Japanese Business Entities

Scott K. Goldsmith

Follow this and additional works at: http://scholarlycommons.law.case.edu/jil
Part of the International Law Commons

Recommended Citation
Available at: http://scholarlycommons.law.case.edu/jil/vol6/iss2/7

This Note is brought to you for free and open access by the Student Journals at Case Western Reserve University School of Law Scholarly Commons. It has been accepted for inclusion in Case Western Reserve Journal of International Law by an authorized administrator of Case Western Reserve University School of Law Scholarly Commons.
NOTES

Japanese Business Entities

In connection with the growing tendency of business enterprise to establish extraterritorial relations and the penchant of international trade to account for a proportionately larger percentage of global income generation, of particular interest are the schematic forms and operational methods of extending and maintaining business enterprise in Japan. The laws of Japan permit the United States juridical person to do business with Japan in several forms, among which are licensing and royalty arrangements, export operations to Japan, and temporary operations in Japan. Further, business relations may be established in Japan on a more permanent basis through the utilization of a branch of an organization formed under foreign law or through the formation of one or more of several types of qualifying business entities recognized under Japanese law.¹

A preliminary caveat, however, is in order in connection with the Japanese law. The Japanese language is not easily or freely translated into English equivalents. In addition the intricacies of Japanese law are complicated by the frequent insufficiencies of exact or satisfactory analogues between Japanese legal concepts and American legal concepts.² Given this inherent disability, this article will necessarily be restricted to a demonstrative but abbreviated delineation of the essential attributes of Japanese business organization available to foreign enterprise. On a practical level, the appropriate choice of a form of business organization suited to the conglomerate needs of a foreign business is most often a matter for consultation with Japanese lawyers particularly versed on Japanese labor and commercial law.³

Although the Japanese government acknowledges the need for

¹ United States juridical entities are to be accorded “national treatment” in Japan. See footnote 16, infra; Shōhō (The Commercial Code of Japan) (Law no. 48, 1974); English: Eibun-Horei-Sha, Inc. No. 2200, II(JA) [hereinafter cited as Commercial Code].

² To a large extent, the provisions of the Commercial Code were modeled on, and resemble, the Illinois statutes on corporations.

³ Two very helpful, brief treatments of foreign enterprise in Japan, and of substantial aid in the preparation of this text, are: ARTHUR ANDERSON & CO., TAX AND TRADE GUIDE — JAPAN (1972) [hereinafter cited as ARTHUR ANDERSON & CO.]; and ERNST & ERNST, CHARACTERISTICS OF BUSINESS ENTITIES — JAPAN (1965) [hereinafter cited as ERNST & ERNST].
foreign investment, it seeks to control the extent of foreign domination of Japanese business entities, the resistance being effectuated primarily by two particular laws. The first of these is the Foreign Investment Law of 1950 which regulates foreign investment, licensing agreements, and loans of more than one year's duration. The foreign investor will be concerned with the application of the Foreign Investment Law primarily in regard to the acquisition of equity interests in existing companies, the formation of new companies, the creation of a liaison office, and the appointment of an agent. Although there are particular and definite requirements under the Foreign Investment Law, the real impact is in the regulation by the procedure of application, disclosure, and validation (approval). Most typically, application for validation is made through the Bank of Japan to the Ministry of International Trade and Industry or the Ministry of Finance. Application for approval to other government agencies and ministries must be made as the endeavor touches upon their areas of concern and regulation. The second law restricting significant foreign control of business in Japan is the Foreign Exchange and Foreign Trade Control Law of 1949 which regulates individual foreign transactions completed within one year. By the kind of regulation primarily effectuated by these two laws, the Japanese government has attempted to channel foreign capital into business arrangements in which the exercise of control by foreign interest is limited: principally, investments in the form of loans, licensing arrangements, and portfolio agreements. This restrictive regulation by the Japanese government is similarly prevalent (both absolutely and indirectly) in most other areas of foreign investment.

Under Japan's present policy, although there is some indication of further liberalization due to Japan's enhanced economic power,
validation of any foreign investment which will result in 100% ownership of the Japanese company by foreign interests is extremely unlikely. Furthermore, 49% ownership by foreign interests is customarily the maximum permitted, although there have been isolated instances of 50% or more.\textsuperscript{11} The extent of governmental regulation of foreign investment encourages and facilitates a union of Japanese nationals (or at the least, Japanese residents) and foreign enterprise in most instances. A Japanese national is likely to be familiar with Japanese business procedure, regulation, and constituent advantages. Japanese participation is also indicated by the fact that the authorities may set certain inchoate requirements with respect to administrative and constituent composition, e.g., a Japanese national as chief executive officer.\textsuperscript{12}

The considerable problem of repatriation of capital and remittance of income has diminished significantly in recent years.\textsuperscript{13} Having made the appropriate applications and disclosures and upon validation, the foreign investor can expect that reasonable means of foreign exchange will be available for remitting income and repatriating capital.\textsuperscript{14} Today, those companies which are listed may remit dividends abroad through an authorized foreign exchange bank upon compliance with prescribed procedures and presentation of papers. In the case of remittance abroad of dividends of a non-listed company, audited financial statements must be submitted to the Bank of Japan if the dividend amount or the foreigner’s ownership interest exceed specified amounts.\textsuperscript{15} In any event, so long as there has been original validation of the venture, a branch office can

\textsuperscript{11} See note 6 supra. Foreign ownership of more than 50% in a Japanese manufacturing enterprise is particularly unlikely.

\textsuperscript{12} See note 6 supra; ERNST & ERNST 8.

\textsuperscript{13} Foreign Investment Law, Articles 1, 2. Treaty of Friendship, Commerce and Navigation between the United States of America and Japan, TIAS 2863; April 2, 1953; 4 UST 2063; Article XII.

