

**PART II**

**BUSINESS ENTITIES**

**AND**

**LEGAL REQUIREMENTS**

## Chapter 2 Types of Business Enterprises in Japan

### 2.1 Summary of the types

The common types of business enterprises in Japan are:

1. Kabushiki Kaisha (Joint Stock Company, abbreviated K.K.)
2. Branch Office (Shiten)
3. Representative office of a foreign company
4. Partnership
5. Joint Venture
6. Non-Profit organization

## Chapter 3 Kabushiki Kaisha

### 3.1 Formation Procedures

There are two methods for the incorporation of a Kabushiki Kaisha. One is “Promotive incorporation”, where the promoters subscribe all of the shares to be issued at incorporation, and the other is “Incorporation by offering”, where only a portion of the shares are issued to promoters, and the remainder are offered to private or public subscribers.

“Incorporation by offering” is an appropriate method to make the scale of the entity large. However, the procedures are complex compared with a “Promotive incorporation” since it requires advertising for subscribers, an inaugural meeting to be held to elect the directors, etc.

### 3.2 Articles of Incorporation

The Articles of Incorporation are the basic rules of a company. They are sometimes called the constitution of the company.

The Articles of Incorporation of a Kabushiki Kaisha must include the following information

- Objective(s)
- Trade name
- Location of the head office
- Value of the property to be contributed at the time of incorporation or the lower limit thereof
- Name and address of each promoter
- Total number of Authorized Shares

It used to be prohibited to use of the same name or a name that could be confused with the name of another company that already exists in the same municipality. Now it is

possible to set up a company if its address is not the same. However the Company Code prohibits the use of a name that may be mistaken for another company if the purpose of this is dishonest.

The Articles of Incorporation must be signed by the promoters and attested to by a Japanese notary public.

### **3.3 Execution of a capital injection**

#### 1. Execution of a capital injection

In the case of a “Promotive incorporation”, the promoter has to pay the full amount of the subscribed shares without delay. In the case of “Incorporation by offering”, the subscribers of the shares have to pay the full amount of the subscribed shares by the deadline or during a period that the promoter determines.

### **3.4 Execution of a capital injection**

#### ① Shareholder’s meetings and the Directors

Every Kabushiki Kaisha must hold shareholders’ meetings since this is the decision-making body of the company. Shareholders’ meetings cannot execute decisions on behalf of the K.K. Thus, directors are also necessary for every K.K.

#### ② Board of Directors

An open corporation<sup>1</sup> is a company with a board of company auditors and a company with committees<sup>2</sup> must have a Board of Directors. It is possible to have a Board of Directors, even though it is not necessary to set it up.

If a Board of Directors is set up, it needs to have at least one auditor, audit committee, or accounting advisor. However, if the company is a large company<sup>3</sup> it should have an auditor or audit committee.

The Board of Directors must be composed of at least three directors.

If a Board of Directors is not set up in a company, the shareholders’ meetings can decide on all matters concerning the company. However, if a Board of Directors is set up, a shareholders’ meeting can only decide on those matters that the Commercial Code of Japan and the Articles of Incorporation define.

Each director has authority to execute business in a company without a Board of Directors. On the other hand, in a company with a Board of Directors, the Board of Directors makes the decisions and a representative director or an executive director

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<sup>1</sup> An open corporation is a company that has no restrictions on stock transfers.

<sup>2</sup> A company with committees is a company that has a nominating committee, audit committee and benefit committee. Each commissioner is appointed from the Board of Directors. Thus, each committee is set up as an organ of the Board of Directors.

<sup>3</sup> A large company means a company whose capital is over 500 million JPY or its liability is over 20 billion JPY.

executes the company business.

### ③ Auditors

A company with a Board of Directors and a company with an accounting auditor should have an auditor, in principal. However, if this company is a company with committees, it is prohibited from having an auditor. This is because a company with committees has an audit committee that supervises the company business. Its function is the same as that of an auditor.

### ④ Other organs

An Open Corporation formed out of a large company that is not a company with committees should have a Board of Auditors or an Accounting Auditor. A company with committees and a large company that is not an open company should have an Accounting Auditor.

## **3.5 Shareholders' meetings**

There is a difference in the authority of a shareholders' meeting between a company with a Board of Directors and other companies.

