NAGASHIMA OHNO & TSUNEMATSU
長島·大野·常松 法律事務所

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■ ANTITRUST/COMPETITION

The JFTC's new evidence disclosure regime: a step forward for companies suspected of anti-competitive conduct?

I. Introduction

Japan's competition authority, the Japan Fair Trade Commission (the "JFTC") is now under pressure to disclose to parties it suspects of anti-competitive behavior more evidence in the JFTC's pre-decision phase with the introduction of a new regime of evidence disclosure and pre-decision hearing sessions.

Under the old regime, the suspected parties that allegedly have infringed the Anti-Monopoly Law only had a limited opportunity in the JFTC's pre-decision phase to seek information from the JFTC about the evidence that the JFTC investigators relied on to prepare their draft order(s). This was typically a few months before the order(s) were issued, usually at the time pre-notification of the draft order(s) was made to the suspected parties.

Although there was an opportunity to request the JFTC to reconsider disputed points before the order(s) were issued, the JFTC's explanation itself did not entail any disclosure of the evidential documents and the explanation was usually not extensive. Therefore, if the suspected parties wanted to review the evidence in detail, they had to resort to filing a complaint with the JFTC's examination panel (as opposed to a judicial court) after the order(s) were officially issued and then had to wait for the JFTC investigators to present the evidence in response to such complaint.

II. The New Regime

However, the new regime has bolstered the pre-order procedure, particularly from the perspective of the suspected parties. The new regime involves:

(i) the pre-decision disclosure by the JFTC of the evidence that its investigators relied on in reaching their factual conclusions and the conclusion of the draft cease and desist order and/or the order to impose a surcharge; and

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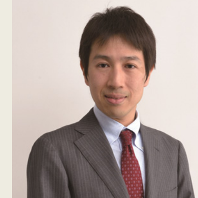

Yoshitoshi Imoto
Partner
T: +81-3- 6889-7258
E: yoshitoshi_imoto@noandt.com

■TAX

Shigeki Minami
Partner
T: +81-3- 6889-7177
E: shigeki_minami@noandt.com

(ii) pre-decision hearing sessions where each of the suspected parties is permitted to ask questions in private of the JFTC's investigators about the draft order(s) and express their opinion on the draft order(s) after fully reviewing the evidence disclosed by the JFTC investigators in the pre-decision disclosure.

The introduction of this new system was related to the 2015 abolishment of the JFTC examination panel and the fact that suspected parties may now seek a judicial court's *de novo* review if they are not satisfied with the order issued by the JFTC. The new regime may ensure more procedural protection for the suspected parties and also enable the JFTC investigators to test the strength of their case prior to it being contested in court.

Unlike the disclosure by the European Commission after issuing a statement of objections, the JFTC does not hand over the other suspected parties' evidence. Rather, the JFTC permits a suspected party to inspect the other suspected parties' evidence at the JFTC's premises. Copying or transcribing the entirety of the other parties' documents is not allowed. Only the taking of short notes is permitted. Further, a suspected party may not access the other suspected parties' leniency records. Also, the JFTC does not need to disclose any exculpatory evidence in its possession.

III. <u>Comment</u>

The usefulness of questioning the JFTC investigators at the pre-decision hearing sessions may be limited. This is because the JFTC's investigators' statements made at these sessions will be put on official record and sent to the JFTC's commissioners together with the case record and the draft orders for final decision and authorization. Consequently, the JFTC investigators tend to answer questions in a conservative and dismissive manner.

As of February 29, 2016, the JFTC has held pre-decision hearing sessions for only a handful of cartel cases. In terms of the scope of the evidence available to the suspected parties before the formal orders, the new regime of disclosure is a fairly big step forward. However, it remains to be seen whether the new regime could work in favor of suspected parties insofar as whether it will result in the JFTC investigators reconsidering and significantly changing the draft orders they intend to issue.

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  (Law Business Research Ltd, December 2015)
  by Ryuji Sakai and Kayo Takigawa (co-author)
- ***Getting the Deal Through - Cartel Regulation 2016 Japan***
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  by Eriko Watanabe

■ TAX

The Supreme Court of Japan decision in the IBM corporate reorganization tax dispute: increased caution required regarding intra-group restructurings

I. Overview

On February 18, 2016, the Supreme Court of Japan passed down a significant decision in a high-profile tax case involving a Japanese corporate taxpayer within the IBM group. The Supreme Court affirmed the earlier Tokyo High Court judgment which had rejected the Japanese tax authorities' claims and cancelled the original substantial tax adjustment levied against the taxpayer. Nagashima Ohno & Tsunematsu represented the taxpayer.

The adjustment was levied on certain intra-group sales of shares that took place between IBM Japan entities between 2002 and 2005 in the context of a global corporate reorganization. The case has attracted significant attention given the massive amounts involved: approximately JPY 400 billion of taxable income and a tax amount of around JPY 120 billion.

The Japanese tax authorities invoked the anti-avoidance rules to apply the adjustment: Article 132 of the Corporate Tax Act of Japan which can apply to the conduct of Japanese "family corporations", provided an "unjustness" requirement is satisfied. A "family corporation" is a Japanese corporation with over 50% of its shares owned by three or less shareholders' groups. There is no official guidance on the meaning of "unjustness" in the context of such reorganizations and consequently its interpretation was heavily litigated at both first and second instance.

The Supreme Court ultimately brought an end to the dispute by rejecting the tax authorities' petition for a final appeal filed in response to the Tokyo High Court judgment (which is an equivalent of a petition for a writ of certiorari under US law). The Supreme Court accepted the taxpayer's arguments and upheld the Tokyo High Court judgment which had cancelled the tax adjustment.

