditable	Creditable
Foreign taxes	No credit, but deductible from income	Creditable (except for those relating to exempted foreign dividend income)
Charges and Allocation of Expenses		
Head office overhead expenses	Allowable	N/A
Direct expenses	Allowable	Allowable
Management fees	Allowable if paid to a separate legal entity	Allowable
Interest costs (other than for a bank branch)	Not allowable for payments to the head office	Allowable, but subject to withholding tax at 20%, or a lower rate under tax treaties
Royalties	Not allowable for payments to the head office	Allowable, but subject to withholding tax at 20%, or a lower rate under tax treaties

Source: KPMG in Japan, 2009

Joint Ventures

A joint venture is generally a Japanese corporation with joint venture partners holding shares in the Japanese corporation, or a Nin-i Kumiai (NK, similar to a partnership) with joint venture partners holding interests in the NK. In Japan, an NK is not recognized as a separate taxable entity and the partners are liable for Japanese tax on the basis of their share of profits under an NK agreement and in accordance with their own Japanese tax status.

Choice of Acquisition Funding

Debt

Interest paid or accrued on debt, including an inter-company loan, is generally allowed as a deduction for the paying corporation, but there are exceptions, particularly in the case of an inter-company loan from a foreign shareholder or affiliate.

Deductibility of Interest

The thin-capitalization rule restricts the deductibility of interest payable by a Japanese subsidiary to its overseas controlling shareholders or affiliates. The safe harbor is debt/equity ratio is 3:1. If loans from the overseas controlling shareholders or affiliates causes the ratio to be exceeded, interest expenses calculated on the excess debt are treated as non-deductible expenses for Japanese corporation tax purposes.

Third-party debts, including the following, may also be subject to the thin-capitalization rule:

- back-to-back loans from overseas controlling shareholders through third parties;
- debts from a third party with a guarantee by overseas controlling shareholders; and
- debts from a third party by providing bonds borrowed from overseas controlling shareholders as collateral for the debts.

In lieu of the 3:1 ratio, a company may use the debt/equity ratio of a comparable Japanese company if a higher ratio is available. A foreign company engaged in trade or business in Japan through its branch is also subject to the thin-capitalization rule.

Interest to overseas shareholders or affiliates should also be reviewed from a transfer pricing perspective.

Withholding Tax on Debt and Methods to Reduce or Eliminate

Under Japanese tax law, the WHT rate on interest payable to a non-resident is 20 percent, in principle. However, reduced tax rates are applicable under tax treaties. To obtain the reduction of Japanese WHT under a tax treaty, the recipient or his/her agent should submit an application form for relief from Japanese income tax to the competent tax office through the payer corporation before the date of payment.

Checklist for Debt Funding

- Consider whether interest should be treated as fully deductible from a thin-capitalization perspective.
- Consider whether interest should be treated as fully deductible from a transfer pricing perspective.
- The use of bank debt may avoid thin-capitalization and transfer pricing problems unless there are back-to-back arrangements.
- Consider whether the level of profits would enable tax relief for interest payments to be effective.
- WHT of 20 percent will apply on interest payments to foreign entities unless a lower rate applies under the relevant tax treaty. For the application of a treaty rate, submitting an application form to the tax office is necessary before the payment.

Equity

Dividends paid by an ordinary Japanese company are not deductible. Under domestic law, WHT is imposed on dividends paid by a Japanese company to its foreign shareholders at 20 percent. WHT on dividends from certain listed companies is reduced to 7 percent until 31 December 2011, and to 15 percent thereafter. Reduced tax rates are available under Japan's tax treaties.

The Japanese Corporation Tax Law provides for a specific regime for corporate reorganizations. Below is an overview of the corporate reorganization regime.

Tax-Qualified reorganizations vs. Non-Tax-Qualified Reorganizations

The corporate reorganization regime provides for the definitions of tax-qualified reorganizations and non tax-qualified reorganizations for the following transactions:

- Corporate division (spin-off and split-off)
- Merger
- Contribution in-kind
- Post establishment transfer
- Share-for-share-exchange (kabushiki-kokan) or share-transfer (kabushiki-iten)

Under a tax-qualified reorganization, assets and liabilities are transferred at tax book value (that is, recognition of gains/losses is deferred) for tax purposes, while under a non tax-qualified reorganization, assets and liabilities are transferred at fair market value (that is, capital gains/losses are realized). Note that when a share-for-share-exchange or a share-transfer is carried out as a non tax-qualified reorganization, built-in gains/losses in assets held by the subsidiaries will be crystallized although assets and liabilities are not transferred and remain in the subsidiary.

