

A New Law on Business Trust

A bill seeking to amend Japan's current *Trust Law* was approved by the Japanese Diet on December 8. The New Trust Bill proposes an overhaul of the current *Trust Law*, which has not been substantially amended for more than 80 years, to better address the modern social and economic situation in Japan.



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The New Trust Bill will introduce new forms of trusts not currently permitted under the current *Trust Law*, including the concept of business trusts, which has attracted much attention from the business community.

Definition and Advantages of a Business Trust

"Business trust" is not a rigidly defined term and can have different meanings. However, for the purposes of the New Trust Bill, it usually refers to a trust for which an entire business is considered an asset. While the entrustment of a business, by its very nature, should mean the entrustment of the debts relating to the business, under the current *Trust Law* the entrustment of assets is restricted to only positive assets, and neither the entrustment of the debts alone nor the entrustment of all components of the business (including its positive assets and debts) is permitted.

However, because of the recognized practical benefits of business trusts for use in fundraising and other purposes, the New Trust Bill makes it clear that business trusts are now possible by expressly providing that debts owed by the settlor prior to the establishment of the trust can become debts of the trust if specifically so provided in the trust agreement or the declaration of trust (Item 3, Paragraph 1 of Article 21 of the New Trust Bill).

Revitalization of a Product Division

With the intent of revitalizing one of a product division's

uncompetitive businesses (Business X), Company A may elect to entrust Business X to Company B, which is engaged in the same type of business. In this case, Company A, as trust beneficiary, will receive the profits derived from Business X being administered by Company B (as trustee). Company B, on the other hand, will receive a trust administration fee from Company A, which is acting as settlor. Upon termination of the trust term, Company B will return Business X to Company A, as the beneficiary.

Engaging in High-risk Business

A company may, through a declaration of trust, establish a self-settled business trust with respect to that portion of its business activities that constitute high risk (Business Y) and, by making such self-settled business trust a limited liability trust, limit the risk attendant with the operation of Business Y by restricting recourse for the payment of debts arising from the operation of Business Y to only the assets

of the trust. Thereafter, the company may sell a portion of the trust's beneficial interest rights to third-party investors.

Decision-making Among Multiple Beneficiaries

For various purposes, including fundraising, a company, as settlor (or in the case of a self-settled business trust, as both settlor and trustee), may wish to structure the business trust so that its interest rights will be held by multiple parties. The current *Trust Law* does not contain provisions for the existence of multiple beneficiaries; in the event that a trust does, in fact, have multiple beneficiaries, it is not clear what kind of decision-making process among them would be permitted under the current *Trust Law*. The New Trust Bill specifically addresses the decision-making process among multiple beneficiaries (Articles 105 through 122 of the New Trust Bill). Under the bill, unless otherwise provided for in the trust agreement or the declaration of trust (as applicable), the default rule will be that all decision-making by multiple beneficiaries must be unanimous. However, with the exception of decisions involving the release of the trustee or its directors from liability, the New Trust Bill affords trusts great flexibility by allowing the parties broad discretion to provide for their own decision-making rules in the trust agreement or in the declaration of trust.

Authorization of Self-Settled Trusts

A self-settled trust is a trust established by the settlor by separating specific assets from its own assets and declaring that the settlor,

as trustee, will itself administer such assets. As a result of the authorization of self-settled business trusts, a company will be able to establish a business trust without changing the operating entity of the entrusted business. Because the current Trust Law does not contain an express provision permitting self-settled trusts and because of concerns over the use of self-settled trusts to defraud the settlor's creditors, it is generally believed that self-settled trusts are not allowed under the current *Trust Law*. However, the potential uses of the self-settled trust have long been well recognized. For example, they may be used by a company to raise funds by combining a self-settled trust with a business trust or to preserve money held by loan servicers and others. Therefore, the New Trust Bill expressly provides for the establishment of self-settled trusts (Item 3 of Article 3), as well as measures intended to prevent self-settled trusts being used to prejudice the settlor's creditors, such as requiring a notarial deed and special measures for the execution by a settlor's creditors against trust assets held by a self-settled trust (Paragraph 2 of Article 23 of the New Trust Bill).