\textsuperscript{14} Prior to 1963, yen-base companies (foreign operations in Japan without government approval) were not assured of the availability of foreign exchange. ARTHUR ANDERSON & CO. 58.

\textsuperscript{15} Audited financial statements must be submitted if the dividend exceeds 3.6 million yen or the owner’s interest exceeds 30%. Id.
be assured of channels for routine distribution of annual profits.\textsuperscript{16} Upon the receipt of proof of compliance with ministry reporting requirements, specified financial disclosure statements, and a certificate of tax payment, generally the Bank of Japan will summarily approve the distribution. Upon the termination of branch operations, the parent company may cause the branch to disburse the original investment.

Normally the taxation of business enterprise in Japan is comprehensive, whether national or local. The avoidance of liability for Japanese income or corporation taxation is possible only if a foreign enterprise restricts its activities to selling into Japan or supplying advertising assistance in Japan.\textsuperscript{17} If the extent of foreign enterprise is so limited, government regulation is more particularly effected through the laws of contract rather than that of validation and taxation.

Under treaties effected between the United States and Japan, an American enterprise will generally not be liable for Japanese income taxes unless a "permanent establishment" is maintained in Japan. "Permanent establishment" denotes, in essence, a fixed place of business.\textsuperscript{18} The tax treaties also provide for six general types of activities of limited involvement, e.g., agency relationships, which a foreign enterprise may conduct within Japan without being deemed to have a "permanent establishment."\textsuperscript{19} The rationale for this limited immunity from liability for Japanese income and corporation tax (but not from the Japanese local enterprise and inhabitant taxes)\textsuperscript{20} is based on the consistent aim of encouraging foreign investment but resisting extensive involvement unless there is either direct or indirect control and regulation by government or a concomitant significant participation by Japanese nationals.

A royalty or licensing arrangement is also a form of doing business with Japan that receives preferential, i.e., less restrictive, governmental treatment because of the consequential role played by Japanese nationals.\textsuperscript{21} Such arrangements, however, must receive

\textsuperscript{16} Treaty of Friendship, Commerce and Navigation between the United States of America and Japan, TIAS 2863; April 2, 1953; 4 UST 2063; Article VII, paragraph 1.

\textsuperscript{17} Convention between the United States of America and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, TIAS 3176, 6 United States Treaties and Other International Agreements 149; April 16, 1954; Article II (1) (c).

\textsuperscript{18} Id.

\textsuperscript{19} Id.

\textsuperscript{20} Id., Article I (1) (b).

\textsuperscript{21} ARTHUR ANDERSON & CO. 11, 59-60.
approval from the Japanese government; they are further regulated by the tax withheld from royalties to be paid to foreigners. Under treaties between the United States and Japan, a ten percent tax is withheld on royalties paid to a U.S. enterprise unless the royalties are "effectively connected" with a permanent establishment in Japan.22

A type of Japanese business encountered consistently by foreign enterprise doing business in Japan is the Japanese trading company, which typically deals in manufactured products and acts as a commission agent. Frequently Japanese manufacturers may refuse to deal directly with foreign enterprise, preferring to utilize the services of the trading companies. The trading company may be recognized by the word "Shoji," "Bussan," or "Bōeki" contained in their names.23 But the function of the Japanese trading company is not limited to agency relationships in the Japanese economy. Quite typically trading companies are utility oriented, performing such sundry tasks as extensive investments, finance and sponsorship operations, and a wide range of research and consultative services.

Entities With Corporate Attributes

There are seven fundamental types of business organizations in Japan that can be classified according to their approximate equivalents in the United States. Two types of entities carry corporate attributes: the kabushiki-kaisha (literally, stock company) and the yūgen-kaisha. The kabushiki-kaisha is an entity very similar to an American corporation or joint stock company with corresponding rules governing organization, administration, and dissolution. The yūgen-kaisha is a limited liability company formed under the Yūgen-Kaisha Law,24 having attributes of both a partnership and an ordinary corporation. There are three Japanese entities with partnership attributes: the gomei-kaisha, the goshi-kaisha, and the kumiai. The gomei-kaisha is a partnership company which is a legal entity whose members have unlimited liability for the firm's obligations. The gōshi-kaisha is a limited partnership company similar to the gomei-kaisha except that it includes both limited and general part-

22 Convention between the United States of America and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, TIAS 3176; 6 UST 149; April 16, 1954; Article VII.
23 Arthur Andersen & Co. 12.
24 Yūgen-Kaisha Law (Law No. 74, 5 April 1938); English: EHS No. 2230; II(JD) [hereinafter cited as Yūgen-Kaisha Law].
ners. The kumiai is a partnership formed under the Civil Code which does not have a separate legal personality. Finally there are two other types of business entities recognized in Japan: the branch of a foreign business and the sole proprietorship. Only the kabushiki-kaisha and the branch office will be of interest to the foreign investor because of the limited usefulness of the other forms. The foreign investor is realistically precluded from the three types of partnership because of the Foreign Investment Law of 1950.25 The yūgen-kaisha is rarely used by foreign investors because of the comparative advantages of the kabushiki-kaisha.

**Kabushiki-Kaisha**

By far the most consequential type of business organization to the foreign investor is the kabushiki-kaisha, or stock company. The kabushiki-kaisha is similar in many respects to joint stock companies and corporations, with the most significant attributes being the representation of the individual's interest by shares of stock and liability for company debts being limited to the amount of the investment. It is a separate legal entity26 and as such can transact business, enter into contracts, and sue or be sued in its own name.27 For enterprises requiring financing through public offerings, the use of the kabushiki-kaisha as a form of doing business is realistically unavoidable.28 In practice, however, after the initial issue, the procedure of issuing new shares at going market prices is available only to companies of excellent financial condition because of three limited restrictions: (1) prior public notice of the terms of the issue must be given;29 (2) the dividend rate must be maintained after the new issue is sold and proportionately increased if earnings improve;30 and (3) preemptive rights must be accorded to shareholders of record.31 The requirements basic to the formation, operation,

---

25 See note 6 supra. In addition, income tax rates are so high for the members of the three types of partnership and for the sole proprietorship as to make these forms of business undesirable to the U.S. investor.

