OUTSIDE PERSPECTIVES

Japan's new LLPs and LLCs

Koji Fujita,
Chisato Higashio and
James M. Minamoto

Earlier this year, the Japanese Diet passed legislation making two new business organization forms available to investors in Japan: Limited Liability Partnerships ("LLPs") and Limited Liability Companies ("LLCs"). This article briefly outlines key features of Japan's LLPs and LLCs.

Background

Currently, entrepreneurs starting a business in Japan can choose between several limited liability organizational business forms. The most common are the *Kabushiki Kaisha* ("KK") and the *Yugen Kaisha* ("YK").

The KK is the Japanese equivalent to a joint stock company and is the prevailing form of business organization in Japan. KKs require a board of directors (at least three, one of whom must be resident in Japan), a corporate auditor ("*kansayaku*"), and at least ¥10 million in capital for corporate shareholders. There are also numerous legal maintenance requirements.

The YK is the current Japanese equivalent to a limited liability company and is generally used by smaller businesses since the establishment and maintenance requirements are not as burdensome as for KKs. YKs need only one director and minimum capital of ¥3 million. YK units cannot be offered to the public and the maximum number of unit holders is 50 – in contrast to the KK where such restrictions do not exist.

One criticism of these currently available organizational forms is their inflexibility resulting from the above mentioned requirements. Recent amendments to the Japanese business law are intended to make business easier and stimulate entrepreneurial activity in Japan.

Important Amendments to Laws on KKs and YKs

Originally, KKs were intended for public and large-sized corporations and had rigid regulations as described above. On the other hand, YKs were intended for non-public and small sized corporations with more flexible rules. However, in practice, there are many small KKs with no substantial difference from YKs.

The YK Law will be abolished when the New Company Law (*Kaisha Ho*) becomes effective in early 2006. Furthermore, the New Company Law will provide new variations of KKs and flexible rules for small-sized corporations. Existing YKs may, but need not, convert into KKs and will essentially be "grandfathered" although they will be subject to provisions of the New Company Law since the YK Law will be abolished. It is likely that any conversion of existing YKs to KKs will be a non-taxable event.

Under the New Company Law, no minimum capital requirement to found a new KK will exist. However, KKs cannot distribute profits to shareholders unless they have net assets of at least ¥3 million. Further, closely-held KKs (which by their Articles of Incorporation ("*teikan*") provide that the transfer of shares is subject to the approval of the company), may have as few as one director instead of the minimum of three directors currently required.

Features of LLCs

After the New Company Law comes into effect, LLCs may be established as a new form of business organization. The purpose of this new form is to provide a more flexible option for entrepreneurs starting business in Japan.

(a) Liability

As it is a form with limited liability, members (equity holders) are not directly liable for LLC debts. Thus, a member's liability will not exceed its

Table A: Available Japan Business Forms and Their Respective Features/Requirements under Japanese Law

Requirement \ Form	KK	Japan Branch Office	LLC	LLP	NK
Limited Liability	✔	✔	✔	✔	✘
Pass-through Tax	✘	✘	✘	✔	✔
Flexible voting rules and profit/ loss allocation	✘	✘	✔	✔	✔
Requirement to set up a board of directors or appoint auditors	✔	✘	✘	✘	✘

Koji Fujita

Chisato Higashio

James M. Minamoto

capital contribution (which may consist only of money or property) in the company. However, an executive member can be liable for third party damages caused by the executive member's willful misconduct or gross negligence in operating the LLC.

(b) Members

An LLC must have at least one member. Any person, whether a natural person or a legal entity, can be an LLC member, but at least one member must be a Japanese resident or a legal entity organized under Japanese law. In principle, each member is authorized to operate the LLC. If the Articles of Incorporation so provide, one or several executive members(s) ("*gyoumu-shikko shain*") can be appointed to operate the LLC. If an executive member is a legal entity, it must appoint a natural person as an executive officer ("*shokumu shikko-sha*").

(c) Distribution of Profits and Losses

Legally, LLCs are allowed to distribute profits and losses in accordance with any agreed upon formula, which can be different from the proportion of capital contributions. However, such disproportional distribution may be treated as donations among members for tax purposes.

(d) Taxation

The LLC is NOT a pass-through entity and is subject to corporate taxation.

(e) Other regulations

Executive members owe fiduciary duties to the LLC. Any member may file a derivative suit against an executive member.

Features of LLPs

(a) Difference from LLCs

The LLP features almost the same characteristics as the LLC, including limited liability (which is something that differentiates the LLP from the Nin-i-Kumiai ("NK"), a general partnership under Japanese law). One significant difference is LLP taxation. Whereas an LLC is subject to corporate taxation, the LLP will be treated as a pass-through entity, not subject to corporate income taxation. Instead, its members are subject to income tax with respect to allocated profits. However, use of allocated losses are subject to restrictions. An LLP member may deduct allocated net losses from other taxable income only so far as the aggregate losses deducted are not more than the amount of its contribution in the LLP. Further, revenues that a non-resident and a foreign corporation receive from LLPs are currently subject to a 20% withholding tax.

(b) Disclosure and registration

An LLP must use the word "Yugen Sekinin Jigyou Kumiai" as a part of its name and be registered with the Legal Affairs Bureau. The LLP must disclose its balance sheet and profit/loss statement and the LLP contract to creditors upon their request. In addition, each member of the LLP must participate in the management of the business of the LLP. Therefore, members cannot delegate the entire business to one or more members. ■

Koji Fujita is a partner at Anderson Mori & Tomotsune, is admitted to the bars in Japan and New York and practices in the area of corporate transactions and international tax.
koji.fujita@amt-law.com

Chisato Higashio is an associate at the firm, is admitted to the Japan bar and practices in the area of general corporate/commercial matters.
chisato.higashio@amt-law.com

James M. Minamoto is the firm's Senior Foreign Counsel, is admitted to the New York bar and the Japan bar as a registered foreign attorney (Gaikoku Ho Jimu Bengoshi), and practices in the area of cross-border corporate transactions/investments.
james.minamoto@amt-law.com

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Anderson Mōri & Tomotsune
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