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How to Withdraw from the Japanese Market Through Liquidation

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The COVID-19 has had a profoundly adverse impact on society and global businesses. As a result of deteriorating market conditions, many foreign companies have been forced to cease their business operations in Japan through the liquidation or dissolution of their Japanese subsidiaries or affiliates. Due to the unique liquidation procedures under Japanese law, however, some foreign companies have found it costly and time-consuming to liquidate their businesses in Japan. To facilitate smoother and more efficient winding down of businesses by foreign companies in Japan, this newsletter outlines the dissolution and liquidation procedures in Japan that are applicable to foreign companies, as well as the ancillary practical issues that should be considered.

It should be noted at the outset that this newsletter only seeks to explain the procedures applicable for a foreign company to liquidate its business in Japan. These procedures described herein may not necessarily apply to the sale of businesses or debt restructuring to enable a business to continue as a going concern.

1. Company liquidation procedures under Japanese law

Japanese law provides for three methods by which to liquidate a company founded in Japan, as follows:

- (1) Ordinary Liquidation: Upon dissolution, a company will undergo ordinary liquidation proceedings to extinguish its juridical personality. Under such proceedings, the company will appoint a liquidator to implement the company's liquidation. Such implementation would include (i) termination of the contracts to which the company is a party, (ii) disposal of all the company's assets, (iii) repayment of all the company's debts, and (iv) distribution of the company's residual property to its shareholders.
- (2) Special Liquidation: Where the debts of a company may exceed its assets, and certain other

conditions are met, the company will be precluded from choosing the option of ordinary liquidation proceedings, but will instead have to undergo special liquidation proceedings. In such proceedings, a liquidator will be appointed to implement the company's liquidation under the supervision of the court. Under special liquidation proceedings, a company will be required to obtain debt waivers from its creditors, or obtain the consent of a certain number of its creditors to a repayment arrangement at a creditors' meeting held in court.

If a company is not a stock company (*kabushiki kaisha*) but another kind of company, such as a limited liability company (*godo kaihsa*), the company cannot undergo special liquidation proceedings. In such cases, the company may opt for special conciliation proceedings and obtain debt waivers thereunder in advance of undergoing ordinary liquidation proceedings.

- (3) Bankruptcy Proceedings: If a company is unable to opt for special liquidation proceedings because its debts exceed its assets and it is unable to obtain debt waivers from its creditors or get a certain number of its creditors to consent to a repayment arrangement, the company will have to undergo bankruptcy proceedings.

Except where otherwise agreed with creditors, companies generally opt for ordinary liquidation proceedings unless their debts exceed their assets, in which case they typically prefer special liquidation proceedings.

2. Procedures for the smooth liquidation of Japanese subsidiaries

A foreign company wishing to liquidate its Japanese subsidiary will generally have to cause its subsidiary to cease its business operations through termination of its transactions, contracts, and employment relationships both before it passes a resolution for dissolution and before the commencement of liquidation proceedings. This is because following the adoption of a dissolution resolution at a shareholders' meeting, the subsidiary will be prohibited from performing any obligations for approximately two months, including obligations to make any payments when terminating transactions, contracts, and employment relationships. Moreover, as a practical matter, the counterparties to the subsidiary's transactions, contracts and employment relationships would face difficulties during the aforementioned two-month "lock out" period, if these relationships are not terminated before commencement of the "lock out" period. In general, therefore, prior to its dissolution, a Japanese subsidiary must negotiate with its creditors and counterparties (other than its parent company) to reach agreement on the extent of all the Japanese subsidiary's debts and other contractual obligations, and to fulfill all such obligations until the parent company is its only remaining obligee.

The following is a summary of the procedures involved in the liquidation of a company founded in Japan.

(1) Closure of business

As noted above, prior to dissolution, a subsidiary must fulfill all its obligations, other than those owed

to its parent company. The parent company is then required to determine whether there is any outstanding payment obligation that the subsidiary has not and is unable to fulfil. If so, the parent company will have to finance the shortfall through a loan to the subsidiary, unless the latter is able to procure debt waivers for the shortfall. The business cessation process often takes a couple of months to complete.

The necessary costs associated with the cessation of a business are as set forth in the following table.

Applicable contracts (typical examples)	Action required	Cost
Supplier agreements	Termination by agreement	Penalty charges for early termination (if any)
Customer agreements	Appointment of new after-sales service providers	Cost of transferring after-sales services (if any)
Lease agreements	Termination by agreement	<ul style="list-style-type: none"> - Penalty charges for early termination - Restoration costs and other costs associated with vacation of premises
Vendor agreements	Termination by agreement	Penalty charges due to mid-term termination (if any)
Employment agreements	<ul style="list-style-type: none"> - Agreement on voluntary redundancy (and payment of severance packages) - Payment of ordinary severance allowances 	<ul style="list-style-type: none"> - Amount of severance packages - Amount of severance allowances

(2) Legal liquidation proceedings

As noted in Section 2 above, the ways by which to liquidate a company include: (A) ordinary liquidation proceedings; and (B) special liquidation proceedings. Practically, the claims of a parent company against its subsidiary will generally be discharged in the liquidation proceedings. As this involves certain tax consequences, the choice between ordinary liquidation proceedings and special

liquidation proceedings is frequently determined on the tax merits and the amount required to be financed by the parent company for completion of the liquidation process.