In a company with a Board of Directors, the shareholders' meeting can decide only on matters that the regulations and the Articles of Incorporation determine.

On the other hand, in a company that has no Board of Directors, the shareholders' meeting can decide on all matters concerning the company's business.

A shareholders' meeting is called by a director, unless it is called by a minority stockholder

In a company that has no Board of Directors, the directors determine the date, place, etc. In a company with a Board of Directors, the Board of Directors decides on the details and the representative of director calls the meeting.

There are two kinds of shareholders' meetings. One is an annual meeting and the other is an extraordinary general meeting. An annual meeting should be called within three months after the end of the business year. An extraordinary meeting may be called whenever it is required.

## **3.6 Directors and the Board of Directors**

### ⑤ Authority of a director

In a company that has no Board of Directors, a director executes the company business unless there is a special provision in the Articles of Incorporation. In cases where there are two or more than two directors, the company business is decided by a majority of the directors unless there is a special provision in the Articles of Incorporation. Each director has the authority to represent the company and to act on everything related the company's business, regarding both legal and non-legal

matters.

In a company with a Board of Directors, each director does not have the authority to be the representative. The Representative Director has rights of representation and can act on anything related to the company business, regarding both legal and non-legal matters. Decisions on the company's business are made by the Board of Directors and their actual execution is performed by the Representative Director or Executive Director. Each director supervises the execution of business by the other directors through the board, as a member of the Board of Directors.

#### ⑥ Appointment and dismissal of a director

- In a Kabushiki Kaisha, it is necessary to appoint at least one director and in a company with a Board of Directors, it necessary to appoint at least three directors. In addition, it is possible to determine the number of directors in the Articles of Incorporation. It is possible to determine a fixed number or a lower limit, but it is normal to set an upper limit.
- Corporate bodies, adult wards, persons under curatorship and persons who have a certain criminal history cannot be appointed as a company director. On the other hand, minors<sup>4</sup> or bankrupts can be appointed. In addition, it is possible to impose conditions that a director should have certain qualifications.

It is prohibited to act as both a director and as an auditor of the same company or the auditor of its parent company. An auditor supervises the company business and has a right to survey any subsidiary company. It is inappropriate for someone to be both an auditor carrying out an audit and a person who is subject to auditing at the same time.

It is also prohibited to be at the same time both a director and an accounting adviser of the same company or its parent company. This is to protect the independence of the accounting adviser.

It is possible to be both a director and an employee except in a company with committees. This is to ensure that a company with committees makes a distinction between the execution of the company business and the supervision of it.

- The directors are appointed by a decision of the shareholders' meeting.
- The term of a director's duties is until its determination at an annual shareholders' meeting for the last accounting year of a period within two years after the appointment, in principle. However, the Articles of Incorporation or a decision of a shareholders' meeting can determine a shorter period. In a company that is not an open company or a company with committees, the period can be extended to a maximum of ten years.
- The relationship between a company and a director is a mandate. Directors can

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<sup>4</sup> A person under 20 years old

resign at any time. However, if the termination of the term or resignation causes a shortfall in the number that is determined by the Companies Act or the Articles of Incorporation, the directors still have the duties and rights of a director until a new director is elected.

- A shareholders' meeting can dismiss the directors at any time. A director who is dismissed can claim for losses unless there are justifiable grounds.

### 3.7 Auditor

#### ⑦ Installation of an Auditor and a Board of Auditors.

The Auditor is an agency to audit the execution of the company business by the directors (if there is an accounting adviser, the auditor also audits the accounting adviser.)

In a Kabushiki Kaisha, it is necessary to have a director, but an auditor or a Board of Auditors is not necessary. This can be determined by the Article of Incorporation. It is prohibited to appoint an auditor to a company with committees.

In a company with a Board of Directors it is necessary to appoint an auditor in principle, unless it is a company with committees or a company with an accounting adviser that is not an open company. In a company with an accounting auditor it necessary to appoint an auditor unless it is a company with committees.

In a large company, it is necessary to appoint a Board of Auditors unless it is not an open company or is a company with committees.