The following conditions apply to a tax-qualified reorganization:

Relationship	Conditions
(1) 100% ownership relationship	(a) Delivery of shares only as consideration for transfer (no cash or other assets involved). (b) Expectation that the 100% ownership relationship will remain intact.
(2) More than 50% (but less than 100%) ownership relationship	(a) Delivery of shares only as consideration for transfer (no cash or other assets involved). (b) Expectation that the controlling ownership relationship will remain intact. (c) Transfer of the main assets/liabilities of the transferred business. (d) Expectation for the transfer and retention of approximately 80% or more of employees engaged in the transferred business. (e) Expectation that the transferee will continue to operate the transferred business.
(3) 50% or less ownership	(a) Same as (2)(a), (c), (d), and (e). (b) The transferred business has a

Relationship	Conditions
	relationship with one of the transferee's businesses.
	(c) The relative business size (that is, sales, number of employees, etc.) of the related businesses is not substantially different (within a 1:5 ratio), or senior directors from both sides will participate in the management of the transferred business.
	(d) Expectation that the shares received for the transferred business will continue to be held.

The conditions for a tax-qualified share-for-share exchange or share-transfer are similar to those mentioned, but slightly different since there is no transfer of business under these reorganizations. For example, the condition in (2)(c) will not be relevant, (2)(d) should be replaced by: expectation that approximate 80 percent or more of the employees in the subsidiary will continue working for the subsidiary; and (2)(e) should be replaced by: expectation that the subsidiary will continue to operate its own main business.

From 1 May 2007, a triangular reorganization (a triangular merger, a triangular spin-off type corporate division, and a triangular share-for-share exchange) is available in Japan, whereby the shares of the parent company of the transferee company (including the company becoming the parent company of the transferred company in a share-for-share exchange) are transferred to shareholders of the transferor company (including the transferred company becoming a subsidiary in a share-for-share exchange) instead of shares in the transferee company. Note that under the Japanese Company Law, although both the transferee company and the transferor company must be Japanese companies, the parent company of the transferee company in a triangular reorganization could be a foreign company. In connection with condition (a), if the shareholders of the transferor company receive only shares in the parent company of the transferee company in a triangular reorganization, condition (a) is satisfied, provided the parent company directly holds 100 percent of the shares of the transferee company.

Pre-Reorganization Losses

Under a tax qualified merger, if certain conditions are met, pre-merger losses are transferred from the merged company to the surviving company. Otherwise, (that is, under a non tax-qualified merger or under an otherwise

tax-qualified merger that does not satisfy certain conditions), such losses cannot be transferred.

As for pre-merger losses incurred in the surviving company, if the merger is tax-qualified, certain requirements must be met to use such losses against future profits after the reorganization, while there are no such requirements if it is a non tax-qualified merger. This rule is also applied to pre-reorganization losses incurred in the transferee company in the cases of a corporate division and a contribution in kind.

There are also a number of rules that restrict use of built-in losses after a reorganization under certain circumstances.

Taxation of Shareholders

When the shareholders receive shares in the transferee company only, or shares in the parent company of the transferee company (in triangular reorganizations) only, capital gains/losses from the transfer of the shares are deferred in principle. In the case of a merger or a split-off type corporate division, if the reorganization is non tax-qualified, the shareholders of the transferor company recognize a deemed receipt of dividends.

Hybrids

Hybrid instruments are deemed to be either shares (and hence treated as equity) or debt (and hence subject to the accrual rules). The following is a list of the major types of instruments and their treatment for tax purposes:

Type	Treatment
Convertible bonds	Debt, subject to accrual rules
Perpetual debt	Debt, subject to accrual rules
Subordinated debt	Debt, subject to accrual rules
Preference shares	Equity

Source: KPMG in Japan, 2009

Discounted Securities

Generally, the issuer of discounted securities would be able to obtain a tax deduction for the discount accruing over the life of the securities, while the lender would recognize taxable income accruing over the life of the securities. However, tax treatments of discounted securities could be different case by case, and each case should be analyzed on its facts.

