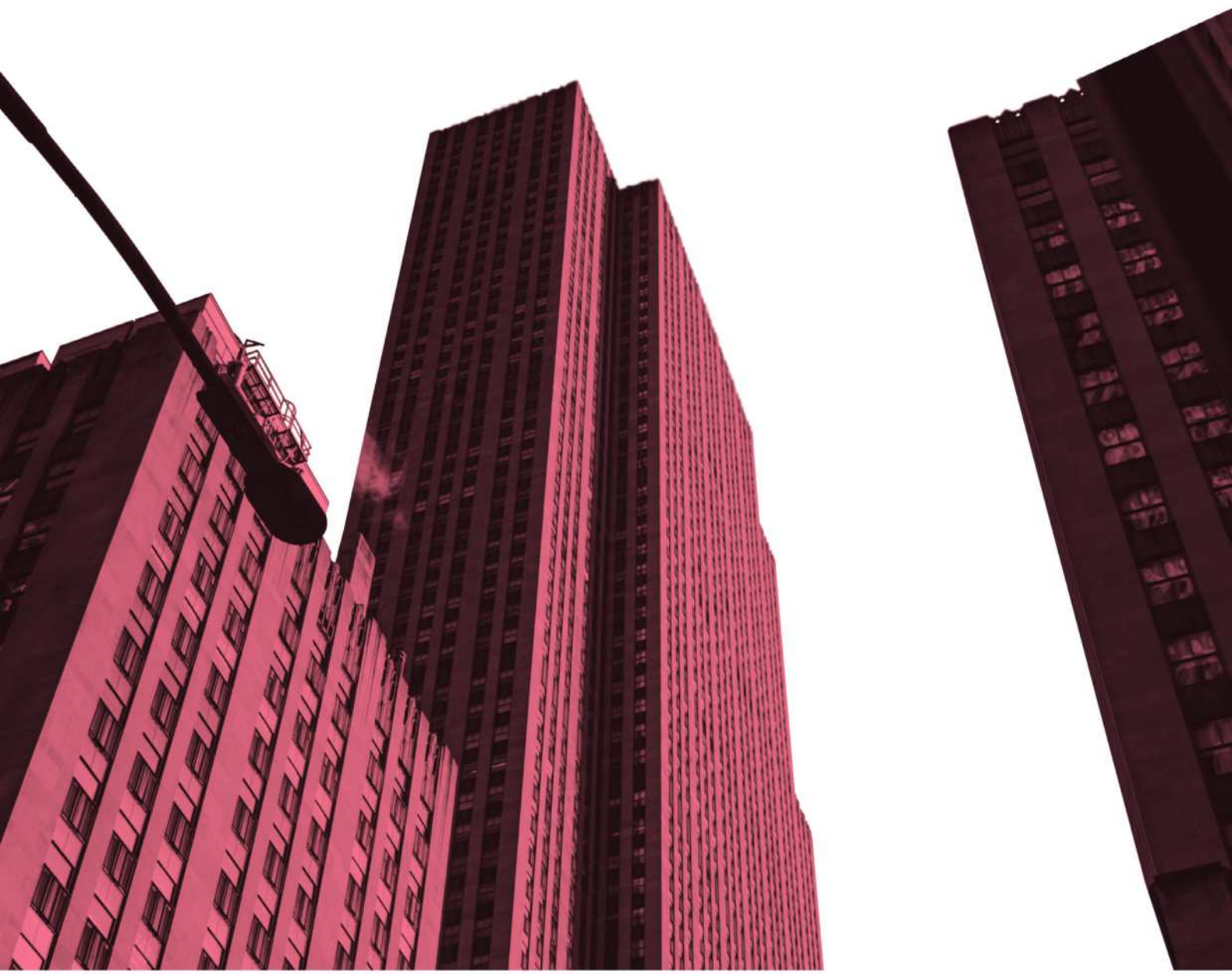
Edition 4 | May 2024 | Japan

REVIEWS LEGAL INDUSTRY



Kotoe Yamasaki, Associate Director and Head of Legal Japan at **Cognizant**, discusses various aspects of negotiating IT contracts with Japanese companies, highlighting challenges beyond language proficiency and digital competitiveness.

Wise Wang, Legal Lead for Japan and Korea at **X**, provides an overview of Japan's legal and societal landscape, highlighting its balanced approach to regulation, cultural influences on legal practices, and the country's resilience amidst socio-economic challenges.


LIR

Daniel Del Rio

Vice Chair of the International Bar Association's ("IBA") Legal Practice Division ("LPD") Partner at SMPS Legal

Daniel has over 40 years of experience advising medium and large companies, focusing on areas such as M&A, compliance, international transactions, and business strategies. He currently serves as Vice Chair of the International Bar Association's ("IBA") Legal Practice Division ("LPD") and is a member of the IBA Management Board.

Daniel began his career with the IBA over 30 years ago, contributing to various activities within the international association. He is one of the founding members of the Latin American Forum, and as Vice Chair of the IBA's Legal Practice Division, he actively supports and promotes the interchange of information and views among its members relating to the practice of law throughout the world and its latest developments he is also a Co-Chair of the Host Committee for the IBA Mexico City Annual Conference.

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THE IBA ANNUAL CONFERENCE IN MEXICO CITY

This year the International Bar Association (IBA) Annual Conference will be held in Mexico City during the month of September. Mexico is the 11th largest economy in the world, with a population of more than 130 million with a great cultural history and abundant natural resources, and the largest Spanish speaking country in the world. Mexico City is also a very important financial centre in the Americas.

The Annual conference will gather around 5,000 participants representing over 2,000 law firms, corporations, governments and regulators from more than 130 jurisdictions. There will be more than 200 specialty programs organized by all the different Divisions and Sections including show cases where attendees will hear from international figures, government officials, general counsel and experts from across all practice areas and continents. Furthermore, this event provides for a great opportunity to make new friends and acquaintances from lawyers around the world in order to develop networking opportunities.

The IBA was established in 1947 shortly after the creation of the United Nations with the aim of protecting and advancing the rule of law globally. Since its creation the organization has evolved from an association comprised exclusively of bar associations and law societies, to one that incorporates individual international lawyers and entire law firms. The present membership is comprised of more than 80,000 individual international lawyers from most of the world's leading law firms and some 190 bar associations and law societies spanning more than 170 countries.

All programs including the inaugural event and opening party will take place at the Citibanamex Convention Center, therefore it will be a great opportunity to learn about the latest legal developments from experts in their respective fields.

Any one joining the conference, will also have the experience of the warmth and friendliness of the Mexican people, as well as the great cultural and culinary offer Mexico City has.