Regulation of Self-Settled Trusts

As mentioned above, companies may combine a business trust with a self-settled trust. However, if the repeated establishment of self-settled business trusts by a company were to be categorized as engaging in a trust business under the Trust Business Law, the current law's regulatory regime for such matters as licensing, concurrent businesses and corporate trade names will apply, making it practically impossible for the company to continue such activity. Therefore, pursuant to a pending bill for the revision of the *Business Trust Law* (the revised Business Trust Bill), an entity establishing a self-settled trust will be required to register with the Financial Services Agency of Japan when a fixed number of persons acquire beneficial interest rights in the trust (Article 50-2) and in all other cases, the regulations under the *Business Trust Law* will not apply.

Limited Liability Trusts

As a general principle, liability for debts arising in connection with transactions in the course of the trustee's administration of the trust

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are not limited to the trust assets; the trustee can also be personally liable. While under the current *Trust Law* the trustee may limit such liability by including a special limited-recourse clause in the transaction documents with trust creditors to the effect that such creditors' recourse shall be limited to only the trust assets, there was no form of trust specifically provided for under the current *Trust Law* that provides the trustee with the benefit of such limited liability. However, since there is a need for limited liability trusts in certain cases (for example, in a trust involving the operation of a high-risk business), and since it is not unfair to permit such trust to allocate risk between the trustee and the trust creditors, the New Trust Bill authorizes the establishment of a trust where recourse for debts will be limited to the trust assets, i.e., a limited liability trust (Articles 216 through 247 of the New Trust Bill). However, to avoid unexpected losses to a counterparty, the New Trust Bill requires this type of trust to be registered (Paragraph 1 of Article 216 and Article 232) and further requires that when entering into a transaction, the trustee clearly indicates to the transaction counterparty that the trustee is the trustee of a limited liability trust (Article 219).

Business Trusts and the Company Law

Where a company intends to entrust a material part of its business pursuant to a trust agreement, as in traditional business transfers (*jigyo jyoto*), such entrustment will need to be approved by way of a special resolution at a shareholders' meeting in accordance with Item 11, Paragraph 2 of Article 309 and Item 2, Paragraph 1 of Article 467 of the *Company Law* (i.e., adoption by two-thirds or more of the votes of shareholders present representing more than one-half of the total number of issued shares). Furthermore, when a company intends to entrust a material part of its business by way of a declaration of trust (a self-settled trust) rather than by way of a trust agreement, in principle, such entrustment will also need to be approved by a special resolution at the shareholders' meeting pursuant to Paragraph 2 of Article 266 of the New Trust Bill, which provides that the provisions of a business transfer under the *Company Law* or other laws shall apply in the entrustment of a business by a declaration of trust.

Duty of Care and Fiduciary Duty of Trustee and Directors

The trustee owes it to the trust's beneficiaries to act with the care of a good manager (*zenkan-chui-gimu*) (Paragraph 2 of Article

29 of the New Trust Bill) and out of loyalty (Article 30). Under the *Company Law*, the directors of the trustee company owe such duties of care and loyalty to the shareholders of their company. In the case of a business trust, these respective duties can sometimes be in conflict. This issue should be further considered in order to enable the use of the business trust model.

Business Trust and Tax Matters

How the business trust will be taxed, especially whether trust profits will be subject to corporate tax at the trustee level, has become a source of much concern. The direction in which discussions will head remains unclear and we should keep a close eye on developments. In general, Japanese tax law treats a trust, in principle, as a conduit. However, subject to certain exceptions, Japanese tax law specifically assesses corporate taxes against the trustee (subject, however, to deductions if certain requirements are met) for the profits accruing during each trust calculation period in the case of a specified trust (*tokutei shintaku*), defined in Item 29-3 of Article 2 of the *Corporate Tax Law*, in order to preserve a balance with the tax system related to specified-purpose companies (*tokutei mokuteki kaisha*) and investment companies (*toushi houjin*). Therefore, it is possible that trustees of certain business trusts may be assessed corporate taxes in order to preserve a balance with the treatment of companies under the tax system.

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