Deferred Settlement

Earn-out arrangements that defer part of the consideration and link its payment to the performance of the acquired business, are not uncommon in acquisitions. Generally, the seller would recognize gains as they are realized, but the tax treatment of such a

deferred settlement will vary case-by-case, and each case should be analyzed on its facts.

Other Considerations

Concerns of the Seller

The seller's concerns or preferences in terms of the form of the deal structuring would be affected by various factors including its tax position, whether it is an individual or corporate, etc. For example, when the seller is a Japanese resident individual, capital gains from the sale of shares of a Japanese non-listed company are taxed at 20 percent. On the other hand, if the Japanese non-listed company in which the Japanese individual holds shares sells assets and distributes the sale proceeds as a dividend to the shareholder, broadly speaking, the company would be subject to corporate tax at approximately 41 percent on the gains from the sale of assets, and then the shareholder would be subject to income tax on dividend income distributed out of the company's after tax profits at a maximum of 50 percent. In this case, a Japanese individual seller may prefer a share deal to an asset deal. The position is not straightforward and professional advice should be sought.

Company Law and Accounting

The new Japanese Company Law came into effect on 1 May 2006. One of the key features of the new law, especially from a mergers and acquisitions point of view, was the relaxation of the form of consideration in mergers. Before the new Company Law was introduced, only the shares of the surviving company were permitted as consideration for a merger. Under the new law other forms of consideration, such as the shares of the parent company of the surviving company (which enables a triangular merger), or cash, etc., can be distributed to the shareholders of the liquidating company in a merger. Because of the concern Japanese companies had about possible hostile acquisitions by foreign companies through a triangular merger, the introduction of the relaxation of merger consideration was delayed for one year until 1 May 2007.

As for accounting, Japan has been working on the convergence of the Japanese accounting standards (JGAAP) with IFRS, with a target date for the completion of convergence of 30 June 2011. In June 2009, the Financial Services Agency of Japan released a roadmap for the adoption of IFRS. According to the roadmap, an optional adoption of IFRS will be allowed for consolidated financial statements of certain listed companies from the fiscal year ending in March 2010. Then, the final decision regarding the adoption of IFRS

will be made around 2012, and mandatory adoption of IFRS may start from 2015, or 2016.

In terms of business combinations, there are currently differences between JGAAP and IFRS. For example, under JGAAP, although the purchase method is the principal method to be applied in a business combination, the pooling of interest method is also allowed in limited circumstances, while only the purchase method is allowed under IFRS. As for goodwill recognized as a result of a business combination, it must be amortized within 20 years under JGAAP, while under IFRS, it is not amortized, but is subject to impairment.

Group Relief/Consolidation

A group of companies may elect to file consolidated tax returns. A group is made up of a Japanese parent company and its 100 percent directly or indirectly owned Japanese subsidiaries. Non-Japanese companies are excluded from the consolidated group. To become a consolidated group, an election needs to be made to the tax office in advance. The tax consolidation system is applicable to national corporation tax only. Each company in a consolidated group is required to file local tax returns individually.

Consolidation allows for the effective offset of losses incurred by one company against profits of other companies in the same group. Consolidated tax losses can be carried forward and set off against future consolidated profits for up to seven years. In principle, losses incurred by subsidiaries prior to joining the consolidated group expire upon joining the group. At the time of joining a consolidated group, a subsidiary may be required to revalue its assets to fair market value and recognize taxable gains or losses from the revaluation.

Transactions among group companies should be based on fair market value. However, capital gains and losses arising on transfers of assets within a consolidated group (excluding inventory and small assets with a tax base of JPY 10 million or less) are generally deferred until the assets are resold or written off. Donations among group companies constitute taxable income for the recipient company and a non-deductible expense for the company paying the donation.

Transfer Pricing

The domestic transfer pricing legislation aims to prevent tax avoidance by companies through transactions with their overseas related companies. In general, the tax authorities require all intra-group transactions to be carried out in accordance with the arm's-length

principle. Two companies are related if one controls the other or they are under common control. A company has control over another company if:

- it directly or indirectly owns 50 percent or more of the total share capital of the other company; or
- it has the power to ensure that the affairs of the other company are conducted in accordance with its wishes.

The standard methods for transfer pricing are the comparable uncontrolled price method, resale price method, cost-plus method or a reasonable alternative method, including the profit split method or transactional net margin method. A company is required to declare in its tax returns the transfer pricing methodology used for all related party transactions and the volume and characteristics of the transactions.