II. Transaction Summary

The dispute concerned tax losses arising out of certain share sales pursuant to a repurchase of those shares by the original issuing company. In general, a sale of shares to an issuing company (i.e., the repurchase of shares) may create tax losses by operation of the following statutory mechanism under Japanese tax law:

(i) part of the consideration paid by the purchaser (i.e., the issuing company) to the seller (i.e., a shareholder) is deemed as dividends since it is considered economically equivalent to a payment of dividends. Consequently, it is not included in taxable income (generally, dividends received by a corporate shareholder are not included, wholly or partially, in the corporation's taxable income); and

(ii) the remainder of the consideration paid to the seller (the shareholder) is deemed as the purchase price for the shares sold by the shareholder. This can result in losses as only the amount of the consideration that remains after deducting the amount deemed as dividends is regarded as the purchase price for tax purposes.

In the IBM case, as part of the group's global restructuring, an intermediate Japanese holding company ("Holdings") acquired from its US parent all of the shares of a Japanese operating company ("Sub") thereby making Sub a 100% subsidiary of Holdings. Thereafter, Holdings sold a portion of Sub's shares that it had owned back to Sub (the issuing company) for the purpose of repatriation of earned profits.

The sales resulted in losses by operation of the mechanism described above. Subsequently, under Japan's consolidated tax return regime, the Japanese consolidated group offset Sub's taxable income with the losses that had been recognized through the share sales.

The Japanese tax authorities invoked Article 132 of the Corporation Tax Act of Japan and did not recognize the sales (and hence the losses resulted from the sales) for the purposes of Japanese tax law. The tax authorities alleged that the reduction of corporation tax due to the tax losses should be regarded as "unjust" because:

(i) when considered in the context of the share sales resulting in the losses, there was no legitimate reason or business purpose in making Holdings an intermediate holding company for Sub;

(ii) the series of sales were not ordinary transactions between independent parties; and

(iii) the intention to commit tax avoidance was evident in the pattern of conduct of the relevant parties.

III. The Tokyo District Court Judgment

At first instance, the Tokyo District Court in its 2014 judgment rejected the tax authorities' allegations and ordered the cancellation of the tax adjustment. The District Court rejected the tax authorities' aforementioned arguments on the basis that:

(i) it disagreed with the tax authorities' allegation that there were no legitimate reason or business purpose to place Holdings as an intermediate holding company in Japan;

(ii) the Court rejected the tax authorities' allegation that the share sales were not ordinary transactions; and

(iii) the Court was not able to identify evidence or circumstances to sufficiently support the tax authorities' allegation that tax avoidance was intended by the relevant parties.

IV. The Tokyo High Court Judgment

In the second instance, the Tokyo High Court in its 2015 judgment upheld the District Court's judgment. It specifically held that:

(i) the establishment of the intermediate holding company (Holdings) and the share transfers (which generated losses) should not be viewed as one integrated transaction (as was argued by the tax authorities) but rather that each share transfer in and of itself had to be examined independently from the other transactions;

(ii) each share transfer itself should not be considered as unreasonable; and

(iii) the tax authorities' allegations that the losses were mere ostensible ones which lacked any real substance had no legal merit.

V. The Supreme Court Decision

The Supreme Court brought an end to the dispute by rejecting a petition for a final appeal filed by the tax authorities against the Tokyo High Court judgment. The Supreme Court did not reveal its reasoning in its decision. It only stated that the petition did not satisfy the requirements for a certiorari which is customary when the Court rejects petitions for a certiorari.

VI. Practical Implications

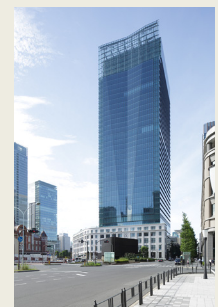
It is important to note that the Corporation Tax Act of Japan was amended in 2010 so that the tax losses which IBM claimed for transactions completed between 2002 and 2005 can no longer be claimed for analogous transactions done post the amendment (i.e., share repurchases between a Japanese parent and its wholly-owned subsidiary).

A driver behind this case is the increased vigilance in recent years of the Japanese tax authorities in attempting to crack down and enforce the anti-avoidance rules on corporate reorganizations and cross-border transactions, in particular those which are structured to be tax-free (or taxable if doing so is advantageous to the taxpayer). This has resulted in tax adjustments being levied against some reorganization transactions. Whilst the taxpayer defended itself successfully in the IBM case, this case exemplifies the recent aggressive enforcement activity of the Japanese tax authorities. Caution and careful structuring of reorganizations and cross-border transactions are required in order to try to ensure the tax authorities do not mistakenly suspect that deals have been designed to avoid tax.

The Tokyo District Court and the Tokyo High Court appeared to have agreed with the Japanese tax authorities on possibly adopting a certain kind of "step transaction doctrine" under which a series of transactions could be considered as integrated and hence evaluated as a whole. The facts in the IBM case did not permit the Courts to invoke the doctrine and consequently the doctrine's scope and requirements are left ambiguous and unclear. Corporate taxpayers are therefore well-advised to review contemplated transactions with experienced tax professionals to ensure they could withstand the tax authorities' potential challenges.

NAGASHIMA OHNO & TSUNEMATSU www.noandt.com

JP Tower, 2-7-2 Marunouchi, Chiyoda-ku, Tokyo 100-7036, Japan
T: +81-3-6889-7000 F: +81-3-6889-8000



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