26 Article 54, Commercial Code, provides that every company recognized under the Code is a juristic person.

27 "The trade name of a company shall contain the word 'gomei-gaisha', 'goshi-kaisha' or 'kabushiki-kaisha' according to its nature." Article 17, Commercial Code.

28 The three types of partnership, the sole proprietorship, and the branch office do not utilize shares to represent capital interest. The yūgen-kaisha may gain members only by unanimous consent of the existing members. Article 19, paragraph 2, Yūgen-Kaisha Law.

29 Art. 280-3-2, Commercial Code.


and termination of the stock company are contained in the Japanese Commercial Code.\textsuperscript{32}

In order to form a \textit{kabushiki-kaisha}, the Commercial Code requires that there be seven or more promoters, who need not necessarily be Japanese nationals or residents.\textsuperscript{33} For convenience and by practical necessity, however, it is more expedient to use Japanese promoters:\textsuperscript{34} convenient in that it is customary for Japanese promoters to act under a power of attorney in complying with incorporation procedures and regulation. Japanese promoters are necessitated on a practical level in fulfilling composition requirements on the board of directors; furthermore, governmental regulation generally discourages control of more than 50% of the \textit{kabushiki-kaisha} by foreign interests.\textsuperscript{35}

The fundamental charter of the \textit{kabushiki-kaisha} is an executed document known as the articles of incorporation, analogous in purpose and design to the articles of incorporation of an American corporation.\textsuperscript{36} The articles must be executed before a notary and contain the following information: (1) the corporate purpose; (2) the trade name; (3) the authorization of share issues, including the total number, number to be issued at the time of incorporation, and the par value of each share or the issue price for shares without par value; (4) the address of the principal office; (5) the name and permanent address of each promoter; and (6) the exact circumstances of any non-cash contributions.\textsuperscript{37} Whereas U.S. promoters are generally permitted to execute a "bare bones" set of articles, the administrative and operating functions and procedures of the \textit{kabushiki-kaisha} are found in the articles of incorporation and specific provisions of the Commercial Code.\textsuperscript{38} By-laws as they are known in the United States are ordinarily not used in Japan.

Constituting the capital structure of the \textit{kabushiki-kaisha} initially

\textsuperscript{32} Bk II, Ch. IV, Commercial Code.
\textsuperscript{33} Art. 165, Commercial Code. Because the Commercial Code contains no specific requirement of promoter qualifications, it appears that all juristic entities may be promoters.
\textsuperscript{34} ARTHUR ANDERSON & CO. 15.
\textsuperscript{35} See note 6 supra.
\textsuperscript{36} A company organized under the Commercial Code comes into being through the basic formula of execution of the articles of incorporation, compliance with formation requirements, registration in the Commercial Registry, and finally public announcement. Articles 9-15, Commercial Code, govern the terms of registration: the place of registration, the effect of registration, and the effectiveness of inaccurate registration.
\textsuperscript{37} Art. 166, Commercial Code.
\textsuperscript{38} Art. 254-2, Commercial Code.
are contributions from prospective shareholders, including promoters, who must subscribe to at least one share each. Contributions of property other than money may be made only by the promoters, but the consequences of non-cash contributions are such as to discourage these contributions, particularly the requirement that non-cash contributions must be appraised by a court-appointed inspector. Although there is no statutory minimum capitalization as such, an effective minimum capitalization of 3,500 yen in the case of par issues is maintained by the requirement of seven promoters taking at least one share of stock with a minimum par value permitted of 500 yen. The stated capital of a kabushiki-kaisha may be increased as often as business needs indicate simply by amending the articles of incorporation; reduction of stated capital requires more elaborate actions in order to protect the equities and interests of the shareholders and creditors. Upon receipt of contributions the promoters as fiduciaries are required to deposit the funds in corporate accounts and to transfer the property received for stock subscriptions to the corporation. At the time of incorporation and at all times thereafter, at least one-fourth of the total number of all classes of stock authorized must be issued, outstanding, and paid.

39 Art. 169, Commercial Code. There is no requirement that the promoters retain any of the shares to which they subscribed after incorporation. Art. 204, Commercial Code.
40 Art. 168, § 2, Commercial Code.
41 The complete details of non-cash contributions must be contained in the articles of incorporation. Art. 168(5), Commercial Code.
43 Art. 169, Commercial Code.
45 Procedure for amendment of articles of incorporation is contained in Art. 342, Commercial Code.
47 Art. 177, Commercial Code. Failure to secure payment in full from the subscribers subjects the promoters to joint and several liability for the amount of the unpaid subscriptions. Art. 192, § 2, Commercial Code.
48 Art. 166, § 2, Commercial Code.
49 In Japanese law the concept of "outstanding" is not as significant as in American law because a kabushiki-kaisha is generally prohibited from acquiring its own shares. Art. 210, Commercial Code. Thus, unless the company retains a portion of its shares after the original issue, or unless the circumstances fall within the exceptions of Article 210, e.g., retirement of shares or business exigencies, the term "issued" is a sufficient cognate for "outstanding." Furthermore, those shares that are issued but not outstanding may not be voted by the company. Art. 241, § 2, Commercial Code. Those shares issued but not outstanding are also subject to the preemptive rights of shareholders of record. Art. 280-4, § 1, Commercial Code.
in full.\textsuperscript{50}

