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## Articles




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# Recent Developments and Prospects on Japanese Stock-for-Stock M&A Regulations

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## Background

Since the 1990s, Japanese M&A regulations have been constantly deregulated and developed. Now, most of the regulations can be considered on par with global standards; however, the stock-for-stock M&A regulations have been significantly left behind.

The Companies Act of Japan ("Companies Act") allows stock-for-stock transactions only by virtue of share exchanges (*kabushiki kokan*) or contributions in kind (*genbutsu shusshi*), which have not been practically useful as a tool in arm's-length acquisitions. The reason was that share exchanges could only be used for domestic acquisitions that will result in an entity becoming a wholly-owned subsidiary of the acquirer, while contributions in kind entailed burdensome and costly valuation procedures to be conducted by a court-appointed inspector and may require a special resolution of the shareholders of the target company.

## Deregulation in 2011 – ASMIR

In 2011, under the Act on Special Measures for Industrial Revitalization ("ASMIR"), the Japanese government tried to ease the burden by exempting acquisitions by tender offer from the above required valuation procedures and shareholders' approval in stock-for-stock deals done by contributions in kind. However, such transactions could not be treated as non-taxable under Japanese tax regulations. ASMIR also allowed cross-border acquisitions to be exempted, but even then there was no precedent of any stock-for-stock acquisition using this exemption.

## Deregulation in 2018 – ASIC Amendment

Considering the outcome of the ASMIR deregulation, the Japanese government tried to further ease the restrictions on stock-for-stock acquisitions by amending the Act on Strengthening Industrial Competitiveness, which took over the role of ASMIR in 2013 (as amended, "ASIC"). The amendment took effect on July 9, 2018.

Similar to the framework of ASMIR, ASIC requires an acquirer to obtain the government's approval of its "Corporate Restructuring Plan" (*jigyo saihen keikaku*) to enjoy the exemption from the requirements of the Companies Act on stock-for-stock acquisitions. It also expanded the scope of exempted transactions by no longer limiting the exemption to acquisitions by tender offer. Acquisitions of listed shares other than by tender offer and acquisitions of unlisted shares may now be exempted. Before the amendment, one of the requirements under the "Corporate Restructuring Plan" was for the target company to become the acquirer's "Affiliated Business" (this definition mainly refers to a subsidiary). But now, the exemption can apply even when a company acquires its existing subsidiary's shares from other minority shareholders by a stock-for-stock transaction.

### Deregulation in 2018 – Tax Treatment

In 2018, the amendment to ASIC created a new tax treatment for stock-for-stock transactions. Under certain conditions qualifying as a "Special Corporate Restructuring Plan" (*tokubetsu jigyo saihen keikaku*), a stock-for-stock acquisition may be treated as a non-taxable transaction under Japanese tax regulations. It may be noted that although the scope of exemptions from the requirements of the Companies Act on stock-for-stock acquisitions was expanded, the requirements for a non-taxable treatment are still quite restricted. Details are as follows:

(i) The consideration for the acquisition must be the acquirer's stock
If consideration for the shares is a combination of the acquirer's stock and cash or any other assets, then the preferable tax treatment will not be available.

(ii) The value of the stock as consideration must exceed the acquirer's cash flow
If the acquirer has sufficient cash flow to enable it to buy the target shares in cash, then the government will not allow the acquirer to enjoy a non-taxable treatment.

(iii) The target company must become the acquirer's Affiliated

Business

Contrary to the exemptions to the requirements of the Companies Act, an additional purchase of its subsidiary's shares is not entitled to a non-taxable treatment.

(iv) The acquisition must be for a new business

This amendment was introduced by the Ministry of Economy, Trade and Industry ("METI") to encourage new business. METI provided this requirement for a non-taxable treatment so that stock-for-stock transactions will be used for the following kinds of business activities:

- Business in a field where remarkable growth and development are expected (e.g., self-driving related technology and mega ventures);
- Providing certain platforms (e.g., e-commerce platform); or
- Focusing business resources to a company's core business.

## Future Amendments to the Companies Act

ASIC has largely deregulated stock-for-stock transactions involving Japanese companies, but the scope of exemptions to the requirements of the Companies Act and tax regulations are still practically limited because the exemptions require governmental approval of "Corporate Restructuring Plans" and "Special Corporate Restructuring Plans," and the requirements for non-taxable treatment are restricted.

