



Press Release

報道資料

For Immediate Release

**ACCJ Voices Concern that Inappropriate "Abuse" Label
Not Be Used to Deny Tax Deferral for Valid Triangular Mergers by
Foreign Firms Newly Investing in Japan**

December 8, 2006 --- The American Chamber of Commerce in Japan (ACCJ) expressed concern today regarding reports that the Government of Japan is now finalizing a tax policy that will make it impossible for foreign companies newly investing in Japan to use their stock as consideration in tax-deferred triangular mergers. The reports indicate that the government will likely reject Ministry of Economy, Trade and Industry (METI)'s Tax Item Request, which was submitted to Ministry of Finance (MOF) in August and would have allowed tax deferral consideration for legitimate triangular mergers between foreign parent companies, their domestic special purpose companies, and Japanese companies.

ACCJ President Charles D. Lake II said, "METI's tax item request was designed to promote foreign direct investment (FDI). Any rejection of this request would be a significant setback for the Government of Japan's stated goal to promote sustained and stable growth through increased FDI. Most experts agree that, without tax deferral, these friendly triangular mergers simply will not occur. Denying tax deferral for triangular mergers by new investors would severely limit FDI into Japan and be interpreted by the global community to mean that Japan has weakened its commitment to expanding inward FDI."

Under Japanese tax law principles, tax deferral at the shareholder and company level can be granted when merging companies are considered to operate businesses that have a "synergy relationship" with each other.

METI's proposal recognizes foreign parent companies and their special purpose companies as a single group when evaluating synergy for qualification as tax-deferred transactions.

Nicholas Benes, Chair of the ACCJ's FDI Committee, said, "Recent press reports indicate that METI's proposal is being mischaracterized as facilitating 'abuse' and the inappropriate use of 'paper companies.' The ACCJ has long been supportive of appropriate anti-abuse measures, proposing detailed rules more than three years ago. But it is not 'abuse' when foreign firms set up special purpose companies in Japan for the provision of support and added synergy to their new Japanese partners for their mutual long-term growth and success."

Benes continued, "The treatment of triangular mergers as two-way domestic mergers between a special purpose company in Japan and a Japanese company would mean that synergy with the foreign parent company – no matter how large – would not qualify for tax deferral consideration, even though such potential economic benefits were the main reason behind facilitating triangular mergers in the first place."

Fact Sheet

Triangular Mergers

- A triangular merger is a structure whereby a company (foreign or domestic) can issue its own shares as consideration in a merger with a Japanese company. The foreign company first issues its shares to a special purpose company it owns in Japan, which then merges with the Japanese company for legal purposes. Prior shareholders of the Japanese company will receive the newly issued shares in an effective "swap."
- A triangular merger cannot be used for a hostile takeover because, by law, Japanese boards must negotiate detailed terms and approve the transaction before it goes to shareholders for their final approval.
- If Japanese boards want their shareholders to receive shares that are listed in Japan, this condition can be demanded in negotiations. If agreement on this condition - or any other terms - is not reached, boards can refuse the deal. Japanese boards cannot be forced to accept a transaction with which they do not agree.

Tax Deferral

- Japan adopted tax-deferred "share exchanges" in 1999 for Japanese "parent" shares only. The qualifying conditions were extremely simple and did not require "synergy." The foreign business community (including the ACCJ) has been asking the MOF to extend this tax deferral treatment to foreign "parent" shares ever since.
- Reportedly, Nippon Keidanren first proposed that Japan adopt a "triangular merger" structure instead of permitting deferral for cross-border share exchanges using foreign "parent" shares. MOJ accepted this approach for Company Law purposes based on the fact Japanese shareholders would then have legal recourse under normal merger rules in Japan.
- In the spring of 2004, the ACCJ issued a Viewpoint proposing details for how tax deferral treatment could simply and easily be extended to share exchange transactions using foreign "parent" shares, without necessitating any amendment of the Commercial Code. This was rejected by MOF.
- In April 2006, Japan abolished the 1999 share exchange tax rules and adopted new deferral rules for share exchanges that were consistent with the existing rules for deferral in corporate reorganizations. These rules required that the companies involved in a "joint business" reorganization have businesses that have a synergy relationship. The rules requiring synergy were vague as to the case of a share exchange transaction by a holding company, leaving potentially serious tax risk if the one of the holding company's subsidiaries (rather than itself) was the source of the synergy.
- With the adoption of the deferral rules for triangular mergers that the MOF reportedly is now seeking to finalize, this "holding company" problem will be eliminated for domestic companies. Synergy with the subsidiary will be sufficient to qualify for deferral. In addition to standard mergers, Japanese companies will then

be able to choose between using share exchanges when there are synergies with the parent firm (or holding company), and triangular mergers when the synergies are with a subsidiary.

- However, as far as tax deferral is concerned: (a) the share exchange approach will still not be available to foreign companies; and (b) the triangular mergers approach will be unusable by any foreign company that does not have existing operations in Japan that will have synergy with the prospective Japanese partner. The fundamental unfairness of present Japanese tax law will continue as before.
- The rule which the MOF is reportedly seeking to finalize would require the special purpose company to be already operating an existing business, having synergies with the prospective Japanese partner, in order for the deal to be eligible for deferral. In other words, in order to undertake direct investment with this mechanism, foreign companies must have already made significant investments. This would not be deferral for "cross-border reorganizations, but rather, just deferral for domestic mergers – only. It would help Japanese domestic companies with holding companies do more M&A deals on a flexible basis, but it would make the use of stock in tax-deferred triangular mergers completely infeasible for new entrants to Japan.

Foreign Direct Investment

- In 2005, FDI flows into Japan slumped to their lowest point since 1996, declining 64 percent year-on-year from 2004. It appears almost certain that the Japanese Government's first five-year target to double the cumulative base of FDI in the period from 2001-2006 will not be reached.¹
- At the end of 2005, Japan's cumulative base of FDI amounted to only 2.2% of GDP, as compared with 14.3% for China, 37.1% for the U.K., 13.0% for the U.S., 33.5% for the European Union, 21.4% for all developed economies, and 22.7% for the entire world.²

Attachment: Tax Request Item submitted by METI to MOF in August of 2006.

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¹ UNCTAD report: World Investment Report 2006,
<http://www.unctad.org/Templates/webflyer.asp?docid=7431&intItemID=2068&lang=1&mode=downloads>

² Ibid.

About the ACCJ

The American Chamber of Commerce in Japan (ACCJ) was established in 1948 by representatives of 40 American companies and has grown into one of the most influential business organizations in Japan. Consisting mainly of executives from American companies, currently the ACCJ has members representing 1,400 companies with offices in Tokyo, Nagoya, and Osaka. Working closely with the governments of the United States and Japan, business organizations, and others, the ACCJ promotes activities that help achieve its mission of further developing commerce between the United States and Japan, promoting the interests of U.S. companies and members, and improving the international business environment in Japan. Over 60 committees representing various industries play the ACCJ's central role in making policy recommendations through advocacy tools such as the Business White Paper and holding over 500 events and seminars annually on public policy and economic trends. The ACCJ is also committed to promoting charitable events and other CSR activities.

ACCJ PRESS CONTACT: Media Relations Officer Mina Takahashi (phone: 3433 6542; email: mtakahashi@accj.or.jp).