After stock subscriptions are received,\textsuperscript{51} a general meeting of all subscribers is required,\textsuperscript{52} at which time directors and statutory auditors are appointed.\textsuperscript{53} Written reports by the promoters\textsuperscript{54} and by a court-appointed inspector\textsuperscript{55} must be submitted at the meeting if there are special arrangements for promoters' compensation and benefits or if there are non-cash contributions. At this general meeting and at all subsequent shareholder meetings, each subscriber and shareholder is entitled to one vote for each share of voting stock held.\textsuperscript{56} Subscriber action at the constituent general meeting requires a quorum of holders of one-half of the total number of shares issued and outstanding; resolutions are passed by a two-thirds majority of those present.\textsuperscript{57} Subsequent to the constituent general meeting, the incorporation must be announced publicly and registered with the local officials and the Judiciary Bureau within two weeks.\textsuperscript{58} The information to be disclosed in the registration is comparable to that included in the articles of incorporation supplemented by current information such as the names of the directors, the identification of auditors, and the number of shares issued.\textsuperscript{59} The fee accompanying registration is a minimum of 50,000 yen.

A kabushiki-kaisha routinely encounters a multi-faceted system of taxation in Japan, including corporate, income, and local or inhabitant taxes,\textsuperscript{60} each with disclosure requirements.\textsuperscript{61} In addition

\begin{itemize}
  \item \textsuperscript{50} See note 47 \textit{supra}. If a subscriber has failed to make payment and the promoters have given appropriate notice after a certain period, the subscriber forfeits his subscription rights. Art. 179, Commercial Code.
  \item \textsuperscript{51} Arts. 174-179, Commercial Code, detail the procedure of solicitation of subscriptions by the promoters, application for subscription, reasons for subscribing, and the promoters' acceptance of subscriptions.
  \item \textsuperscript{52} Art. 180, Commercial Code.
  \item \textsuperscript{53} Art. 183, Commercial Code.
  \item \textsuperscript{54} Art. 182, Commercial Code.
  \item \textsuperscript{55} Art. 181, Commercial Code.
  \item \textsuperscript{56} Art. 241, Commercial Code.
  \item \textsuperscript{57} Art. 180, § 2, Commercial Code.
  \item \textsuperscript{58} Art. 188, Commercial Code.
  \item \textsuperscript{59} \textit{Id.}
  \item \textsuperscript{60} Blakeney, \textit{Legal Aspects of Private Investment in Japan}, \textit{Proceedings of the 1961 Institute on Private Investments Abroad and Foreign Trade} 295-96 (International and Comparative Law Center, The Southwestern Legal Foundation, Dallas) [hereinafter cited as \textit{BLAKENEY}].
  \item \textsuperscript{61} E.g., Art. 224, The Income Tax Law of Japan (Law No. 33, 31 March 1965); English: EHS No. 4050; IV(CA) [hereinafter cited as Income Tax Law], which requires that shareholders receiving dividends must file written announcement of such fact.
\end{itemize}
to the registration provisions of the Commercial Code and the labor laws, a newly organized kabushiki-kaisha (as well as a newly organized branch or other business organization) must periodically submit and supplement reports containing relevant corporate data to the tax officials. To prior to commencement of business activity, the kabushiki-kaisha must notify the National Tax Office of its incorporation, of the initiation of payroll payment, and of the methods selected for inventory valuation and depreciation. Further, notification of commencement of operations must be filed with the local tax office.

The capital structure of the kabushiki-kaisha is comparable to that of a United States corporation except as to the customary range of the debt-equity ratio. Debt financing is common in Japan and the ratio of debt capital to equity capital is ordinarily much higher than that found in U.S. companies. The Commercial Code regulates the issuance of debt instruments generally, with respect to debentures, the Code contains provisions which prescribe procedures for their subscription, transfer, and conversion as well as sections relating to meetings of debenture holders. Such provisions prohibit the offering of debentures in excess of an amount equal to stated capital and surplus reserves. Although ordinary debentures are also used, the issuance of convertible debentures is one of the most prevalent methods of raising capital for the kabushiki-kaisha. Rather than sale on the public market, debentures issued by the kabushiki-kaisha are typically offered to and held by financial institutions, both within Japan and in foreign countries.

Equity financing of the kabushiki-kaisha is similarly regulated by the Commercial Code. Under the Commercial Code, the kabushiki-kaisha is allowed to utilize several types of equity securities: common and preferred, par and no par, registered and bearer, and shares convertible into another class. Yet in practice, the equity

---

62 Art. 150, The Corporation Tax Law of Japan (Law No. 28, 31 March 1947); English: EHS No. 4100; IV (DA) [hereinafter cited as Corporation Tax Law].
63 Arts. 122, 148, Corporation Tax Law.
64 Art. 229, Income Tax Law.
65 ERNST & ERNST 13.
66 Arts. 296 — 341-6, Commercial Code.
67 Art. 297, § 1, Commercial Code.
68 Art. 222, Commercial Code.
69 Art. 199, Commercial Code.
70 Art. 222, Commercial Code.
71 Arts. 213, 222-2, Commercial Code.
of most companies, generally, is composed entirely of par value common stock. The Commercial Code demands that par value stock have a par value of no less than 500 yen and prohibits issuance for less than par value.72

Typically an increase in authorized stated capital approved by the shareholders necessitates a concomitant authorization and issuance of new shares. Protection from dilution of shareholder interests may be afforded shareholders of record by according them preemptive rights.73 Under the influence of the Commercial Code, the board of directors customarily offer new shares of capital stock to existing shareholders on a pro rata basis. In accordance with the doctrine of preemptive rights the new shares are ordinarily offered to registered shareholders for par value irrespective of current market values.74 Occasionally new shares are issued to nonshareholders; they may be offered at nonfavorable prices with the consent of the board of directors75 or they may be offered at a "specially favorable" issue price if there is shareholder consent.76 In order to be deemed a specially favorable price under Articles 280-2, paragraph 2, the issue price must be significantly less than market price.77