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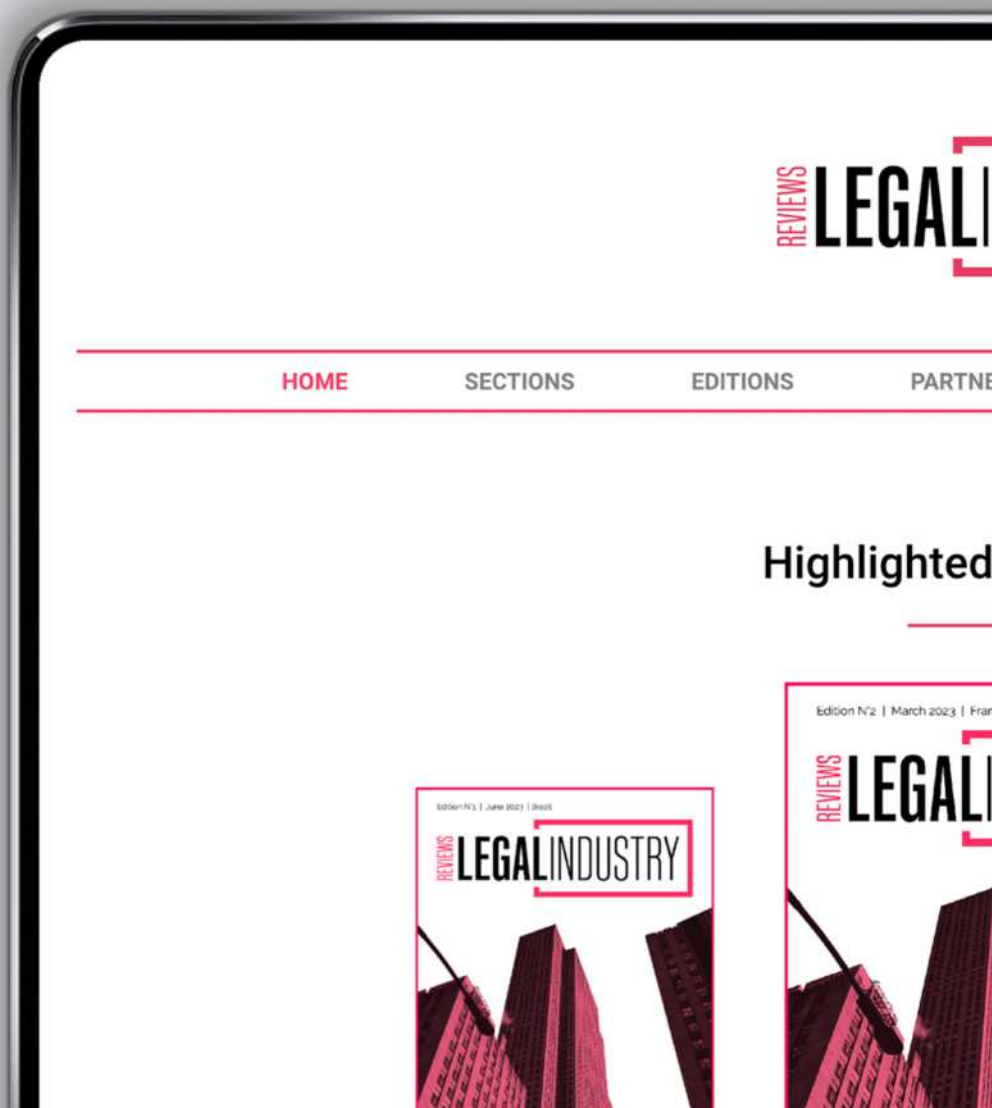

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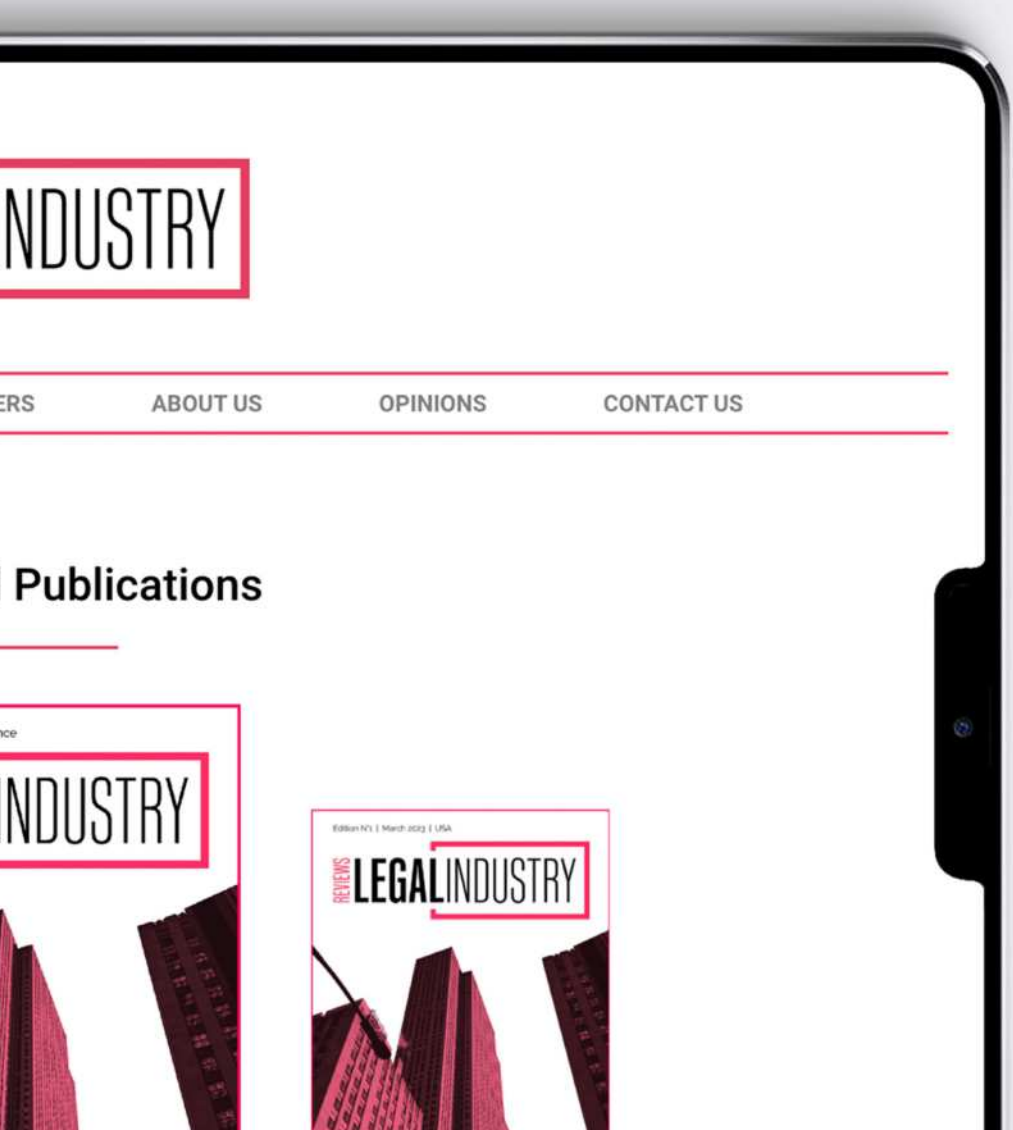

Kotoe Yamasaki

Kotoe Yamasaki started the position of Head of Legal Japan at Cognizant in April 2024. She works on supporting Japan Commercial Contracts and other general legal advisory pertaining to Japanese law.