	Auditor		Board of Auditors
It is necessary, in principal	Company with a Board of Directors	Company with an accounting auditor	Large company
It is not necessary	<ul style="list-style-type: none"> <li>•Company with a Board of Directors that is a company with committees.</li> <li>•Company that is not open and with an accounting adviser.</li> </ul>	Company with an accounting auditor that is a company with committees	<ul style="list-style-type: none"> <li>•Company that is not open</li> <li>•Company with committees</li> </ul>

#### ⑧ Appointment of an Auditor

- Corporate bodies, adult wards, persons under curatorship and persons who have a certain criminal history cannot be appointed as the Auditor. On the other hand, minors<sup>5</sup> or bankrupts can be appointed. In addition, it is possible to establish a condition than the Auditor should have certain qualifications.
- The Auditor is elected by a decision of the shareholders' meeting.

<sup>5</sup> A person under 20 years old

⑨ Right to agree to the agenda for a new appointment

- Directors should obtain the Auditor's consent (if there are more than two auditors, the majority of them. If it is a company with a Board of Auditors, its consent.), before proposing the agenda item related to the appointment of auditors at a shareholders' meeting.
- The Auditor (or the Board of Auditors, if it is a company with such a board) can ask the directors to make the appointment of an auditor the purpose of the shareholders' meeting.
- Auditors can comment on the appointment of auditors at a shareholders' meeting.

⑩ Prohibition on holding concurrent posts

It is prohibited for auditors to at the same time also hold the post of a director in the same company or a subsidiary company, or be an employee of the company or employee of a subsidiary company.

⑪ Number of auditors and outside company auditors

In a company with a Board of Auditors, the number of auditors should be three or more and the majority of the auditors should be outside company auditors.

⑫ Term of the duties

The term of the duties of an auditor is, in principle, until its determination at an annual shareholders' meeting for the last accounting year of a period within four years after the appointment. In contrast to directors, it is not permitted to shorten the term of the duties of auditors in order to protect their status so as to enable them to properly execute their duties.

On the other hand, except for open companies, it is possible to extend the term until its determination at the annual shareholders' meeting of the last accounting year of a period within ten years after the appointment.

⑬ Dismissal of an auditor

The dismissal of an auditor may be caused by the termination of duties, resignation from the duties, the loss of the qualification to perform as an auditor or a change in the Articles of Incorporation.

If the number of auditors is less than the required number after the termination of duties, etc., the auditor still has duties and rights until the new auditors are elected.

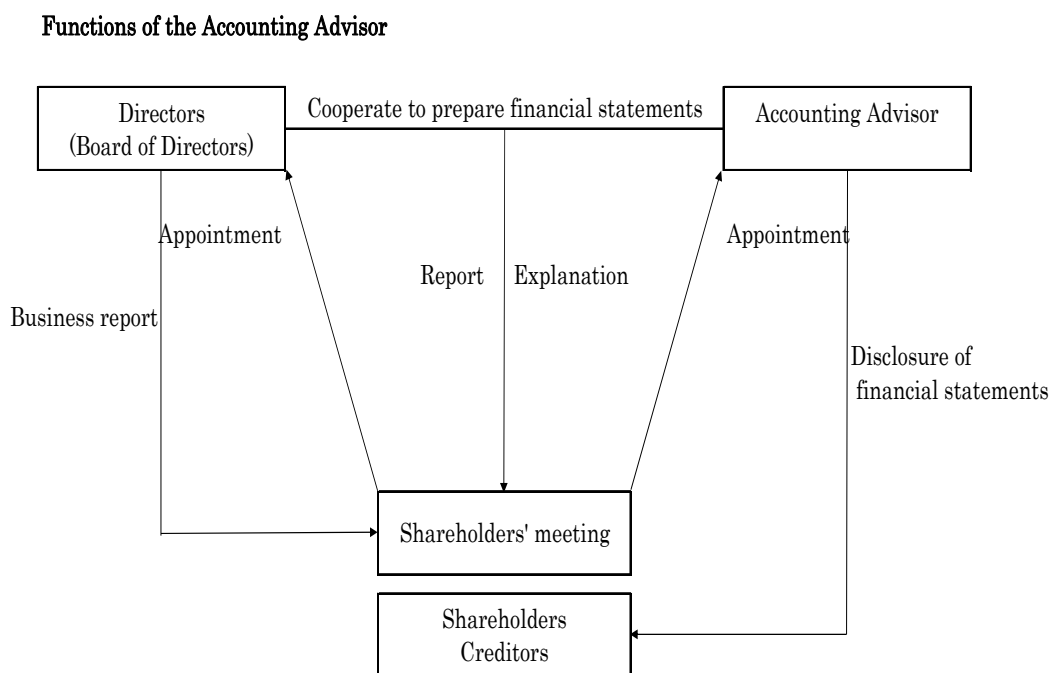
A shareholders' meeting can dismiss the auditors at any time. Any auditor who is dismissed can claim for losses unless there are justifiable grounds for the dismissal.