Apart from according shareholders their preemptive rights, the kabushiki-kaisha may reasonably restrict the alienability of shares of capital stock by appropriate provision in the articles of incorporation, provided a majority of all shareholders who hold voting and nonvoting stock and shareholders representing two-thirds of all outstanding voting and nonvoting shares approve such a provision.78 The major disadvantage of the utilization and application of transfer restrictions is that the enforcement procedure is lethargic and has received varying judicial interpretations.79 Private shareholder agreements which restrict transfers, particularly contracts between shareholders, are also valid, but, as a practical matter, are not easily enforceable.

In addition to the constituent general meeting of subscribers at the formation of the kabushiki-kaisha, ordinary and extraordinary shareholder meetings are governed by the Commercial Code. The

---

74 BLAKENEY 262 — 294.
75 Art. 280-2, § 2, Commercial Code.
76 Art. 280-2, § 1 (8), Commercial Code.
77 ARTHUR ANDERSON & CO. 16-17.
78 Art. 342, Commercial Code.
79 Arts. 204-2 — 204-5, Commercial Code.
general rule is that shareholder meetings must be held at the corporate office or at a nearby location, although the articles of incorporation may provide for a different arrangement. Scheduling of shareholder meetings is within the discretion of the board of directors. Nevertheless, factors of profits and dividend distribution and consequent tax liability limit directorate discretion and necessitate shareholder action. Although the Commercial Code requires only one shareholder meeting annually, because profits are quite commonly distributed twice a year, a meeting for each distribution is convened. Furthermore, companies typically elect for a six month fiscal period, upon the expiration of which a tax return must be filed; thus semiannual meetings are called to approve the financial statements on which the tax returns are based. Appropriate items for requisite shareholder action at regular meetings usually include: (1) approval of the balance sheet, the income statement, the business report, and proposals relating to surplus reserves and distributions of profits; (2) election of directors and statutory auditors; (3) determination of the compensation for directors and statutory auditors if not prescribed in the articles of incorporation; and (4) action on resolutions submitted by the board of directors.

Ordinarily shareholders representing one-half of the total shares outstanding constitute a quorum. Of a quorum, a simple majority is necessary to pass ordinary resolutions while a two-thirds majority is necessary for extraordinary resolutions such as those amending the articles of incorporation, disposing of all or a significant part of the business, or acquiring another business. Each shareholder is entitled to one vote for each share of voting stock held, and voting by proxy is permitted upon appropriate notice to the company. Aside from proxy agreements, two other methods of voting may be

---

80 Art. 233, Commercial Code.
81 Art. 231, Commercial Code.
82 Art. 234, Commercial Code.
83 Art. 283, Commercial Code.
84 Art. 281, Commercial Code.
85 Arts. 254, 273, Commercial Code.
86 Art. 269, Commercial Code.
87 Art. 260, Commercial Code.
89 Art. 239, § 1, Commercial Code.
90 Arts. 245, 343, Commercial Code.
92 Art. 239, § 3, Commercial Code.
available on a restricted basis to the shareholder. In limited situations, i.e., the election of two or more directors, cumulative voting rights are permitted, unless expressly denied in the articles, upon written demand five days prior to a general meeting.\textsuperscript{93} Even if the right of cumulative voting is denied in the articles, this method of voting may still be available if five days prior to a general meeting shareholders representing 25\% of the total number of voting shares issued make such a demand in writing to the company.\textsuperscript{94} Under even more restrictive circumstances, a shareholder may utilize the advantages of split-voting privileges if the shares are held for the benefit of others and notice and explanation of intent are communicated to the company at least three days prior to the particular shareholder meeting.

Qualification for the exercise of voting rights may be determined by the \textit{kabushiki-kaisha} up to two months prior to the shareholder meeting.\textsuperscript{95} During this time the company may refuse to recognize a change in stock ownership or may presume the correctitude of the register as of a determined time. To receive voting rights, holders of bearer certificates must deliver them to the corporation one week prior to the meeting.\textsuperscript{96}

Notice, voting rights, and voting privileges for ordinary shareholder meetings are equally applicable to extraordinary shareholder meetings. Extraordinary shareholder meetings may be convened by the board of directors or, under limited circumstances, by shareholders.\textsuperscript{97} In the case of a shareholders’ request, application must be made in writing to the directors explaining the purpose of the meeting and the reason for demanding it.\textsuperscript{98}

A \textit{kabushiki-kaisha} is required to have at least three members on its board of directors.\textsuperscript{99} The directors who are initially elected for a one year term in the first year of the company and two year terms thereafter (although shorter terms may be provided in the articles of incorporation),\textsuperscript{100} need not be shareholders,\textsuperscript{101} Japanese nationals,

\textsuperscript{93} Art. 256-3, Commercial Code.
\textsuperscript{94} Art. 5, Supplementary Provisions to Commercial Code, (Law No. 21, 2 April 1974).
\textsuperscript{95} Art. 224-3, Commercial Code.
\textsuperscript{96} Art. 228, Commercial Code.
\textsuperscript{97} Art. 235, Commercial Code.
\textsuperscript{98} Art. 237, Commercial Code. Shareholders representing at least 3\% of the shares issued must make the demand.
\textsuperscript{99} Art. 255, Commercial Code.
\textsuperscript{100} Art. 256, Commercial Code.
or residents of Japan. Unlike U.S. corporations, a primary function of the board of directors is to be responsible for the management and administration of the company;\(^\text{102}\) representative directors, serving by appointment, are authorized to perform all acts relating to the business of the company. In practice, the directors may be employees of the corporation, serving as its officers, or they may delegate administrative matters to salaried officers. Quite typically the directors' function is exercised at board meetings where, unless otherwise indicated in the articles, resolutions are adopted by a simple majority vote of a quorum consisting of one-half of the board members.\(^\text{103}\)