Prior to joining Cognizant, she worked as Senior Legal Counsel at AVEVA, a UK-based industrial software provider, serving as Japan Commercial Legal Lead. She started her career at a Japanese manufacturing company and has since worked as an in-house legal counsel for over two decades at several IT companies including Microsoft, Hewlett Packard Enterprise, Amazon, and Cisco Systems. Apart from Commercial Contracts, she has hands-on experience on policy drafting, privacy / data protection, export control, HR advisory and corporate governance. She graduated in Law from Kyoto University, Japan.

Navigating Complexities: Cultural Insights in Negotiating IT Contracts with Japanese Companies

1. Negotiation of IT contracts with Japanese companies - Challenges beyond low English proficiency and digital competitiveness

The low level of English proficiency and digital competitiveness in Japan is as publicly disclosed by various institutions [1]. It is certain that this makes negotiations of IT contracts between non-Japanese companies and Japanese companies challenging.

Furthermore, Agile development, which is mainstream in software development, is difficult to adapt to the fixed manufacturing processes in the Japanese manufacturing industry, and is not easily accepted by Japanese companies accustomed to Waterfall development. Such discussions have already been exhausted, and there is no need to discuss them again here.

What I would like to point out is that, in addition to those things above, **(1)** Japanese cultural

values that are generally considered favorable not only in manufacturing and business but in all matters, and **(2)** negotiations by technical personnel originating from Japanese style management make it difficult to negotiate IT contracts that provide products and services under uniform conditions to pursue scalability.

I started my career as an in-house legal counsel in a Japanese manufacturer (classic, not SIer), and have worked for over 15 years as an in-house legal counsel at several non-Japanese IT companies. I believe this is a relatively rare career path. Based on my experiences in both, I would like to consider how Japanese cultural values and management style influence IT contract negotiations with Japanese manufacturing companies, and how to negotiate contracts taking that into consideration.

2. Japanese cultural values behind contract negotiations - Customization and equality

(1) I believe that the foremost aspects of Japanese cultural values behind contract negotiations are customization and equality. Even though these two things may seem contradictory, Japanese people tend to seek both. Regarding customization, it may be desired by any country, not just in Japan, but the level of demand seems to be high in Japan. For example, in Japan, parcels and mail can be redelivered at precisely specified times according to individual customer needs, but are there any other countries like this?

(2) Japanese customers often demand both customization and equality for each clause in a contract. In other words, they say, "Please provide a different service (customization) than you would provide to other customers under the same conditions (standard price) as to other customers". When putting it into words like this, most people would likely feel that this is a self-centered and unreasonable request. However, during contract negotiations, Japanese customers naturally make such demands. Perhaps the idea behind this is that customization is the default and comes at the standard price. Although it may seem contradictory, for Japanese customers, customization is a natural standard condition that should be provided to all customers, including their own. This way of thinking embodies the essence of Japanese business, as exemplified by the saying "The customer is God". From the perspective of non-Japanese IT vendors, "Customization requires additional costs. Do you really need that customization even if you pay the additional fee? Since similar requests have not reached a certain number, it is difficult to accurately calculate additional costs and reflect them in reasonable additional charges,

"Negotiations become challenging because Japanese customers may not understand or may resist the starting point that 'customization requires additional charges'".

so why not stop doing that?". This is extremely reasonable. However, negotiations become challenging because Japanese customers may not understand or may resist the starting point that "customization requires additional charges". Even if it were possible to absorb the immediate extra costs into the corresponding additional charges, accommodating the customization requests of a significant number of customers would decrease scalability and make it difficult to deliver high-quality products and services promptly, ultimately not benefiting the customers. Surprisingly, however, even we, the sales teams at IT vendors, often do not understand this or fail to assert it in an attempt to be in line with the customers' preferences.

(3) Regarding "equality," in addition to the above-mentioned equality among customers, equality between customers and vendors is also an issue. For instance, common clauses in IT vendor contracts include: **(i)** the IT vendor has the right to temporarily suspend the provision of products or services for technical or operational reasons in addition to compliance with regulations and security needs; **(ii)** the IT vendor can freely use customer feedback on the products or services for future development; **(iii)** the latest online terms and conditions are applied as the terms of use for the IT vendor's products or services; and **(iv)** the customer is obligated to install updates (such as error corrections) released by the IT vendor, among others. Customers often object to these clauses. From the customer's perspective, these terms represent the unilateral discretion of the IT vendor to realize its unilateral benefit, thereby creating inequality between the customer and the IT vendor. Customers may push back by not granting these rights to the IT vendor or requiring prior consent from customers or notification to customers regarding these matters. However, it is when these rights are given to the IT vendor that the vendor's products and services can withstand security threats, adapt to rapid technological and market changes, ultimately benefiting the customer.

3. Negotiating with technical personnel - Intellectual property rights negotiation as the toughest challenge

(1) Negotiating intellectual property rights is likely the most challenging item in negotiations, not only in Japan but in other countries as well. Since the ownership of intellectual property rights has a significant impact on business over the medium to long term, intellectual property issues cannot be resolved solely at the discretion of the sales department at that moment, unlike warranty and liability issues that can be managed as a cost issue (although the management of intellectual property rights can be converted into a cost issue). In any non-Japanese IT vendor, the local subsidiary, which is nothing more than a local sales department, is given almost no discretion in negotiations regarding intellectual property rights. Therefore, negotiations over intellectual property rights between local subsidiaries and customers are difficult in any country, but in Japan, technical personnel often lead negotiations on the customer side, and this makes negotiations even more difficult.

(2) Characteristics of Japanese style management include the corporate organizational structure based on lifetime employment and a seniority-based wage system, corporate governance centered on internally promoted managers with technical backgrounds and banks, and long-term transaction relationships between affiliated companies. Under such Japanese style management, decisions are often made from the bottom up, with technical personnel having extensive decision-making authority. Furthermore, collaboration between departments within a company and the practice of long-term transactions among affiliated companies have enhanced coordination on the ground, fostering close communication and information sharing for effective coordination. Such advanced collaboration and coordination capabilities have become the source of the competitiveness of Japan's manufacturing industry, and have demonstrated an advantage in the integral product development process.