Foreign Investments of a Local Target Company

Japan operates an anti-tax haven system whereby a Japanese company holding 5 percent or more of a specified foreign subsidiary (that is, a foreign company, more than 50 percent of which is owned by Japanese-resident companies/individuals and the effective tax rate of which is 25 percent or less: a tax-haven subsidiary) can be subject to tax on a pro-rated portion of the income of the tax haven subsidiary. Before the Tax Reform 2009, undistributed income of a tax-haven subsidiary was subject to this taxation, but by virtue of the introduction of the foreign dividend exclusion system in the Tax Reform 2009, the rule has changed so that a tax haven subsidiary's income should be subject to the taxation as it is generated.

The tax haven taxation does not apply where the tax haven subsidiary:

- maintains an office, store, factory, or other fixed place of business necessary to conduct its business in the country where the head office of the subsidiary is located;
- functions with its own administration, control and management in the country in which the head office of the subsidiary is located;
- conducts its business mainly in the country in which the head office of the subsidiary is located; or
- conducts its business mainly with unrelated parties.

A company conducting wholesale, banking, trust, securities, insurance, ocean transport, or air transport business is required to meet the first, second, and fourth conditions. A company conducting any other business must meet the first, second, and third conditions. Certain businesses are excluded from this exemption.

Comparison of Asset and Share Purchases

Advantages of Asset Purchases

- Goodwill may be recognized and amortized for tax purposes.
- Fixed assets may be stepped up and depreciated or amortized for tax purposes (except for land).
- No previous liabilities of the target company are inherited.
- It is possible to acquire only part of a business.

Disadvantages of Asset Purchases

- Capital gains, including those arising from goodwill, are taxable for the seller; therefore the price could be higher.
- Real estate acquisition tax and registration tax are imposed.
- Consumption tax (VAT) arises on certain asset transfers.
- The benefit of any losses incurred by the target company remains with the seller.

Advantages of Share Purchases

- Legal procedures and administration may be simpler, and thus could be more attractive to the seller and the price could be lower.
- Purchaser may benefit from tax losses of the target company.
- No consumption tax (VAT) is imposed.
- If the seller is non-Japanese, Japanese tax on capital gains from the sale of shares in the Japanese target company could be exempted, depending on the tax treaty Japan has with the country where the seller is located.
- The purchaser may gain the benefit of existing supply or technology contracts, and licenses or permissions.

Disadvantages of Share Purchases

- Liable for any claims or previous liabilities of the target company.
- No deduction is available for the purchase price.
- Step-up of the target company's underlying assets is not possible. Amortizable goodwill will not be recognized.

Withholding Tax Rate Chart

Japanese WHT is imposed on dividend, interest and royalty payments to foreign companies and non-resident individuals. The tax rate under domestic law is 20 percent (but for dividends from certain listed shares, etc., is reduced to 7 percent until 31 December 2011 and, is 15 percent thereafter, and in certain limited cases for interest is 15 percent). However, reduced tax rates are available under Japan's tax treaties as follows.

The rate information and footnotes contained in this table are from the 2009 IBFD/KPMG Global Corporate Tax Handbook.

Country	Dividends		Interest (%)	Royalties (%)
	Individuals, Companies (%)	Qualifying Companies (%)		
Australia	10	0/5 ¹	0/10 ²	5 ³
Austria	20	10 ⁴	10	10
Bangladesh	15	10 ⁵	10	10
Belgium	15	10 ⁵	10	10
Brazil	12.5	12.5	12.5	12.5/15/25 ⁶
Bulgaria	15	10 ⁵	10	10
Canada	15	5 ⁵	10	10
China (People's Rep.)	10	10	10	10
Czech Republic	15	10 ⁵	10	0/10 ⁷
Denmark	15	10 ⁸	10	10
Egypt	15	15	9	15
Fiji	9	9	9	10
Finland	15	10 ⁵	10	10
France	10	0/5 ¹⁰	0/10 ¹¹	0
Germany	15	10 ⁸	10	10
Hungary	10	10	10	0/10 ⁷
India	10	10	10	10
Indonesia	15	10 ⁸	10	10
Ireland	15	10 ⁵	10	10
Israel	15	5 ⁵	10	10
Italy	15	10 ⁵	10	10
Korea (ROK)	15	5 ⁵	10	10
Luxembourg	15	5 ⁵	10	10
Malaysia	15	5 ⁵	10	10
Mexico	15	0/5 ¹²	10/15 ¹³	10
Netherlands	15	5 ⁵	10	10
New Zealand	15	15	9	9
Norway	15	5 ⁵	10	10
Pakistan	10	5/7.5 ¹⁴	0/10 ¹⁵	10
Philippines	15	10 ¹⁶	10	10/15 ¹⁷
Poland	10	10	10	0/10 ⁷
Romania	10	10	10	10/15 ⁷
Singapore	15	5 ⁵	10	10
Slovak Republic	15	10 ⁵	10	0/10 ⁷
South Africa	15	5 ⁵	10	10
Spain	15	10 ⁵	10	10
Sri Lanka	20	20	9	0/10 ¹⁸
Sweden	15	0/5 ¹²	10	10
Switzerland	15	10 ⁵	10	10
Thailand	9	15/20 ¹⁹	10/25 ²⁰	15