Except as provided in the articles, each director must be notified of a board meeting at least one week in advance,\(^\text{104}\) unless there is unanimous consent to a shorter period.\(^\text{105}\) Directors holding office in a quasi-fiduciary capacity,\(^\text{106}\) are subject to potential liability comparable to a promoter's liability. Directors may be held jointly and severally liable to the company and to third persons for authorizing or engaging in illegal conduct, for wrongful intent or gross negligence, and for malfeasance of corporate duties.\(^\text{107}\) Under the doctrine of apparent authority, a director's conduct which leads third persons to believe his acts are authorized obligates the corporation.\(^\text{108}\) Finally, a director may be removed from office at any time by a two-thirds majority of a quorum at a general meeting of shareholders; however, the director so removed may recover his compensation for the remainder of his unexpired term if removed without cause.\(^\text{109}\)

In addition to directors, the Commercial Code also requires the *kabushiki-kaisha* to have at least one auditor whose function is to report on share subscriptions, court-appointed inspectors' reports, and directors' statements.\(^\text{110}\) The statutory auditor (*kensuyaku*), who has no counterpart in U.S. business, has as his primary function

---

\(^{101}\) "The Company cannot, even by the articles of incorporation, provide for [sic] that the directors shall be shareholders." Art. 254, § 2, Commercial Code.

\(^{102}\) Art. 260, Commercial Code.

\(^{103}\) Art. 260-2, Commercial Code.

\(^{104}\) Art. 259-2, Commercial Code.

\(^{105}\) Art. 259-3, Commercial Code.

\(^{106}\) Art. 254-2, Commercial Code, provides that directors must perform their duties faithfully.

\(^{107}\) Arts. 266 — 266-3, 267 — 268-3, Commercial Code.

\(^{108}\) Art. 262, Commercial Code.

\(^{109}\) Art. 257, Commercial Code.

the duty to examine documents of account and render opinions on them to shareholder meetings.

The bases and causes of dissolution and liquidation of a kabushiki-kaisha are comparable to those in the United States. The Commercial Code provides for statutory regulation of dissolution and liquidation in Book II, Chapter IV, Sections 8 and 9.

Yūgen-Kaisha

Although the yūgen-kaisha has many of the corporate attributes of the kabushiki-kaisha, it is also endowed with partnership characteristics. The yūgen-kaisha or limited liability company is a legal entity,¹¹¹ formed under the Yūgen-Kaisha Law and its amendments. On the corporate side it can transact business, enter into contracts, and sue or be sued in its own name.¹¹² In regard to the company’s debt, the potential liability of the owners, who are called “members” rather than “shareholders,” is limited to their capital contributions.¹¹³ On the partnership side, the procedural requirements for formation, management, and termination of this entity are less stringent and formalistic than those for a kabushiki-kaisha. Furthermore, there are significant restrictions on the transfer of capital interests, comparable to those attaching to partnership interests.¹¹⁴ The yūgen-kaisha, however, is seldom utilized by foreign investors in Japan.

The capital structure and the permissible constituency of the yūgen-kaisha is provided by statute. The minimum capitalization of a limited liability company is set at 100,000 yen¹¹⁵ and divided into interests of at least 1,000 yen,¹¹⁶ each representing an undivided share of the company’s net assets. The certificates received for capital contributions may not be in bearer or order form.¹¹⁷ The nature of the capital contributions are divulged in at least two ways. First, the articles of incorporation, which are signed by all the members, must contain information regarding the amount of all capital contributions and complete account of all contributions of property

¹¹¹ Art. 1, Yūgen-Kaisha Law.
¹¹² The trade name must include the word “yūgen-kaisha.” Art. 3, Yūgen-Kaisha Law.
¹¹³ Art. 17, Yūgen-Kaisha Law.
¹¹⁴ Art. 19, Yūgen-Kaisha Law.
¹¹⁵ Art. 9, Yūgen-Kaisha Law.
¹¹⁶ Art. 10, Yūgen-Kaisha Law.
¹¹⁷ Art. 21, Yūgen-Kaisha Law.
other than money. Second, the yūgen-kaisha must file an application for registration, disclosing information about the company's capitalization, along with the directors' names and addresses and the appointment of representative directors.

Composition requirements of the yūgen-kaisha are set at a minimum of two members and a maximum of fifty, unless the court grants otherwise. The Yūgen-Kaisha Law and its amendments place no restrictions on alienability of certificates among members, but transfers to nonmembers may be effectuated only with the consent of the members and in accordance with specified procedures. Except as provided in the articles of incorporation, subscription to capital increases is permitted on a percentage basis.

The powers of members of a limited liability company generally correspond with those enjoyed by shareholders in a kabushiki-kaisha. Action by members is achieved in meetings providing a quorum of a majority of the shares issued exists. In such meetings, ordinary resolutions are adopted upon a simple majority vote; extraordinary actions, such as amendment of the articles, require the consent of 50% of the members and 75% of the shares outstanding. As with shareholders in a kabushiki-kaisha, voting by proxy is generally permissible; and meetings are dispensable if there is unanimous and written concurrence in the resolution.