In addition to the ASIC reform, the government is considering amendments to the Companies Act including the introduction of the option of a stock delivery (*kabushiki koufu*), which would allow a Japanese company to acquire a domestic or foreign target by a stock-for-stock transaction without any inspection procedure. A stock delivery may be conducted with the shareholders' approval and creditors' protection similarly required for mergers or share exchanges. If a stock delivery is treated as a non-taxable transaction, then it could be more useful than the current treatment under ASIC since it will not require any governmental approval. For now, we should closely observe future practices concerning such treatment under ASIC and possible amendments to the Companies Act to further deregulate stock-for-stock transactions.

Back to List of Articles

# The Regulatory Sandbox in Japan

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## 1. Introduction

The regulatory sandbox in Japan was introduced through the Act on Special Measures for Productivity Improvement (the "Productivity Improvement Act"), which took effect on June 6, 2018.

Among others, the Productivity Improvement Act established a regulatory sandbox, which is a completely new project-based deregulation scheme to enhance the implementation of any new outstanding technology or business model for society, thereby opening doors to smart ideas with smart regulation.

## 2. Background and Outline of the Regulatory Sandbox

Over the past several years, due to rapid innovations led by developments in information technology, such as artificial intelligence, the Internet of Things ("IoT"), and big data, industrial structures have rapidly changed and international competition to introduce such innovations to society has become intense.

A fledgling business idea or technology with the potential to break out of a set paradigm needs appropriate administrative support and understanding since such idea or technology may conflict with existing regulations. To tackle such potential conflict and establish an innovation-friendly environment, Japan has introduced a regulatory sandbox that seeks to accelerate the development of new ideas by limiting administrative barriers and regulations on a case-by-case basis through exemptions from existing regulations.

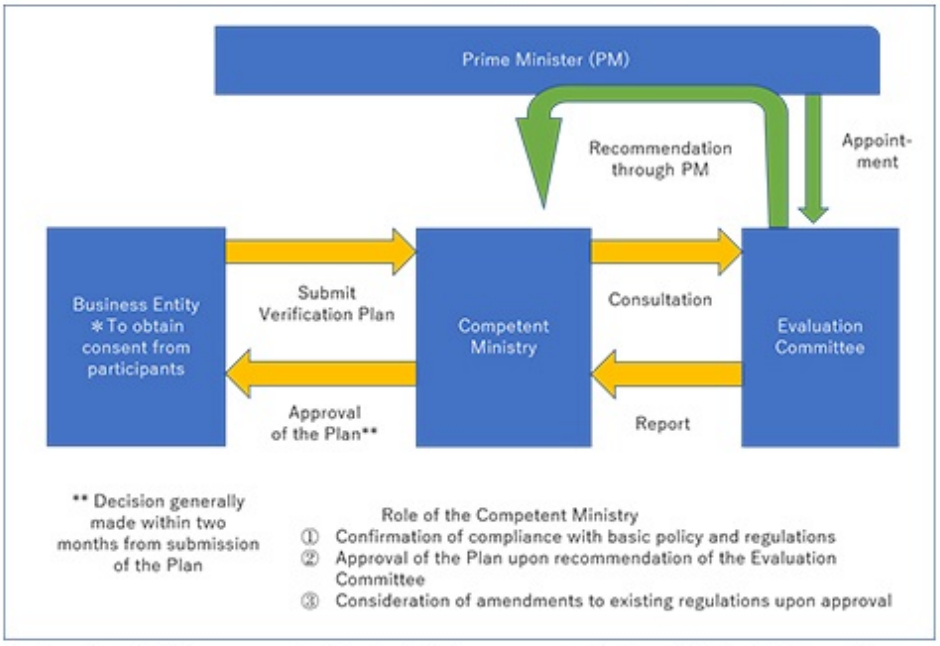
To allow businesses to collect data within a short period of time, under the regulatory sandbox system, businesses are allowed to conduct demonstration tests and pilot projects for new technologies and business models with a limited number of participants and within a predetermined implementation period, regardless of the existing regulations. This approach can lead to future regulatory reforms.

One of the characteristics of the regulatory sandbox in Japan is that it

is open to any technology tests and pilot projects in any industrial sector, and to any company, including foreign companies.

## 3. Basic Flow and Scheme of the Regulatory Sandbox

The basic flow and scheme of the regulatory sandbox is outlined in the chart below.