Country	Dividends		Interest (%)	Royalties (%)
	Individuals, Companies (%)	Qualifying Companies (%)		
Turkey	15	10 ⁵	10/15 ²⁰	10
United Kingdom	10	0/5 ²¹	0/10 ¹¹	0
United States	10	0/5 ²²	0/10 ²³	0
USSR ²⁴	15	15	10	0/10 ⁷
Vietnam	10	10	10	10
Zambia	0	0	10	10

Notes

- Five percent applies to dividends paid to an Australian company that owns directly at least 10 percent of the voting shares of the Japanese dividend-paying company; 0 percent applies to dividends paid to an Australian company that has owned directly at least 80 percent of the voting stock of the Japanese dividend-paying company for the 12-month period ending on the date on which entitlement to the dividends is determined, provided that the Australian company is a qualified publicly-traded company or has at least 50 percent of the aggregate vote and value of its shares owned directly or indirectly by up to five such qualified publicly-traded companies, or has received a determination of entitlement to the treaty benefits. Pension funds are also entitled to the reduced tax rates, depending on the shareholding ratios.
- Zero percent applies to interest paid to:
 - the contracting state or a political subdivision or local authority thereof, any other body exercising governmental functions in a contracting state, or the Reserve Bank of Australia;
 - a financial institution which is unrelated to and dealing wholly independently with the payer;
 - the Export Finance and Insurance Corporation, or public authority that manages the investments of the future fund; and
 - any similar institution as agreed.