The administration and management of the yūgen-kaisha parallel the corresponding operations in a kabushiki-kaisha. One or more directors are elected as representatives of the company with responsibility and authority approximating that of their counterparts in a stock company. Similarly, delegation of administrative responsibilities to a management group appointed by the directors is customary. The directorate obligation to prepare financial statements is on the order of that of a stock company but the utilization of the

---

118 Art. 7, Yūgen-Kaisha Law.
119 Art. 13, Yūgen-Kaisha Law.
120 Art. 8, Yūgen-Kaisha Law.
121 Art. 19, § 1, Yūgen-Kaisha Law.
122 Art. 19, § 2 — 6, Yūgen-Kaisha Law.
123 Art. 51, Yūgen-Kaisha Law.
124 Art. 38-(2), Yūgen-Kaisha Law.
125 Id.
126 Art. 48, Yūgen-Kaisha Law.
127 Art. 41, Yūgen-Kaisha Law; Art. 239, § 3, Commercial Code.
128 Art. 42, Yūgen-Kaisha Law.
129 Art. 27, Yūgen-Kaisha Law.
statutory auditor is optional. A final significant attribute of the \( \text{yūgen-kaisha} \) is the required establishment of a statutory reserve in an amount equal to 25\% of the stated capital.

**Other Business Entities**

Of the types of business associations recognized under Japanese law, only the branch office is of real importance to the foreign investor, even though the appeal of a branch office is itself severely limited. The \( \text{gomei-kaisha} \), \( \text{goshi-kaisha} \), \( \text{kumiai} \), and the sole proprietorship are only of limited significance because of restrictions imposed by the Foreign Investment Law of 1950. The three forms of partnership are profiled herein largely to acquaint the foreign investor with the types of entities encountered in doing business in Japan.

**Gomei-Kaisha**

The \( \text{gomei-kaisha} \) is similar in many respects to a modern U.S. partnership in that as a legal entity it can transact business, enter into contracts, and sue or be sued in its own name. Because of its partnership nature, all members are jointly and severally liable for the excess of the company's debts over its net assets. Nevertheless, the \( \text{gomei-kaisha} \) is taxed as an entity under the Corporation Tax Law.

The Commercial Code prohibits a company from becoming a member with unlimited liability in another company; therefore, only natural persons may be members in a \( \text{gomei-kaisha} \). Formation and capitalization, though governed by the Commercial Code, are loosely regulated, the primary requirement being the execution of the articles by all the members before a notary and subsequent

---

130 Art. 33, \( \text{Yūgen-Kaisha Law} \).
131 Art. 46, \( \text{Yūgen-Kaisha Law} \). This statutory reserve is now designated as earned surplus. Art. 20, Supplementary Provisions to the \( \text{Yūgen-Kaisha Law} \) (Law No. 214, 8 June 1951).
132 See note 25 \( \supra \).
134 See note 26 \( \supra \).
135 See note 27 \( \supra \).
136 Art. 80, Commercial Code.
137 Art. 40, \( \text{National Tax Collection Law} \) (Law No. 147, 20 April 1959); English: EHS No. 4000A; IV(AA-A) [hereinafter cited as \( \text{National Tax Collection Law} \)].
138 Art. 55, Commercial Code.
139 Arts. 62 — 63, Commercial Code.
registration in the Commercial Registry. Contributions by the members are not limited in amount or as to type of property.

Unless the articles provide otherwise, representation of the company and participation in its management is a right of all members; however, the customary practice is to delegate management responsibilities to one or more representative members. The sharing of profits and losses may be delineated in the articles, but absent express refutation, profits and losses are apportioned in accordance with the members' equities. In accordance with U.S. partnership law, the exclusivity of association is maintained by limiting transfers of capital interests to situations where prior unanimous consent is obtained. With such consent, the new member becomes liable for all existing company debts and the retiring member remains liable for two years following registration of his retirement.

Upon dissolution of a gomei-kaisha, all the members retain liability for company obligations generally for a period of five years.

Goshi-Kaisha

The limited partnership company is similar in most respects to the gomei-kaisha, but differs principally in that it includes both limited and general partners. The limited partner's liability is confined to the amount of his capital contribution; the general partner's potential liability is restricted only to the amount of company debts. The advantages of limited liability are offset by the prohibition against his making non-cash contributions and his exclusion from managerial participation and authorized representation

---

140 Art. 64, Commercial Code; see also note 36 supra.
141 Art. 63(4), Commercial Code.
142 Art. 70, Commercial Code.
143 Art. 71, Commercial Code.
144 Arts. 76 — 78, Commercial Code.
145 Art. 80, Commercial Code.
146 Art. 73, Commercial Code.
147 Art. 82, Commercial Code.
148 Art. 93, Commercial Code.
149 Art. 145, Commercial Code. Article 145, paragraph 2, however, states that even after five years creditors may demand payment if there are still surplus assets to be distributed.
150 Art. 146, Commercial Code.
151 Art. 147, Commercial Code, provides that unless otherwise provided in the Code, the provisions applicable to the gomei-kaisha are applicable to the goshi-kaisha.
152 Art. 157, Commercial Code.
153 Arts. 80, 147, Commercial Code.
154 Art. 150, Commercial Code.
of the company. A limited partner is not, however, precluded from engaging in similar business enterprises nor is he prevented from participation in other companies. Despite the restrictive scope of activity, a limited partner may, under the doctrines of misrepresentation and estoppel, incur general liability if his acts reasonably suggest to third persons the status of a general partner. Unanimous consent of the general partners is required to effect the transfer of a limited liability interest or a portion thereof.

**Kumiai**

The business association known as a *kumiai* does not have a separate legal personality and therefore cannot do business as an entity. Although formed under the Civil Code rather than the Commercial Code, the *kumiai* is still subject to the Commercial Code in a number of ways. The *kumiai* is comparable, therefore, in many primary aspects to the traditional common law view of partnerships in the United States.