(3) Customers' technical personnel involved in contract negotiations, with such an integral product development process as the premise, are very particular about their company owning intellectual property rights. They strongly object to the almost standard condition often included in IT vendor contracts, where intellectual property rights jointly developed by the customer and the vendor are assigned to the vendor. However, it is virtually impossible for a customer, who is not a Sier but a pure manufacturer, to engage in true "joint" development with an IT vendor. What is anticipated is that the IT vendor customizes its products or services for the customer. In such cases, the customer's insights are provided in some form, which is what the customer considers "joint" development. It is reasonable to attribute the intellectual property rights of such customized deliverables to the IT vendor. However, customers, especially in the technical departments, have a strong image of "joint" development with subcontractors of affiliated companies in their core business, and they are reluctant to agree to assign the intellectual property rights of jointly developed deliverables to the IT vendor. Once again, the cultural tendency to value equality may influence the idea that intellectual property rights should be shared, since the development was carried out "jointly".

4. Ideal contract negotiation - Pursuing customer benefits together

(1) Contract personnel from the customer's engineering and procurement departments have quite a bit of experience in contract negotiations, often delving into detailed negotiations article by article. They frequently negotiate on "legal" conditions such as warranty, indemnity, and limitation of liability. They also argue that the contract terms with Japanese vendors (such as subcontractors for their core business) which they are used to are "standard", while claiming that contracts with non-Japanese IT vendors

are not. However, the goal should not focus on concluding an "equal treaty" that achieves equality article by article based on what the customer perceives as "standard." The objective should be to realize customer benefits through the products and services of the IT vendor.

(2) In order to realize customer benefits through the products and services of IT vendors, they must be provided as originally intended, without being altered by the customer's contractual conditions. In addition, in order to achieve this at a reasonable price, there is a certain degree of need for contractual conditions that make it easy for IT vendors to uniformly manage various tangible and intangible items required for such provision. While these may appear to be unilateral benefits for the IT vendor, they ultimately benefit the customer. If this is not possible, IT vendors will lose their competitiveness and be weeded out. The fact that non-Japanese IT vendors, who present contract terms that seem one-sided to Japanese companies, generally demonstrate strong competitiveness compared to Japanese IT vendors, indicates that the contract terms of non-Japanese IT vendors are kind of correct. (Of course, factors other than contract terms also affect competitiveness, so I do not intend to draw absolute conclusions about competitiveness based on contract terms alone.) I sincerely believe that an "equal treaty" does not necessarily benefit the customer, but it seems that Japanese customers, including their legal departments, do not seem to have that view.

(3) To achieve a mutually beneficial contract for both customers and IT vendors, it is essential to: **(i)** understand the customer's genuine concerns, **(ii)** provide specific explanations on how the IT vendor's products and services will function in the customer's actual business environment to address those concerns, and gain understanding, **(iii)** collaboratively discuss the explanation to advance contract signing within the customer's organization.

The common reasoning often heard in non-Japanese companies, "We can't compromise because that's what the headquarters says," is something that Japanese customers detest the most. When I worked as an in-house legal counsel in a Japanese company, I often thought, "it's a stop of thinking!" every time I hear such a response from non-Japanese companies. (I now know that that is not necessarily the case.)

What is required of in-house legal counsels in IT vendors is to understand how our own products and services benefit the customer, convey this understanding alongside their sales team, and escalate within the customer's organization in collaboration with the customer.

5. Contract "negotiation" instead of contract "review" - Function of in-house legal

The role of in-house legal counsel is to work with the sales team to help customers close deals with the company. This is exactly the kind of contract "negotiation'" that in-house legal

> *"In-house legal counsels should move beyond being contract 'reviewers' and serve as integral members of the company-wide negotiation team".*

counsels should do. While "reviewing" contracts can be done by outside counsel or even by AI. It is natural to be expected to infer the attributes, experience, negotiation strategy, etc. of the person in charge of a customer's contract based on their comments and proposed revisions, and negotiate the contract accordingly, but this could be done even by outside counsel. In addition, in-house legal counsels should consider various factors regarding the project under negotiation, including the product/service to be provided, the amount, and other business impacts, the impact on the customer's business, and the customer's stakeholders. Then, we should consider conditions that are key to negotiations, conditions that can be conceded with internal approval, conditions that may be difficult to agree to until the end, and conditions which we should bargain for. Thus, it is vital to work closely with the sales team to hear the above-mentioned factors to be considered from the initial stages of contract negotiations, develop a detailed negotiation strategy, and work backward to play negotiation cards effectively. For instance, if there are certain conditions that we absolutely want the customer to compromise on, it is necessary to set aside the conditions we can bargain for until the final stages without making concessions midway through. It is like a Tetris game, if we leave only one block at the end, the block will not disappear.

Furthermore, it is completely insufficient to simply "respond" to each proposed revision from the customer. In fact, sometimes not responding can be an effective negotiation tactic. While outside counsels would not be allowed to refrain from responding to specific matters in a client's contract review request, in-house legal counsels have the privilege of remaining silent and not responding when deemed appropriate. Having said that, it is not acceptable to directly ignore the other party's question, so "not responding" would be deflecting the answer, shifting to another point, or negotiating in a way that does not provoke the question in the first place. It is crucial to maintain coordination with the sales team to navigate these situations effectively.

The bottom line is that in-house legal counsels should move beyond being contract "reviewers" and serve as integral members of the company-wide negotiation team. This integration is the true value and pleasure of in-house legal work.

According to the 2023 edition of the "English Proficiency Index (EF EPI)" published by EF Education First, a leading company in international education (based in Switzerland), Japan ranks 87th in English proficiency among the 113 non-native English-speaking countries and regions. This places Japan in the "Low proficiency" category, which is the 4th out of 5 proficiency levels. Additionally, in the 2023 World Digital Competitiveness Ranking released by IMD's World Competitiveness Center, Japan ranked 32nd out of 64 countries, marking a new record low.

Please note: The views expressed herein are from my personal perspective and do not represent those of my employer.

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Wise Wang

Wise Wang serves as the Legal Lead for Japan and Korea at X. Before his tenure at X, Wise was the inaugural in-house legal counsel at ByteDance K.K., where he supervised a myriad of products including TikTok and various other B2B and B2C services. A significant milestone in his career was leading the IPO (Global Offering) process for the Japan-based start-up, Plaid. With his background as a business management consultant at IBM and Deloitte, Wise offers a unique and well-rounded legal perspective, enabling him to significantly contribute to some of the world's rapidly expanding companies across the IT industry, such as SNS, Live-streaming, EC, Games, Payment, SaaS, among others.