However, 10 percent applies if the interest is paid as part of an arrangement involving back-to-back loans, or other arrangements that are economically equivalent and intended to have similar effects.
- Royalties include forbearance payments and exclude payments for the use of spectrum licenses.
- The rate generally applies with respect to participations of more than 50 percent of share capital or voting shares, during a period of 12 months immediately before the end of the accounting period for which the distribution takes place, or during the entire taxable year for which the dividends are paid, as the case may be.
- The rate generally applies with respect to participations of at least 25 percent of voting shares, voting power or share capital, during the period of six months immediately preceding the date when such dividends are paid or become payable, or the end of the accounting period for which the distribution takes place, as the case may be.
- Twenty-five percent for royalties arising from the use of, or the right to use, trademarks (20 percent is applicable under the domestic tax law); 15 percent for royalties arising from the use of, or the right to use, copyright of cinematograph films and films or tapes for radio or television broadcasting.
- The lower rate applies to royalties received as consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films and films or tapes for radio or television broadcasting.
- The rate generally applies with respect to participations of at least 25 percent of voting shares during the period of 12 months immediately preceding the date when such dividends are paid, or the end of the accounting period for which the distribution takes place, as the case may be.
- The domestic rate applies; there is no reduction under the treaty. (For the treaty with Fiji, see the supplemental document to the Exchange of Notes of 25 September 1970 between Japan and the United Kingdom, which states that art. 6 [dividends] and art. 7 [interest] are not applicable to Fiji.)
- Five percent if the beneficial owner is a company holding directly or indirectly at least 10 percent of voting shares in the Japanese dividend paying company during the period of six months ending on the date on which entitlement to the dividends is determined; 0 percent if the beneficial owner is a company holding directly at least 15 percent of voting shares in the Japanese dividend paying company for six months or if the beneficial owner is a company holding directly or indirectly at least 25 percent of voting shares in the Japanese dividend paying company for six months. Pension funds are also entitled to the reduced tax rates, depending on the shareholding ratios.
- Zero percent applies to interest paid to:
 - the government, local authority, central bank, or institution wholly-owned by the government;
 - a resident of the treaty partner whose debt claim is guaranteed, insured or directly financed by one of the above;
 - a bank, an insurance company, a securities dealer, or other non-financial institution that satisfies specified asset/liability tests;
 - a pension fund or scheme, provided that such interest is not derived from the carrying on of a business, directly or indirectly, by such pension fund or scheme; or
 - a resident of the treaty partner with respect to indebtedness arising as part of the sale on credit of equipment or merchandise.
- Five percent if the beneficial owner is a company which owns at least 25 percent of the voting shares of the Japanese company during the period of six months immediately before the end of the accounting period for which the distribution takes place, and 0 percent if the beneficial owner also satisfies on the date of payment various conditions on the trading and ownership of its shares.
- The lower rate applies where the beneficial owner is a bank or an insurance company, the interest is derived from bonds and securities that are regularly and substantially traded on a recognized stock exchange, the interest is paid by a bank, or the interest is paid in respect of the sale on credit of equipment or machinery, provided that the recipient of such interest is the seller of the equipment or machinery.
- Five percent if the beneficial owner is a company holding directly at least 50 percent of voting shares in the Japanese dividend-paying company during the period of six months ending on the date on which entitlement to the dividends is determined; 7.5 percent if the beneficial owner is a company holding directly at least 25 percent of voting shares in the Japanese dividend-paying company during the period of six months ending on the date on which entitlement to the dividends is determined.
- The 0-percent rate applies to interest derived by the government of the contracting states or specified institutions.
- The rate applies with respect to direct participations of at least 10 percent of voting shares or the total shares issued, during the period of six months immediately preceding the date of payment of the dividends.
- Fifteen percent applies to royalties for the use of or the right to use cinematograph films and films or tapes for radio or television broadcasting.
- The lower rate applies to royalties or other amounts payable as consideration for the use of, or for the right to use, any copyright of cinematograph films.
- The rates apply with respect to participations of at least 25 percent of voting shares during the period of six months immediately before the end of the accounting period for which the distribution of profits takes place. Fifteen percent applies to dividends paid by a company engaged in an industrial undertaking.
- The lower rate applies to interest paid to a bank or a financial institution, as the case may be. The maximum rate is 20 percent under the domestic tax law.
- Five percent if the beneficial owner is a company that has owned, directly or indirectly, at least 10 percent of the voting power of the Japanese company for the period of 6 months ending on the date on which entitlement to the dividends is determined; 0 percent if the beneficial owner of the dividends is either:
 - a company that has owned, directly or indirectly, at least 50 percent of the voting power of the Japanese company paying the dividends for the period of six months ending on the date on which entitlement to the dividends is determined; or
 - a pension fund or pension scheme, provided that such dividends are not derived from the carrying on of a business, directly or indirectly, by such pension fund or pension scheme.
- Five percent if the beneficial owner is a company that owns directly or indirectly, on the date on which entitlement to the dividends is determined, at least 10 percent of the voting stock of the Japanese company; 0 percent if the beneficial owner of the dividends is:
 - a company that has owned, directly or indirectly through one or more residents of either state, more than 50 percent of the voting stock of the Japanese company for the period of 12 months ending on the date on which entitlement to the dividends is determined, and that satisfies various requirements on the ownership of its shares, or has received a determination of entitlement to the treaty benefits; or
 - a pension fund, provided that such dividends are not derived from the carrying on of a business, directly or indirectly, by such pension fund.
- Zero percent applies to interest paid to:
 - the government, local authority, central bank, or institution wholly-owned by the government;
 - a resident of the United States whose debt claim is guaranteed, insured or directly financed by one of the earlier;
 - a bank (including an investment bank), an insurance company, a registered securities dealer, or any other enterprise that satisfies specified asset/liability tests;
 - a pension fund, provided that such interest is not derived from the carrying on of a business, directly or indirectly, by such pension fund; or
 - a resident of the United States with respect to indebtedness arising as part of the sale on credit of equipment or merchandise.
- Japan continues to apply the USSR treaty in relations with Armenia, Azerbaijan, Belarus, Georgia, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan.

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