The primary provisions of the Civil Code relating to the *kumiai* postulate an organizational structure where the partners take contributions as co-owners and share profits and losses in proportion to their equity interests. In addition, the management and administration of the firm are governed by majority rule, except as to removal of partners for reasonable cause, in which case unanimous consent is required. In a manner that resembles the law governing joint ventures in the United States, the *kumiai* is dissolved on completion of its purpose, when existing circumstances impede or prohibit attainment of its objective, or upon fulfillment of the terms of the partnership agreement.

**Branch of a Foreign Company**

The provisions of the Commercial Code permit a foreign enter-

---

155 Art. 156, Commercial Code.
156 Art. 155, Commercial Code.
157 Art. 159, Commercial Code.
158 Art. 154, Commercial Code.
160 Art. 668, Civil Code.
161 Art. 674, Civil Code.
162 Art. 670, Civil Code.
163 Art. 680, Civil Code.
164 Arts. 678, 682, Civil Code.
165 For a persuasive article dealing with the advantages of a branch office over Japan.
prise, irrespective of its legal form, to establish branches in Japan under terms similar to those granted Japanese companies.\textsuperscript{166} As with a branch office of a company formed in Japan of the same or similar nature, the foreign company establishing a branch office in Japan must, in respect of its office of business, register and file a public notice.\textsuperscript{167} At the time of registration, the foreign company must also indicate the jurisdiction and applicable law under which the company was incorporated, as well as the full name and permanent residence of its representative in Japan.\textsuperscript{168} As with most types of Japanese business entities, representatives of the foreign company, acting under authority, real or apparent, may perform all judicial and extra-judicial acts relating to the business of the company.\textsuperscript{169}

Although use of the branch office form of business is realistically the only practical means to retain 100\% control of the enterprise, the branch office has the disadvantage of relatively complete disclosure and accounting requirements which extend beyond the scope of branch operations.\textsuperscript{170} A foreign business intending to establish branches in Japan must file with the Minister of Finance and the Minister of International Trade and Industry information concerning the parent company as well as the branch.\textsuperscript{171} The parent company must divulge appropriate data including the parent's name and address, its date of incorporation, the names and addresses of its directors, and details of its capital structure including the par value of its stock and the number of shares authorized and issued.\textsuperscript{172} The parent company must also present copies of its articles of incorporation, a certificate of nationality, and financial statements for the most recent fiscal period.\textsuperscript{173} Furthermore, the parent company is required to give sufficient proof of authority for the appointment of an agent

\textsuperscript{166} Art. 482, Commercial Code.
\textsuperscript{167} Art. 479, § 2, Commercial Code.
\textsuperscript{168} Art. 479, § 3, Commercial Code. Art. 150, Corporation Tax Law.
\textsuperscript{169} Arts. 78, 479, § 4, Commercial Code.
\textsuperscript{170} Art. 485-2, Commercial Code.
\textsuperscript{171} Ministerial Ordinance Concerning Report of Branch Office, Plant and/or Other Place of Business of Non-Residents in Japan, Ministry of Finance and Ministry of International Trade and Industry Joint Ministerial Ordinance of July 1, 1963.
\textsuperscript{172} Id.; Arts. 149, 150, Corporation Tax Law.
\textsuperscript{173} Art. 149, Corporation Tax Law of Japan (Law No. 28, 31 March 1947). English: EHS No. 4100 IV (DA).
before such act, pursuant to Article 479 of the Commercial Code; other information demanded includes the branch location, name and address of the Japanese representative, and financial statements and plans. Upon filing the report containing the relevant information, assuming no impropriety, the report is accepted. Although the procedure of application and validation is not applicable to establishing a branch office, the acceptance of this report operates as a validation.

Despite acceptance of the initial report, the branch office will be subject to continuing disclosure obligations. Within three months of the end of each fiscal period, the branch must submit a report containing information on sales, production, capabilities, business plans and current financial statements.

Another very real regulatory feature of doing business in Japan in the form of a branch office is the strong opposition encountered from existing Japanese enterprises. Frequently the scope of a branch's activity may be determined in part by the extent of opposition generated. Thus, the popularity of a market and the degree of territorial infringement and competition may be sufficient impetus for existing Japanese businesses to force enterprise concessions in the range of branch operations. Although some areas of enterprise are presumptively foreclosed to foreign investors by operation of the Foreign Investment Law of 1950, most notably most manufacturing operations, other fields may be closed to foreign enterprise by operation of national business opposition.

With elemental perseverance national demarcation lines are decreasing in significance due to the pressures of international mercantilism. The multinational corporation owes allegiance, if only technically or procedurally, to a variety of flags. Nevertheless, nations are bound to protect their respective interests both as to private citizens and to sovereignty, Japan no less than others. Quite naturally Japan places limitations on foreign investment, vitiated only by economic and trade treaties, most notably bilateral treaties with the United States.

Japan's primary concern, however, remains prominent throughout: protection of the Japanese economy and of Japanese nationals.

---

174 Art. 479, ¶ 2, Commercial Code.
175 Art. 485-2, Commercial Code; see note 171 supra.
176 See HENDERSON, Appendix I, Table 7, at 358; Appendix X at 395-396; Jensen, "Know-How" Investment in Japan, PRIVATE INVESTORS ABROAD — STRUCTURES AND SAFEGUARDS 259 (International and Comparative Law Center, The Southwestern Legal Foundation, Dallas).
doing business with the foreign investor. With this rationale influencing policy, comprehensive regulation (both direct and indirect) of foreign investment is understandable and unavoidable. As a consequence, only the *kabushiki-kaisha* and the branch office remain attractive prospects as a form of doing business. However confronted with these alternatives, the foreign investor encounters difficulty in doing business in Japan which may be altered under the influence of national and international economic conditions and the internal movements of liberalization and counterliberalization.

**Scott K. Goldsmith**