### 3.8 Accounting Advisors

#### ⑭ Functions of an accounting advisor

Any Kabushiki Kaisha can appoint an accounting advisor based on the Articles of Incorporation. An Accounting Advisor is one of the company entities that the CPA (included audit corporation) or Certified Public Tax accountant (included a Tax Accountant Corporation) can assume. Any accounting advisor makes financial statements in collaboration with the directors.

It is necessary for a company with a Board of Directors that it should not have an Auditor and that if it is not an open company that it should not have an Accounting Advisor.



#### ⑮ Relationship between the Company and the Accounting Advisor

The relationship between the Company and the Accounting Advisor is mandatory. The charges for the Accounting Advisor are based on the Articles of Incorporation. If there is no description concerning the fees in these articles, they are determined by a shareholders' meeting.

#### ⑯ Appointment of an Accounting Advisor

Only a CPA (including an Audit Corporation) or a certified public tax accountant



(including a Tax Accountant Corporation) can be appointed as an Accounting Advisor.

### **3.9 Accounting Auditors**

- An Accounting Auditor has a duty to audit the financial statements. Large companies (unless it is not an open company) or companies with committees should have an Accounting Auditor.

The qualifications of an Accounting Auditor are limited to certified public accountants (CPA) or auditing corporations (Kansa Houjin).

To maintain the independence of the Accounting Auditor, the participation of an accounting auditor (the Board of Directors in the case of a company with a Board of Directors) in the appointment, dismissal, fees, etc., is required.

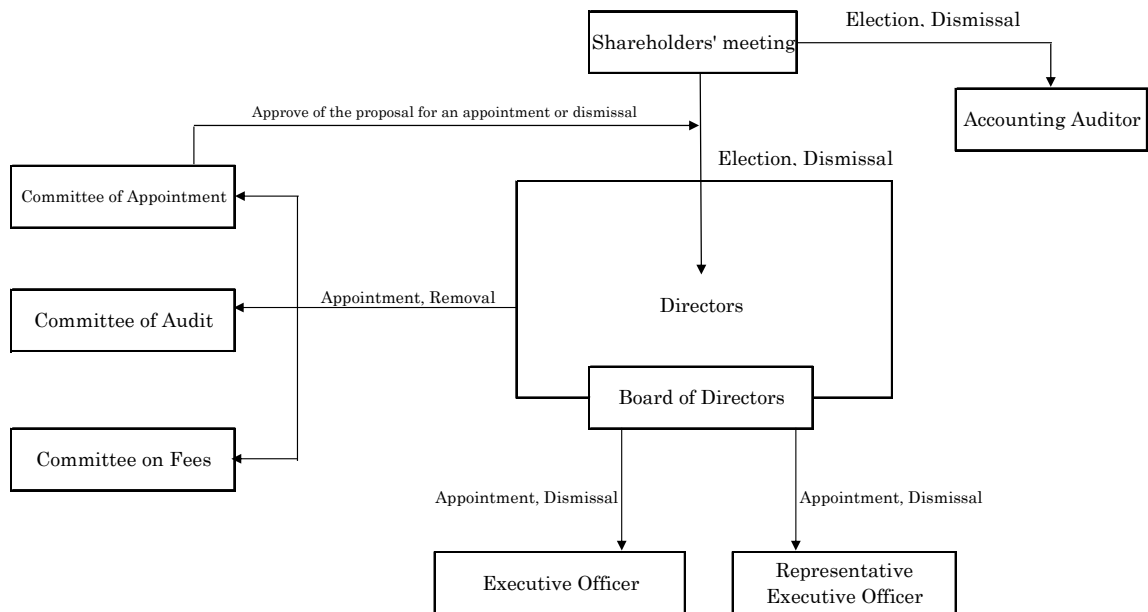
### **3.10 Companies with committees**

#### **⑰ Purpose**

A company with committees is a company that has a nominating committee, an audit committee, and a compensation committee according to the provisions of the Articles of Incorporation.