Local Legal Landscape and Cultural Considerations in Japan

Local Legal Landscape

In the context of Japan's legal and societal landscape, it is noteworthy to acknowledge its unique blend of cultural coherence, economic prowess, and legal regulation, which collectively foster a conducive environment for both domestic and foreign investment. Japan's status as a leading global economy is, in part, a reflection of its well-regulated society, marked by a distinct approach to law enforcement. Compared to some jurisdictions where aggressive regulatory enforcement is prevalent, Japan's legal system operates on a premise of restraint. This less aggressive stance towards regulation, particularly in the business sector, has not only stemmed from a fraction of legal violations by domestic companies but also reflects a strategic choice to foster innovation and growth through relatively sparse regulatory interventions. Central to Japan's regulatory and societal principle is the significant role of reputation and public

perception. The potential for reputational damage acts as a powerful informal control mechanism, often exerting more influence than formal legal sanctions. This societal dynamic effectively deters unethical behavior, complementing the formal legal framework.

On the other hand, the legal framework within Japan's IT sector offers an illustrative example of this nuanced approach. Being lenient historically, recent years have witnessed a progressive tightening of regulations, with significant amendments and new enactments aimed at enhancing oversight and consumer protection. This is evidenced by successive amendments, including the "Act on the Protection of Personal Information", the "Telecommunications Business Act", and the "Act on the Limitation of Liability for Damages of Specified Telecommunications Service Providers and the Right to Demand Disclosure of Identification Information of the Sender". New legislations include the "Act on Improving Transparency and Fairness of Digital Platforms". These legal developments collectively signal a move towards more stringent control within the IT industry. Moreover, the advent of generative AI and its integration into various societal facets has prompted a reevaluation of regulatory frameworks, particularly concerning distribution of misinformation/disinformation and violation of intellectual property rights, privacy, and other interests. While Japan has yet to formalize a holistic legal framework specifically addressing generative AI, there is a growing emphasis on industry-specific self-regulation and the development of guiding principles to navigate the complex implications of AI on society.

As an aside, there has been an interesting cultural shift accelerating acceptance of digital alternatives over traditional practices catalyzed by the COVID-19 pandemic, such as the widespread use of corporate/personal seals (*hanko*) for signing contracts. This pivot, though seemingly minor, marks a significant departure from entrenched customs, alleviating previous inconveniences associated with the practically mandatory use of seals on agreements or other official documents.

> *"The reluctance to award large compensations and the absence of punitive damages in the Japanese legal system are indicative of a broader societal value that prioritizes reconciliation and collective well-being over adversarial confrontation".*

At the judiciary level, the preference for settlement and mediation over litigation reflects a cultural inclination towards harmony and consensus-building. The reluctance to award large compensations and the absence of punitive damages in the Japanese legal system are indicative of a broader societal value that prioritizes reconciliation and collective well-being over adversarial confrontation.

In summary, Japan's legal and societal framework is characterized by a balanced integration of formal regulation and informal social controls, fostering an environment that supports economic innovation while adapting to technological advancements and cultural shifts. This balance underscores a broader commitment to maintaining harmony, reputation, and public trust, which are integral to Japan's approach to governance and societal cohesion.

Cultural Considerations

The Japanese legal and cultural landscape is deeply interwoven, characterized by high-context communication that emphasizes unspoken cues and shared understandings over explicit expressions. This intrinsic communication style extends into the realm of legal practice, where contracts and agreements are crafted with room for rational interpretation, rather than being bound by the exhaustive specificity often seen in the Common Law legal system.

This approach underscores a preference for maintaining relationships and harmony over strict adherence to the letter of the law, reflecting a broader societal emphasis on consensus and relational ties. In addition, the importance of personal relationships and a collective decision-making process aimed at achieving consensus cannot be overstated. These cultural values apply to legal proceedings, making them less adversarial and more focused on reconciliation. The emphasis on harmony and obligation influences all aspects of legal practice, from the selection of counsel to the outcomes of negotiations, prioritizing relational dynamics over contractual rigidities.

Japan's cultural and technological landscape has been significantly shaped by its interactions with neighboring countries, yet it has managed to carve out a distinct developmental path. Japan's approach to foreign influences has been characterized by a discerning process of adoption, modification, or rejection, guided by the collective wisdom of its people and the distinct characteristics of its various ethnic communities. Despite its openness to external cultures, Japan has maintained a remarkable degree of cultural consistency and identity across regions. This resilience has allowed Japanese culture to remain vibrant and influential through the ages, seamlessly integrating traditional values with contemporary innovations.

Remarkably, Japanese companies are considered to represent over 40 percent of the global entities that have surpassed a hundred years in operation. This statistic is particularly striking in the context of today's rapidly evolving technological landscape, where change is the only constant. The enduring nature of these companies underscores the importance of consistency and persistence, offering valuable insights into navigating the challenges of modernity. Japan's example suggests that maintaining a steadfast commitment to foundational principles, while simultaneously adapting to the fast-paced changes of the global environment, is not only possible but also crucial for sustained success and relevance. This balance between tradition and innovation is a testament to the adaptability and resilience that define the Japanese approach to business and culture alike.

In recent years, however, Japan has faced significant socio-economic challenges, including a declining birthrate and a consequent labor shortage. In response, the country has sought to stimulate its economy through tourism and by encouraging immigration to bolster its workforce. These measures represent a pragmatic approach to addressing demographic and economic issues and introduce new dynamics into the traditional Japanese legal and cultural landscape.

As Japan opens its doors wider to the global community, the interplay between its distinctive legal practices and cultural norms with the diverse values of its international residents and businesses becomes increasingly complex. The challenge lies in maintaining the integrity of Japan's cultural identity while accommodating the needs and perspectives of a broader, more varied population. This evolution presents an opportunity for Japan to redefine its place in the global community, balancing tradition with innovation and exclusivity with inclusivity. In navigating these changes, Japan's legal system and cultural practices will undoubtedly adapt, reflecting the country's ongoing journey towards a more integrated society both domestically and on the international stage.

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Corporate Law

Practical Notes of METI's "Guidelines for Corporate Takeovers"

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The Japanese Ministry of Economy, Trade, and Industry released Guidelines for Corporate Takeovers (the "Guidelines") in August 2023. The Guidelines present "principles and best practices that should be shared among the economy to develop fair rules regarding M&A transactions, with a focus on how parties should behave in the context of acquiring corporate control of a listed company". The Guidelines aim to promote "desirable acquisitions", meaning "acquisitions that both increase corporate value and secure the interests of shareholders." (Guidelines 1.1 and 1.2). Although the Guidelines are not legally binding, they are based on judicial precedent and corporate takeover practices in Japan. As such, most acquisition proposals and responses made after August 2023 reflect the Guidelines. "The Guidelines primarily address transactions in which an acquiring party acquires corporate control of a listed company by acquiring its shares" for cash consideration, including "acquisition without consent" of the target company's board of directors. (Guidelines 1.3). However, the Guidelines should also be considered even in other transactions.