Act on Special Measures for Productivity Improvement, June 2018, Ministry of Economy, Trade and Industry. Based on the excerpt at http://www.meti.go.jp/press/2018/06/20180606001/20180606001-3.pdf.

To take advantage of the regulatory sandbox system, a verification plan for the new technology (the "Verification Plan") must be prepared and submitted by the business entity to the competent ministry for approval.

The Verification Plan shall verify the actual use of the new technology (the "New Technology") specifying the implementation period and the relevant participants, together with their consent. In addition, if the Verification Plan includes an analysis of the regulations needed for the New Technology, then there should be a study of the implementation of such regulations and an examination of the results of such analysis.

New Technology means a technology or method to be used for an innovative business activity, which has significant novelty in the relevant field and may generate additional high value. An innovative business activity is one that uses an innovative technology or method in a business field where Japan needs to strengthen its international competitiveness. Based on the basic policy issued under the Productivity Improvement Act,[1] new technologies or methods related

to artificial intelligence, IoT, big data and blockchains all fall within the definition of New Technology with significant novelty.

The deregulation scheme of the regulatory sandbox is an option not only for Japanese companies but also foreign companies planning to launch a new business that introduces a new technology or business model which is or may not be in compliance with existing regulations. For details of the scheme and the scope of qualified projects, professional advice should be sought.

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1. *See* Basic policy of the regulatory sandbox scheme in Japan at http://www.kantei.go.jp/jp/singi/keizaisaisei/pdf/underlyinglaw/basicpolicy.pdf (Japanese only).

Back to List of Articles

## FAQ on Investments in Medical Organizations

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When considering investments into Japan, the field of medical services might be one of the areas that foreign investors consider to be difficult to enter. However, there are more than 53,000 medical organizations in Japan and this number is growing. With an understanding of their difference from other business entities, foreign investors can invest in Japanese medical organizations. In this article, I will explain some fundamental concepts regarding investments in medical organizations in Japan in FAQ format.

### Q1. What are the main features of the Japanese medical system?

A. In Japan, there has been a solid policy governing the area of medical services – the non-profit principle. Under this policy, all medical organizations must provide their services to any patient with any disease without regard to profit. With this policy and a national

health insurance system, all patients are entitled to avail of medical services with minimal out-of-pocket costs while medical organizations can be reimbursed by the government based on the actual cost of treatments.

### Q2. Who can engage in medical services in Japan?

A. In general, only an individual doctor (sole proprietor) or a medical corporation (*iryo hojin*) can establish a hospital and engage in medical services in Japan.

Under the Medical Care Act[1] and its relevant regulations, hospitals cannot engage in any commercial business, thus, no person or entity can establish and operate a hospital for profit. On account of this non-profit principle, typical legal entities regularly used to conduct business in Japan, such as a corporation (*kabushiki kaisha*) or a limited liability company (*godo kaisha*), cannot engage in the hospital business.

Broadly speaking, there are three types of medical corporations in Japan: (a) a medical corporation with equity interests ("Medical Corporation-A"), (b) a medical corporation without equity interests ("Medical Corporation-B"), and (c) a medical corporation foundation ("Medical Corporation-C"). Details of these companies will be explored in the next questions.

### Q3. What are the major restrictions on medical corporations?

A. Since medical corporations cannot engage in any business for profit, the Medical Care Act imposes some restrictions. Among other things, (a) medical corporations may not be established without the approval of the prefectural governor;[2] (b) medical corporations shall not distribute dividends of any surplus;[3] (c) the president of a medical corporation (*riji-cho*) shall be elected from among the directors who are physicians or dentists with only a few exceptions;[4] and (d) medical corporations cannot undertake profit-making activities other than those prescribed by the Ministry of Health, Labor and Welfare ("MHLW"), and to do so, they need a special authorization from the prefectural governor as a social medical corporation.[5]

### Q4. What characteristics do medical corporations have compared to regular business corporations?

A. For Medical Corporation-A and Medical Corporation-B, first, unlike

regular corporations, these medical corporations do not have shareholders. Instead, they have members (*shain*), which hold general meetings similar to shareholders' meetings in regular corporations. Members may elect and/or dismiss the directors of a medical corporation at such meetings. The difference between Medical Corporation-A and Medical Corporation-B is whether the members have an equity interest therein; they do in Medical Corporation-A and don't in Medical Corporation-B. However, it should be noted that members possess only one voting right each at the general meetings regardless of the amount they may subscribe for or donate to such medical corporations.

