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A Note From the Editors-in-Chief

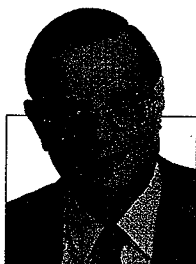
Welcome to CORPORATE BUSINESS TAXATION MONTHLY, the only publication specifically committed to meeting the needs of corporate tax executives and their professional advisers. As such, CORPORATE BUSINESS TAXATION MONTHLY continues to provide analysis of relevant and timely corporate business tax issues. We hope that you, the reader, will suggest article topics, recommend authors and prepare articles for publication.

This June 2005 issue addresses international reorganizations first and foremost. On January 5, 2005, the IRS and Treasury Department issued proposed regulations that, if finalized, would permit corporate mergers and consolidations effected under foreign law to qualify as statutory mergers under Code Sec. 368(a)(1)(A). **Thomas W. Avent, Jr.**, Southeast Partner-In-Charge, Mergers & Acquisitions—Tax, KPMG LLP (Atlanta) examines these provisions.

The proposed regulations, from our point of view, seek to correct an overly restrictive interpretation of a U.S. statute. What makes this situation fascinating is that the Government's corrects an erroneous interpretation made 70 years ago in response to the 1934 Act, Code Sec. 112(g)(1). The proposed regulations would replace the requirement in Reg. 1.368-2(b)(1)(ii) that a merger or consolidation be effected under the laws of the United States. The proposed regulations, if finalized, would permit corporate mergers and consolidations effected under foreign law to qualify as statutory mergers under Code Sec. 368(a)(1)(A).

Margaret Kent is an attorney and counselor with the law firm of Feinschreiber and Associates in Miami (Key Biscayne), Florida.

In *International Taxation*, **Jim Croker** and **Yushi Hegawa** discuss the forthcoming modifications of Japanese corporate law that would repeal the law establishing the limited liability company known as the *Yugen Kaisha*, which is an eligible entity under check-the-box regulations. In their *Multistate Taxation* column, **Philip Tatarowicz** and **Rebecca Bertothy**, examine recent developments of significant interest to the states. **Gary Q. Cvach** and **Karen M. Field**, in *Taxation of Compensation and Benefits*, discuss required changes to non-qualified deferred compensation plans set forth in Code Sec. 409A, added by the American Jobs Creation Act of 2004.



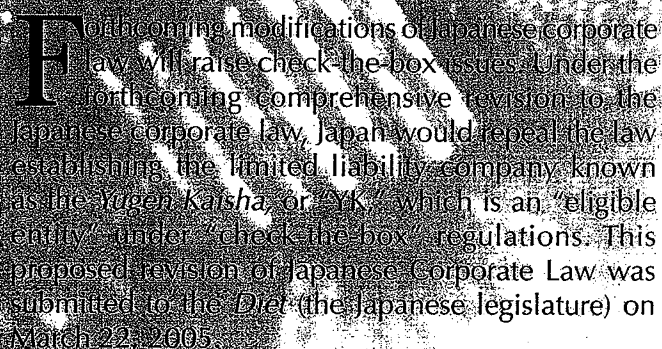
Robert Feinschreiber is an attorney and counselor with the law firm of Feinschreiber and Associates in Miami (Key Biscayne), Florida.

Each article is the responsibility of the author(s). As editors, we welcome your suggestions and comments as to your corporate business tax concerns. Feel free to contact us at 305-361-5800, and to submit material to us at multijur@aol.com.

Best Regards,
Robert Feinschreiber and Margaret Kent

International Taxation

*By Jim Croker and Yushi Hegawa**



Forthcoming modifications of Japanese corporate law will raise check-the-box issues. Under the forthcoming comprehensive revision to the Japanese corporate law, Japan would repeal the law establishing the limited liability company known as the *Yugen Kaisha*, or "YK," which is an "eligible entity" under "check-the-box" regulations. This proposed revision of Japanese Corporate Law was submitted to the *Diet* (the Japanese legislature) on March 22, 2005.

Existing YKs will be automatically converted to the *Kabushiki Kaisha*, or "KK," form. A KK is a *per se* corporation under the check-the-box regulations. If the check-the-box regulations are not amended to provide grandfather relief for existing companies, complex and possible costly restructuring may be necessary for U.S. companies that use the *Yugen Kaisha* in their Japanese structure.