To be a company with committees, the size of the company is not relevant, or whether or not it is an open company. However, it is necessary to be a company with a Board of Directors. A company with committees has an Audit Committee, so it should not have an Auditor.

Members of the committees are appointed from the Board of Directors by a resolution of a Board of Directors meeting. The number of members of each committee needs to three or more. The majority of the members of each committee should be outside directors.



⑱ Directors and the Board of Directors

I Appointment and term of the duties of a director

In a company with committees, the directors are appointed by a shareholders' meeting. The shareholders' meeting makes decisions concerning proposals that a nominating committee brings to it.

The term of a directors' duties is until the determination of the annual shareholders' meeting for the last accounting year of a period within a year after the appointment.

II Authority of a director

In a company with committees, the Board of Directors has the authority to make decisions concerning all of the company's business. In addition, certain affairs can only be decided by the Board of Directors.

The Board of Directors in a company with committees supervises the execution of the business by the executive officers, etc, (the Executive Officer, Directors, Accounting Advisor).

In a company with committees, each committee makes the decisions and executes the company business concerning matters determined by a decision of the Board of Directors.

⑲ Duties and Fees of directors

In a company with committees, the directors are not allowed to execute the

company business, in principal.

A director can also be an executive officer, but cannot be an employee.

The fees for directors are determined by a compensation committee.

#### ⑳ Committees

In a company with committees, a Nominating Committee, an Audit Committee and a Compensation Committee should be appointed.

A committee can call on each of the directors to perform as committee members. It is necessary to assure the right to call on outside directors. Therefore, it is not allowed to concentrate on the right to call only on certain directors for membership. The Executive Director, Directors and Accounting Advisors are required to explain affairs whenever a committee requests them to do so.

A member of a committee that is selected by the committee is required to explain the situation of the performance of the committee to the Board of Directors.

#### 21 Nominating Committee

A Nominating Committee has the authority to determine the agenda of the election and dismissal of the directors.

#### 22 Audit Committee

In a company with committees, an Audit Committee must be appointed. Auditors cannot be appointed in place of such a committee. More than half of the committee members should be outside directors.

The Audit Committee has the authority to supervise the execution of business by the Executive Officer, etc.

#### 23 Compensation Committee

A Compensation Committee shall prescribe the policy regarding the contents of the remuneration for individual executive officers, etc.

#### 24 Executive Officers

In a company with committees, one or more Executive Officers are elected by a resolution of the Board of Directors. An Executive Officer cannot at the same time act as a director, or a member of an audit committee or an accounting advisor.

## Chapter 4 Branch Offices (Shiten)

## **4.1 Branch Offices**

A branch office is referred to as a “place of business” (eigyō sho) under the Companies Act. It is the simplest form of vehicle through which a foreign company may fully conduct its business in Japan with a physical presence.

## **4.2 Formation**

If a foreign company intends to establish a branch office in Japan, it must first appoint one or more representatives in Japan. Then, the foreign company must file a registration application with the relevant local legal affairs bureau (Hōmu Kyōku) within three weeks of the appointment of the representative. After such commercial registration, the foreign company may engage in business transactions on a continuing basis.

## **4.3 Representative**

The appointed representative in Japan is deemed to have the full statutory powers and authority to represent and bind the foreign company in all transactions and in any court proceedings in connection with the business of the foreign company in Japan. Any restrictions on such powers and authority under a contract or other methods cannot be asserted against bona fide third parties. The foreign company shall be liable for any damage incurred by third parties and caused by the representative in Japan in connection with the performance of his/her duties.

## **4.4 Registration**

Once the local representatives have been appointed, the company must then file a registration application with the relevant local legal affairs bureau.

## **4.5 Requirements**

When a foreign company first appoints its representative in Japan in order to engage in transactions on a continuing basis in Japan, the foreign company must apply for the registration of the foreign company within three weeks of the appointment with the relevant legal affairs bureau.

The application must be submitted to the legal affairs bureau having jurisdiction over the location of the branch office, if a branch office is established, or the residential address of the representative in Japan, if no branch office has been established.

# **Chapter 5 Representative Office of a foreign company**

The activities of a Representative Office are limited to the collection and dissemination of information on behalf of a foreign company and no business transactions may be undertaken within Japan. A representative office is therefore not taxable in Japan, provided it only operates in its representative capacity. Permission to establish a Representative Office is normally only required with respect to foreign banks, securities and investment management companies.