The Guidelines advise the board of a target company to give "sincere consideration" to a "bona fide offer." "Whether an acquisition proposal corresponds to a 'bona fide offer'" is considered through its specificity, rationale, and feasibility. Examples corresponding to these factors are also stated in the Guidelines. (Guidelines 3.1.2). It is important for an acquirer to propose, at any stage, an offer corresponding to a "bona fide offer" in order to facilitate consideration by the board of a target company.

In the case of a competing proposal or "the proposal is for an all-cash, full acquisition," the price and other transaction terms will be important. (Guidelines 3.2.1 and 3.2.2). Therefore, an acquirer should pay attention to whether the price and other transaction terms in its acquisition proposal are at a sufficient level for protecting shareholder interests of a target company.

In addition, the Guidelines recommend enhanced disclosure by acquirers, aiming for increased transparency regarding acquisitions. The Guidelines go beyond what is required by laws and regulations where "an acquirer attempts to acquire corporate control in a short period of time through open-market purchase," or "a party intending to make an acquisition" has definite "intention to make a subsequent tender offer... when advancing to purchase the company's shares in the market prior to its tender offer." (Guidelines 4.1.1.2).

Moreover, Section 4.3 of the Guidelines sets forth inadvisable actions for the acquiring party, as summarized below.

- Engaging in aggressive and coercive acquisition techniques;
- Disclosing inaccurate information or providing misleading information;
- Advancing to share purchases while concealing the intention of acquisition;
- Announcing advance notice of a planned tender offer, without a reasonable basis for actually commencing the tender offer;
- Approaching the acquiring party's business partners holding shares of the target company and leveraging business relationship with them for any favorable actions to the acquiring party;
- Providing money or goods when soliciting votes and proxies.

The Guidelines also refer to "takeover response policies and countermeasures"that may be taken by a target company, such as issuing no-cost stock acquisition rights. (Section 5 and Appendix 3 of the Guidelines). An acquirer should not only avoid the above actions, but also examine its strategy considering the possibilities of takeover response policies as well as countermeasures that may be taken by a target company.

Practice Area News

Amendments to Tender Offer Regulations. JFSA submitted amendments to the **Financial Instruments and Exchange Act (FIEA)**, including tender offers, to the Diet on **March 25, 2024**. The scope of mandatory tender offers includes open-market and auction trading, which were previously not subject to regulation. Additionally, the threshold will be lowered to 30%. This reflects the percentage of votes exercised and foreign regulatory standards. These revisions will be effective within two years from promulgation.

Change in the Large Shareholdings Reporting System. Due to the amendments to the **FIEA** mentioned previously, the large shareholdings reporting system will also change. The system requires shareholders to report within five business days if the shareholding ratio exceeds 5%. After the change it will be specified that unless multiple investors enter into an "agreement that will have a significant impact on management," they do not fall under the category of "joint holders," whose shareholding would be aggregated.

Acquisition of Benefit One by Dai-ichi Life Holdings. On March 12, 2024, Dai-ichi Life succeeded in a tender offer for Benefit One to become a wholly owned subsidiary through a share consolidation and share repurchase. The tender offer was a competing proposal during M3, Inc.'s tender offer, without their consent. It was unusual for a major financial institution like Dai-ichi Life to directly compete and may be symbolic of changes in Japan.

Mizuho Securities Commences Advisory Services Regarding Takeovers Without Consent. Mizuho Securities has started advising companies on unsolicited takeovers. C&F Logistics submitted a tender offer LOI for AZ-COM MARUWA on **March 21, 2024**. In this proposal, Mizuho Securities acts as financial advisor and tender offer agent. This is Mizuho's first time advising on an unsolicited takeover. The Guidelines for Corporate Takeovers seem to have spurred this change in Japan, where takeovers including hostile ones are expected to increase going forward.

In the Firm

• **U&P's Corporate Practices.** We handle various corporate and M&A matters, and have abundant expertise in unsolicited takeovers, with extensive experience working as counsel for acquirers, target companies, and special committees.

• **Awards.** Ushijima & Partners' corporate/M&A practice has received high praise in attorney rankings such as Chambers, Legal 500, and Best Lawyers. Click **HERE** for further details.

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Data Protection & Cybersecurity

Japan's Government Publishes AI Guidelines for Business

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On **April 19, 2024**, the **Ministry of Internal Affairs and Communications and the Ministry of Economy, Trade and Industry** jointly published the AI Guidelines for Business ("AI Guidelines"). The AI Guidelines were created based on the "Social Principles of Human-Centric AI," which was released by the Japanese government in 2019 as principles for implementing AI in society. The AI Guidelines intend to review and integrate three existing AI-related guidelines while considering AI regulations in other countries and advances in technology.

The AI Guidelines broadly apply to all individuals or entities who develop, provide and/or use AI for their business (including organizations in the public sector, such as a governmental body) (collectively, "AI Businesses").

The AI Guidelines provide three values — Dignity, Diversity and Inclusion, and Sustainability — as the "Basic Philosophy" to be respected. They also enumerate 10 "Common Guiding Principles" that each business should work on: **(i)** Human-Centric; **(ii)** Safety; **(iii)** Fairness; **(iv)** Protection of Privacy; **(v)** Security; **(vi)** Transparency; **(vii)** Accountability; **(viii)** Education/Literacy; **(ix)** Fair competition; and **(x)** Innovation.

The Common Guiding Principle regarding the protection of privacy requires AI Businesses to:

- comply with relevant laws and regulations, such as the Act on the Protection of Personal Information ("APPI");
- take measures to ensure stakeholder's privacy by preparing and publishing the privacy policy of each business, considering the social context and people's reasonable expectations; and
- consider measures to protect privacy while ensuring compliance with the APPI and referring to international personal data protection principles and standards.

Following the explanations about the Basic Philosophy and Common Guiding Principles, the AI Guidelines further describe what each type of business involving AI — i.e., AI Developer, AI Provider and AI User — should be mindful of.

With regard to the protection of privacy, the AI Guidelines suggest the following:

The AI Developer should ensure appropriate data learning through privacy by design and timely disclosure of information about its AI systems to relevant stakeholders.

The AI Provider should

- take measures to protect privacy, such as the introduction of mechanisms to control and restrict access to personal information appropriately in light of the characteristics of the technology adopted;
- gather information on violations of privacy in AI systems/services and take appropriate actions against a violation when becoming aware of it;
- disclose the information about the collection of learning data and the methods of data learning; and
- warn users on improper input of personal information into AI systems/services provided by the AI Provider.