Current Japanese law offers two major corporate entities—a *Kabushiki Kaisha* (a stock corporation, a "KK") and a *Yugen Kaisha* (a limited liability company, a "YK"). Both a KK and a YK provide shareholders with limited liability. For U.S. investors, the choice between a KK and a YK has largely depended upon the following:

- the difference of treatment for U.S. federal income tax purposes, and
- the difference of recognition and prestige among the Japanese business community.

A KK is generally considered more recognized and prestigious than a YK in the Japanese business community. Nevertheless, it is now not uncommon for U.S. investors to conduct Japanese business in the form of a YK that elects to be classified as a partnership or disregarded entity for U.S. tax purposes. Many U.S. investors are using a YK as a vehicle for various portfolio investments for the same tax reason.

Jim Croker and **Yushi Hegawa** are Partners at the firm of Alston & Bird LLP.

A comprehensive revision to the Japanese corporate law is in progress. The revision is intended to modernize the overall corporate legislation in response to the changing societal and economic circumstances. Among other things, the new law would repeal the YK law and provide that any YKs in existence as of the effective date of the new law would continue as KKs under the new corporation law (*i.e.*, existing YKs will be automatically reformed as a KK as a matter of legal characterization under Japanese law). A KK that has been reformed from a YK pursuant to this law must include the phrase "*Yugen Kaisha*" in its corporate name, and is referred to as a "Special *Yugen Kaisha*" (*Tokurei Yugen Kaisha*). The new law would also allow a Special *Yugen Kaisha* to retain indefinitely its governance structure under the repealed YK Law. This means that, practically speaking, there would be few differences between the old YK and the new Special *Yugen Kaisha* that is a KK.

While it technically remains uncertain whether the proposals will be approved by each of the two Houses of the *Diet*, or whether there will be any change to the substance of the proposals, many observers expect that the proposals will be approved without much substantive change at the current session of the *Diet*, with an expected effective date not before April 2006.

Ramifications Under the Check-the-Box Regulations

Under the check-the-box regulations, a YK is eligible to elect to be classified as either a partnership (or a disregarded entity) or a corporation for U.S. income tax purposes (*i.e.*, it is an "eligible entity"). On the other hand, a KK is listed as a *per se* corporation under the check-the-box regulations, and it is not eligible to elect to be taxed as a partnership (or a disregarded entity). The check-the-box regulations are silent on the effect of a change to foreign law that affects the *per se* corporations list.

The reformation of a YK as a KK under the proposed law could be treated as the reformation of an eligible entity into an entity that is classified as a *per se* corporation by operation of foreign law. If this interpretation applies, the check-the-box regulations would treat the transformation of a YK into a KK as a transfer of assets to a new foreign corporation in exchange for stock in that corporation. Depending on the location of the YK in the corporate structure (as well as other issues), such a transaction might result in the recognition of taxable gain by YK shareholders deemed to transfer property to the new KK. For example, the transformation of a YK with direct U.S. shareholders into a KK would be subject to the rules of Code Sec. 367(a).

There currently exist two other Japanese entities that are eligible to make a check-the-box election. However, it is impossible under current Japanese law for a YK to be reorganized as either of these two entities. Moreover, these entities require at least one member with unlimited liability for debts of the entity. On the other hand, it would be possible for a YK, after first becoming a Special *Yugen Kaisha* that is a KK, to be reorganized as another new entity called a *Godo Kaisha* (a joint company, a "GK") that will be established by the new proposal as a Japanese equivalent of a U.S. LLC.

A GK should be an eligible entity under the check-the-box regulations. However, this may not be practically feasible for a number of reasons. Among others, such reorganization would be subject to the Japanese registration tax, which is 0.15 percent of the amount of the stated capital of the reorganizing entity. Also, the reorganization of a YK into a GK would involve significant transaction costs (including the complete renewal of various documents, contracts, accounts, forms, signs, invoices, brochures and all other materials that bear the corporate name of the YK, as well as with advertisement and publication of the name change).

Planning Considerations

Since it is likely that the proposal will be enacted into law, it is not too soon for U.S. companies to start thinking about the impact the changes would have on their Japanese structures. Although there is certainly a good chance that the IRS will issue some type of grandfather rule specifically applicable to a YK that is classified as a partnership (or a disregarded entity) for U.S. income tax purposes as of the effective date of the new law. Indeed, these authors have urged the IRS to do so,[1] there is no guarantee that this will happen.

ENDNOTES

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1 *See "Check-the-Box" Guidance Following Japanese Corporate Law Changes*, TAX NOTES TODAY, Apr. 5, 2005, at 27.