## Chapter 6 Partnerships

The following four types of partnerships exist in Japan

- ( i ) a partnership (nin-i-kumiai)
- ( ii ) a general partnership company
- ( iii ) a limited partnership company
- ( iv ) a limited liability business partnership

### **6.1 Partnership (Nin-i-kumiai)**

A Nin-i-kumiai (“NK”) is formed by way of a partnership agreement in which two or more persons agree to jointly conduct business. The NK does not have any corporate veil.

The establishment of an NK requires two or more partners. If the number of partners of the NK decreases to one, the NK will be dissolved.

Unless otherwise provided for in the partnership agreement, each partner of the NK has unlimited liabilities and obligations in relation to the NK in proportion to the ratio of their contributions. Contributions by partners may be made by credit or by the provision of labor.

Each partner may assign their partnership interests in the NK pursuant to an applicable partnership agreement or with the consent of all the partners. Any member of a partnership may withdraw from the NK for unavoidable reasons.

The formation of an NK is accomplished by the execution of a partnership agreement. There is no registration requirement with respect to the formation of an NK.

The properties and assets of an NK are subject to joint ownership among the partners of the NK concerned. However, the partners of an NK may not request a break-up of the property if the NK remains in existence and is restricted from the disposal of the partner’s interests in the properties and assets of an NK.

Unless otherwise provided for in the partnership agreement, the business affairs of an NK are operated based on the consent of the majority of the partners.

### **6.2 General partnership company and limited partnership company**

A general partnership company (Gomei gaisha) consists of unlimited liability members

only. Any member of a general partnership company is directly liable for the full amount of debts and obligations of the general partnership company to creditors of the company (direct unlimited liability).

A limited liability company (Goshi gaisha) consists of unlimited liability members and may have limited liability members. Each unlimited liability member is directly liable for the debts of the company to creditors.

### **6.3 Limited liability business partnership (LLP)**

#### ① LLP

An LLP is a partnership under the Law concerning Limited Liability Business Partnership Contracts (The LLP Law).

Each partner is responsible for the liabilities of the partnership only to the extent of the amount of the contribution that was provided. However, if one of the partners behaves with malicious intent or is grossly negligent in their duties, then their liability may exceed the amount of such a contribution.

The distribution of profits and the allocation of losses may be made without regard to the ratio of the contribution by any partner, pursuant to the partnership agreement.

Unless otherwise provided for in the applicable partnership agreement, a partner may assign its partnership interests in the LLP to third parties only with the consent of all the other partners. Any partner may withdraw from the LLP without the consent of the other partners if there are any unavoidable reasons, unless otherwise provided for in the applicable partnership agreement.

#### ② Formation of an LLP

An LLP is formed effectively upon the execution of a contract (Partnership agreement) between or among individuals/companies (partners) by which it is possible to jointly carry on a business for commercial purposes, and the making of a contribution (in cash or other types of property only, not credit or labor) by each partner.

#### ③ Residency requirement

At the time of the formation of an LLP and thereafter, the LLP must have at least two partners and at least one partner must either be an individual who has an address in Japan or has had a domicile in Japan for a consecutive period of one year or more, or a company having a head office or principal office in Japan.

#### ④ Operations

Since the LLP does not have any separate corporate existence, it does not have any corporate organization, such as a shareholders' meeting or a board of directors.

The operation of the business affairs of the LLP are decided by the unanimous consent of all the partners, unless otherwise provided for in the partnership agreement.

One of the most important characteristics of the LLP is that each partner of the LLP must be involved in the operations of the LLP

#### ⑤ Property of the LLP

Since the LLP does not have a separate corporate existence, any property or assets of the LLP are legally considered to be jointly owned by all the partners. However, since the disposal and break-up of the property of an LLP is restricted, its property is independent of each partner to this extent.

The registration of real estate and industrial property rights of the LLP may be made in the name of all the partners in a description of the LLP. If the business to be conducted by the LLP requires government permits and licenses, each partner may need to obtain them.

The property of the partnership cannot be distributed beyond the net assets after the deduction of three million yen or the total amount of the contributions, whichever is the lesser.