The AI User should

- take precautions to ensure that personal information is not inappropriately fed into AI systems and services; and
- gather information on violations of privacy in AI systems/services and consider preventing such violations.

The AI Guidelines should be read together with their appendices, which help AI Businesses consider approaches to be taken in practice. For example, Appendix 1 provides various examples of AI systems/services, specific applications, AI Businesses, benefits of using AI depending on the industry and business, and risks based on actual cases. Appendix 2 includes information on actions that businesses should take to establish AI governance. Appendices 3, 4 and 5 deal with supplementary explanations of the suggestions made by the AI Guidelines and specific examples to guide the AI Developer, AI Provider and AI User in implementing them.

Practice Area News

"Three-Year Review" Process — Penalties and Youth Protection. On **March 22, 2024**, and **April 10, 2024**, the **PPC** published materials on potential amendments to the APPI. As part of the triennial review of the APPI, the PPC and experts have been conducting research on the privacy issues and privacy regulations of other countries. These materials particularly cover more severe criminal penalties, newly introduced administrative penalties, the protection of children's personal data and collective action systems.

PPC Publishes a Warning on the Use of Cloud Services. On **March 25, 2024**, the **PPC** issued a warning on the use of cloud services. The PPC clarified its interpretation on when the use of a cloud service is regulated under the APPI. The PPC considers some factors such as the cloud service provider's right to access users' personal data under the terms of services, technical accessibility to such data and whether a cloud service provider actually handles such data.

Amendments to the Privacy Guidelines for the Financial Industries. On **March 12, 2024**, the **PPC** and the Financial Service Agency jointly published amendments to the Guidelines on Protection of Personal Information in the Financial Industries and relevant practical guidance on the security measures. The amendments were made because a new type of data breach to be notified to the PPC and affected individuals was added under the APPI.

PPC Publishes a Recommendation to a Major IT Company. On **March 28, 2024**, the **PPC** issued an administrative recommendation to a major Japanese IT company relating to a data breach that potentially affected around 520,000 individuals. The data breach was caused by unauthorized access to information systems of the company's subcontractor. The PPC demanded that the company take necessary actions to improve its security measures. The company needs to regularly submit to the PPC a report on the improvement of the situation until March 2025.

In the Firm

• Connect on Tech — Online Data Protection Portal.

Connect on Tech is our online portal for global developments in data protection, data security, information management and more. You can access this portal **HERE**.

• Global Data Privacy and Security Handbook.

Our highly sought-after Global Data Privacy and Security Handbook provides detailed and forward-looking information on data privacy and security standards in over 50 countries. Please check it out **HERE**.

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Fintech

Decentralized Autonomous Organization (DAO) with Legal Entities

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Introduction

On April 22, 2024, the amended Cabinet Office Order on Definitions under Article 2 of the Financial Instruments and Exchange Act (the "*FIEA*") took effect (this "*Amendment*"). This Amendment is said to develop the possibility of allowing DAO to be incorporated as *Godo Kaisha* ("*GK*", one of the corporate foams in Japan).

What is DAO?

A decentralized autonomous organization ("*DAO*") is a new legal structure with no central authority and central management members. DAOs make decisions in a bottoms-up management style using smart contracts based on blockchain technology.

Discussions so far

DAOs are compatible with GK, a relatively flexible legal entity in Japan, when they are incorporated.

Under previous regulations, tokenized equity interests of GKs were classified as Type I securities as electronically recorded transferable rights ("*ERTR*"). Under the FIEA, sales by a third party for an issuer need a Type I license. A Type II license is necessary for the self-offering of GK.

These FIEA regulations made it difficult to form DAO as GK, and the Liberal Democratic Party's web3 Project Team had proposed revision requests since 2023.

Changes due to this Amendment

As a result of this Amendment, even a tokenized equity interest of GK or another entity does not fall under ERTR if the token is not transferable to anyone other than the executive member (*gyoumu-shikkoushain*) of the entity or if the token does not distribute proceeds from the entity.

In other words, by ensuring that tokens for non-executive members do not receive a profit distribution from the DAO in excess of their investment and by taking technical measures to ensure that tokens for executive members are not transferred to third parties other than executive members, the tokens would be considered Type II securities, not ERTR. In this case, a Type II license is not required for the self-offering by the executive member of the tokenized GK equity interest. Please note that solicitation by non-executive members requires a Type II license as handling of the public offering.

Further Discussions

On April 12, 2024, the Liberal Democratic Party's web3 project team published the 2024 edition of their web3 whitepaper. The paper presents various issues that need to be discussed to promote web3, including DAOs, tax reform, and NFTs.

The paper mentions the inability of non-executive members to solicit DAOs and the fact that DAOs sometimes cannot open a bank account as practical issues for promoting the use of DAOs. In addition, the paper also mentions the necessity of clarification of cases where DAOs use legal forms other than GKs and ensuring interoperability with DAO legal systems overseas.

An industry organization called the "Japan DAO Association" was established this April, and it is expected that discussions will continue.

Practice Area News

Web3 Whitepaper. On April 12, 2024, the Liberal Democratic Party's Web3 Project Team published the **2024 Edition of their Web3 Whitepaper**. The whitepaper presents strategies and policies for Japan to become a leader in digital innovation by leveraging web3 technologies.

In the Firm

• **Awards.** Chambers & Partners ranks So Saito top FinTech lawyer 2023-2024. Best Lawyers recognizes So Saito for Banking and Finance Law, Financial Institution Regulatory Law and FinTech Practice for 2024.

• **New member.** William T. Gillespie has joined us as a Senior Counsel. He is a highly experienced senior counsel with a proven track record in international disputes.
Click **HERE** for his profile.

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Insurance

Establishment of Advisory Committee on Structural Issues and Competition in the P&C Insurance Industry

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Recent cases involving fraudulent insurance claims by Big Motor Co., Ltd., a non-life insurance agent, and insurance premium adjustments cases conducted by major P&C insurers which led to the imposition of administrative orders by Japan's Financial Services Agency ("FSA"), revealed structural issues and problematic business practices in the P&C insurance industry that induce inappropriate conduct and impede appropriate competition among P&C insurers, insurance agents, and related companies. In response, on March 16, 2024, the FSA established the "Advisory Committee on Structural Issues and Competition in the P&C Insurance Industry" ("Committee") to consider necessary measures, mainly in terms of systems and supervision, from the perspective of encouraging customer-oriented business operations in the P&C insurance market and the realization of a sound competitive environment.