The following steps are required under both ordinary and special liquidation proceedings: (i) holding of a general shareholders' meeting to approve the dissolution of the subsidiary and appointment of a liquidator; (ii) holding of a general shareholders' meeting to approve the liquidation balance sheet and inventory of assets as prepared by the liquidator; (iii) disposal of all the subsidiary's assets and performance of its remaining obligations; (iv) filing of a tax return and payment of tax; and (v) registration of completion of the liquidation.

The costs of these legal procedures are generally as set forth in the following table. These procedural costs must be determined and, if necessary, financed by additional loans from the parent company prior to the commencement of the legal procedures.

No.	Action	Cost
(i)	Liquidation proceedings	Attorney's fees, court costs
(ii)	Filing of tax return	Both a dissolution tax return and a liquidation tax return must be filed, and fees for the certified public accountants and tax accountants engaged for this purpose are payable.
(iii)	Taxation costs	Such amount as determined by a certified public accountant.
(iv)	Office costs	Warehousing costs for storage of documents will generally be incurred.

3. Model Cases

The following is an example of the steps to be taken by an overseas company for the liquidation of its subsidiary in Japan. For purposes of the following example, we have used the case of a Japanese subsidiary that imports goods from overseas for sale in Japan. As will be noted below, liquidation procedures generally begin after the cessation of business. While the following example indicates the steps that are typically taken for the liquidation of a Japanese subsidiary, it should be noted that the necessary procedures will vary from case by case.

(1) Termination of transactions, contracts, and employment relationships (cessation of business)

	Items	Actions
Step1	Preparation in advance and loans from the parent company	(i) Making preparations in advance, such as appointing a new after-sales service provider;
		(ii) Calculating the costs related to the termination of the above-mentioned contracts, where a shortfall in funds needed must be funded by a loan from the parent company.
Step 2	Press release on the cessation of business	(i) To provide explanation to employees and to offer retirement packages;
		(ii) To provide notice of termination of contracts to suppliers;
		(iii) To notify customers of cessation of business and appointment of a new after-sales service provider. Note: The actions referred to in items (i) to (iii) above will typically be conducted on the same day.
Step 3	Negotiation with counterparties to contracts and fulfilment of remaining obligations (which will take approximately 2 to 3 months to complete)	(i) Negotiating with counterparties to contracts and employees to agree on the amounts payable and other obligations to be fulfilled, and fulfilling these obligations;
		(ii) Following item (i) above, the parent company will be the only remaining obligee of the subsidiary.

(3) Legal Procedures

(A) Ordinary liquidation proceedings

	Items	Timeline	Note
Step1	Hold a general shareholders' meeting to approve the dissolution of the Japanese subsidiary and to appoint a liquidator	Day X	Following registration of the subsidiary's dissolution, the subsidiary will be prohibited by law from performing any of its obligations for two months. During this two-month "lock out" period, creditors with claims against

			the subsidiary will register their claims.
Step2	Hold a general shareholders' meeting to approve the Japanese subsidiary's liquidation balance sheet and inventory of assets	X + 1 month	The financial conditions of the subsidiary as of the date of dissolution will be reported to, and approved by, the shareholders.
Step3	Completion of disposal of all the Japanese subsidiary's assets and performance of its remaining obligations (other than those owed to the parent company), filing a dissolution tax return and liquidation tax return, and paying tax. Only the amount remaining (if any) after the subsidiary has satisfied payment obligations owed to third parties will be used to satisfy payment obligations owed to the parent company. All remaining claims of the parent company will be waived.	X + 2 to 3 months	
Step4	Hold a general shareholders' meeting to approve the Japanese subsidiary's financial statements	X + 2 to 3 months	Distribution of the Japanese subsidiary's residual assets (if any) to shareholders
Step5	Register the conclusion of liquidation by the subsidiary	X + 3 months	

(B) Special liquidation proceedings

	Items	Timeline	Note
Step1	Hold a general shareholders' meeting to approve the dissolution of the Japanese subsidiary and to appoint a liquidator	Day X	Following registration of the subsidiary's dissolution, the subsidiary will be prohibited by law from performing any of its obligations for two months. During this two-month "lock out" period, creditors with claims against the subsidiary will register their claims.
Step2	Hold a general shareholders'	X	The financial conditions of

	meeting to approve the Japanese subsidiary's liquidation balance sheet and inventory of assets	+ 1 month	the subsidiary as of the date of dissolution will be reported to, and approved by, the shareholders.
Step3	Submit petition for special liquidation proceedings to court	X + 1 to 2 months	
Step4	Completion of disposal of all the Japanese subsidiary's assets and performance of its remaining obligations (other than those owed to the parent company), filing a dissolution tax return and liquidation tax return, and paying tax. Only the amount remaining (if any) after the subsidiary has satisfied payment obligations owed to third parties will be used to satisfy payment obligations owed to the parent company. The parent company will waive all remaining claims based on settlement or agreement with the approval of a court	X + 2 to 3 months	
Step5	Submit a petition for the conclusion of the special liquidation proceedings to the relevant court	X + 3 months	
Step6	Register the completion of the Japanese subsidiary's liquidation with a court	X + 3 to 4 months	

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