#### ⑥ Financial statements

Financial statements such as a balance sheet and income statement of profits or losses must be prepared and made available to any creditors. However, unlike a joint stock corporation, an LLP is not obliged to publicly disclose these documents.

#### ⑦ Tax treatment

Since the LLP does not have any separate corporate existence, it is eligible as a “pass-through” entity for tax purposes. However, any losses of the LLP beyond the amount calculated based on the capital contribution of any corporate partner may not be deductible from the taxable income of such a corporate partner.

## **6.4 Limited liability company (LLC)**

### ⑧ LLC

A limited liability company (“LLC”) is a new type of company in Japan, modeled on the limited liability company in the US.

An LLC can be established and survive with a sole shareholder. The LLC is constituted by the “limited liability members” only. Each limited liability member of the LLC is liable for the debts and obligations of the LLC to the extent of the amount of their contribution as stated in the Articles of Incorporation.

However, since each member has a duty to operate the business affairs of the LLC,

if they fail to perform such duties, they may be liable for the payment of compensation in the event of damage caused to the LLC or third parties.

⑨ Formation

An LLC is legally formed upon the registration of incorporation at the location of its principal office, after going through the preparation of the Articles of Incorporation and a capital contribution by the persons considered to be its initial members.

Any contribution to the LLC must be in property such as cash. No credit or labor services can be contributed for the formation of an LLC.

⑩ Operations

Any fundamental issues must be determined with the consent of all the members.

Unless otherwise provided for in the articles of incorporation, each member has the duty and authority to operate the LLC's business affairs and to represent the LLC. If any member with the duty to operate its business affairs is not a natural person, then that member must appoint a person who will actually perform the relevant duties.

A shareholders' meeting and a board of directors as required in a joint stock corporation are not required for an LLC. No accounting auditor can be appointed by an LLC, even if its size is the same as a "large corporation" of a joint stock corporation. In addition, no LLC is obliged to facilitate an internal control system or to disclose its balance sheet to the public, as is required for a joint stock corporation.

Accounting and the dividend distribution of the surplus of the LLC shall comply with similar rules as are applicable to a joint stock corporation.

⑪ Tax treatment

During the course of preparing the bill on the Companies Act, the LLC was intended to be a pass-through entity in terms of tax treatment, as it is in the US. However, under the current Companies Act, an LLC is not eligible to be a pass-through entity for Japanese tax purposes.

⑫ Assignment of an LLC's interests and withdrawal

The assignment of an LLC's interests by a member requires the consent of all the other members, unless otherwise provided for in the Articles of Incorporation. However, the assignment of an LLC's interests by a limited liability member having no duty to operate the business affairs of the LLC will require only the approval of other members having the duty to operate its business affairs.

Nonetheless, a member may at any time withdraw from the LLC for any "unavoidable reason", even if his or her withdrawal is restricted in the Articles of



Incorporation. Withdrawing members are entitled to receive a refund in cash for their contribution.

The name, address and amount of the LLC interests of each member of an LLC must be set out in its Articles of Incorporation, and the name of each member authorized to operate the business affairs or to represent the LLC must be recorded in the commercial registry. Accordingly, any change to these matters as the result of the assignment of LLC interests requires amendment to the articles and application for registration, as applicable.

### **6.5 Differences between an LLP and an LLC**

- An LLC can be incorporated and exist with only one member. However, an LLP always requires two or more partners.
- Every partner of an LLP must be involved in the operations of the LLP. The members of an LLC are not necessarily involved in the operations.
- An LLC may obtain any necessary business permit, license or approval in its own name. On the other hand an LLP may not obtain them in its own name, and thus each partner of the LLP needs to obtain these.
- The members of an LLP may be entitled to the benefit of pass-through tax treatment, but the members of an LLC may not be eligible for this.

## **Chapter 7 Joint Ventures**

Many foreign companies wishing to start a business in Japan form a joint venture operation (usually a joint stock company) with a Japanese company. Such agreements can sometimes facilitate the provision of manufacturing bases and patents, the recruitment of suitable personnel, negotiations with distributors and market penetration. However, great care must be taken over the selection of a Japanese partner, particularly in the areas of business philosophy and long-term corporate objectives, and in the drafting of the joint venture documentation.

## **Chapter 8 Non-profit making organizations**

In addition to ordinary business entities as described above, there are other legal entities for non-profit making or charitable organizations.