Second, Medical Corporation-A and Medical Corporation-B have a board of directors (*riji-kai*), which carries out their normal operations like a board of directors of a regular corporation.

As to Medical Corporation-C, first, it has no members and the board of directors has the highest decision-making authority therein. Second, its directors may only be elected and/or dismissed by a board of councilors (*hyogi-in-kai*).[6]

The table below summarizes the differences between the different investors in the medical sector:

| | Equity Interests | Who has the rights and obligations to the business? | Organizations |
|---|---|---|---|
| **Sole Proprietor** | N/A | Individual | N/A |
| **Medical Corporation-A** | ○ | Medical Corporation | Members' General Meeting<br>Board of Directors<br>Auditor |
| **Medical Corporation-B** | × | Medical Corporation | Members' General Meeting<br>Board of Directors<br>Auditor |
| **Medical Corporation-C** | × | Medical Corporation | Board of Directors<br>Auditor<br>Board of Councilors |

## Q5. Are there any specific restrictions on foreign investments in medical organizations?

A. No. There are no specific restrictions on foreign investments in

medical organizations in Japan. At least in theory, any foreigner can be a member of a Medical Corporation-A or a director of any medical corporation. Please note, however, that since 2007, new Medical Corporation-A entities may no longer be established under the current Medical Care Act and its relevant rules. Thus, the purchase of an equity interest for membership is only available in those that have been existing prior to 2007.

### Q6. How can investments be made in medical organizations in Japan?

A. As mentioned above, under Japanese law, the legal structure of medical organizations is different from regular corporations, so when it comes to considering an M&A of a medical corporation, a different mindset is essential. Although there are no specific restrictions on foreign investments in medical organizations in Japan, as the restrictions under the Medical Care Act themselves are stringent (e.g., a medical corporation may not be established without the approval of the prefectural governor and the plans for its establishment are subject to the scrutiny thereof), it is in practice difficult for foreign investors to establish medical corporations in Japan.

As mentioned in the preceding QA, the purchase of an equity interest in a Medical Corporation-A and being a director of a medical corporation are theoretically possible. In either case, however, the non-profit principle shall apply. Thus, under the circular published by the MHLW,[7] no business entity shall either have voting rights in a medical corporation or participate in its management. Therefore, foreign business entities cannot basically obtain voting rights in a Medical Corporation-A or Medical Corporation-B, or hold the position of director at any medical corporation because it is highly likely that the prefectural governor would consider their involvement as participation of a business entity in the management of a medical corporation.

### Q7. Are there alternative ways to invest in a medical corporation?

A. It is not unusual for a medical corporation to have a medical services corporation ("MS Corporation") as a separate entity (generally, a regular corporation) to provide administrative, finance or consulting services to such medical corporation. Notably, the MS Corporation holds the title to the real estate and then leases the building and/or land to the medical corporation where it operates the hospital or its principal business. Through an MS Corporation, an

investor may have some control over the medical corporation, whether in theory or in fact. Thus, an investment into an MS Corporation (via a stock purchase, business transfer, etc.) is relatively the typical way of indirectly investing in a medical corporation.

### Q8. What are the important things to note when investing in an MS Corporation?

A. Under the MHLW's circular, an officer or director of an MS Corporation cannot concurrently hold the position of director of a medical corporation if there is an economic relationship between the MS Corporation and the medical corporation. Although there are some exceptions to this restriction, since any violation of the Medical Care Act or its relevant rules may be subject to administrative directives and penalties, careful consideration on a case-by-case basis is necessary when examining the specific investment scheme for an MS Corporation or a medical corporation. Moreover, if the MS Corporation leases the building to a medical corporation, then the rent should not be too high because the government may consider it as a distribution of dividends of surplus, which is prohibited under the Medical Care Act.

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1. Iryo ho [Medical Care Act], Act No. 205 of July 30, 1948, as last amended by Act No. 57 of June 14, 2017.
2. *Id.*, art. 44.
3. *Id.*, art. 54.
4. *Id.*, art. 46-6.
5. *Id.*, art. 42-2.
6. *Id.*, arts. 46-5(3) and 46-5-2(4).
7. *See* response of the Chief of the Guidance Division of the Health Policy Bureau of the Ministry of Health and Welfare (now, the MHLW) to a query regarding investments or donations in medical corporations, January 17, 1991.

Back to List of Articles

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