The Committee is discussing various issues; those raised among the members at the first meeting include:

(1) Despite what the Insurance Business Act (the "IBA") requires, in the relationship between large-scale independent agents acting on behalf of multiple P&C insurers (*daikibo noriai dairi-ten*, "LSIA") and P&C insurers, the P&C insurers may not be able to supervise and manage LSIA properly, and may be prioritizing relationships with the LSIA instead, based on the LSIA's influence on the P&C insurers' business. This prioritization leads to inappropriate supervision and management of LSIAs, and potential distortion of the competitive environment, for example, through inappropriate assessment of LSIA insurance claims by P&C insurers. Also, the establishment of inappropriate agency commission point systems led to the inappropriate incentive for LSIAs;

(2) When LSIAs solicit the insurance products they handle, the IBA requires the LSIAs not to make misleading statements to customers about the features of their insurance policies, in comparison with other policies, but this rule might not have been implemented properly, resulting in distortion of appropriate product selections by customers;

(3) Insurance agents that concurrently operate other businesses, such as automobile repair shops, might involve conflicts of interest, damaging the interests of policyholders;

(4) The corporate co-insurance underwriting business practice whereby the P&C insurer that offers the lowest premium becomes the lead manager, and is structured based on such insurance premiums offered by the lead manager, may risk violating the Antimonopoly Act;

(5) In corporate insurance, facts other than policy terms, such as cross-shareholding and P&C insurers' support of a client's business, including through purchases of a client's goods and services, secondment of employees to the client, etc., had a considerable impact on the market share of the relevant P&C insurer, which may have distorted the fair competition environment;

(6) "In-house insurance agents" present a conflict of interest issue, as they are part of the group companies of corporate policyholders as well as agents of P&C insurers, are responsible for acting on behalf of P&C insurers, and receive commissions from those insurers.

After additional discussions among the Committee members, a report is expected to be compiled by the end of June 2024.

Practice Area News

Administrative Disposition Against Sompo Japan and Sompo Holdings. On January 25, 2024, the FSA issued business improvement orders to Sompo Japan Insurance Co., Ltd. ("SJ") and Sompo Holdings Co., Ltd. ("SHCL"), finding serious deficiencies in the internal control of SJ's governance system and three-line management system in the case of fraudulent insurance claims by Big Motor Co., Ltd. as well as insufficient function of the internal control and other monitoring systems of SHCL for its subsidiaries, including SJ.

Amendment of Comprehensive Supervisory Guidelines for Insurance Companies. On February 15, 2024, the FSA amended its comprehensive supervisory guidelines for insurance companies to deal with IFRS 17 (insurance contracts) applied from January 2024 to clarify that if an insurance company uses the financial statements of its overseas subsidiaries prepared in accordance with IFRS for the purpose of its consolidated financial statements, the amount of income shall be appropriately reclassified when recording insurance premiums, etc. therein.

In the Firm

• Delivering Diverse Solutions Across Asia.

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• Our Dedicated Insurance Team.

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M&A

Regulatory Changes to TOB & Beneficial Ownership Reporting in Japan

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On March 15, 2024, the Japanese Financial Services Agency ("**FSA**") submitted a bill to amend the Financial Instruments and Exchange Act ("**FIEA**") among other laws that outlined significant changes in the current regulations related to take-over bid ("**TOB**") and Beneficial Ownership Reporting. On May 15, 2024, the Diet approved this bill. As a result, significant amendments to the TOB regulations and Beneficial Ownership Reporting rules will be implemented. The transactions subject to TOB regulations will become broader and the Beneficial Ownership Reporting will implement an exception to the "joint holder" rule.

As widely known, under the TOB regulations, an acquirer planning to make large purchase(s) of shares under certain circumstances is required to disclose the detail of its proposed purchase(s) (e.g., timing, quantity, price, among others) in advance and provide an equal opportunity to existing shareholders to tender their shares.

To date, the TOB regulations in Japan primarily applied under two circumstances. One was when the acquirer purchased shares from multiple parties in a relatively short period through off-market trading, resulting in owning over five percent of the ownership (the "**5% Rule**"), and the other was when the acquirer purchased shares through off-market trading or off-floor trading, resulting in owning over one-third of the voting rights (the "**1/3 Rule**"). However, these rules are about to change.

With the increasing hostile takeovers, the importance of enhancing transparency and fairness in securities transactions has increased significantly. Accordingly, with the amendment, the transactions subject to the TOB regulations will expand to include on-floor trading or on-market trading and the threshold for the 1/3 Rule will be lowered to 30%.

Additionally, under the current regulations related to Beneficial Ownership Reporting, a shareholder who comes to own more than five percent of the total voting rights of a listed company must disclose within five business days that it has reached the threshold. Under the current FIEA, shareholders who agree to "jointly acquire or transfer the shares" or "jointly exercise voting rights or other shareholder rights" are considered as "joint holders," and the Beneficial Ownership Reporting requires aggregating those shares when assessing the applicability of this reporting rule.

With the recent promulgation of the Stewardship Code aiming to enhance the discussion among investors and the issuing company, many investors began to actively engage in discussions with the company they are investing in. However, this trend has given rise to a risk that investors jointly engaging in discussions with the company to pursue similar goals may be seen as "joint holders," requiring them to go through tedious disclosure requirements. This in a way impeded some investors from engaging in discussions with the company.

To eliminate the chilling effect, the amendment will implement an exception to the current rule - i.e., the institutional investors agreeing to pursue the same goal that will not affect the management of the company on a one-time basis will not be considered as "joint holders."

Given that amendments to the FIEA and other laws were approved, matching changes will be promulgated going forward through amendment of the cabinet orders and other regulations. These changes will inevitably affect the parties contemplating acquisition of Japanese companies by purchasing existing shares. Companies planning to proceed with transactions falling outside the current TOB regulations but would be regulated under the new rules need to start reviewing how they are to be regulated.

Practice Area News

Updated M&A Guidelines for Small and Medium-Sized Companies. On September 22, 2023, the Japanese Ministry of Economy, Trade, and Industry ("**METI**") updated its "M&A Guidelines for Small and Medium-Sized Companies" to further promote M&As involving small and medium-sized companies. With the recent increase of M&As involving these companies, various issues related to involvement of M&A specialists (mainly intermediaries and financial advisors) became apparent. This updated guideline intends to address these issues.

METI Formulates Guidelines for Corporate Takeovers. On August 31, 2023, the METI formulated the "Guidelines for Corporate Takeovers" that developed fair rules regarding M&A transactions, with a particular focus on how parties should behave when acquiring corporate control of a listed company. "Hostile takeovers" were renamed to a "takeover without consent," and it was defined as "an acquisition made without the approval of the target company's Board of Directors."

In the Firm

Real Estate

Recent Developments in Real Estate Security Token Offerings

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In recent years, the market for digital asset transactions which utilize the blockchain system has developed exponentially. In particular, the market for real estate security token offerings in Japan has been rapidly expanding in terms of factors such as offering size, offering scheme, market players, underlying assets. We set out below an overview of the recent developments in this area.

Public real estate security token offerings under the trust scheme

Currently, public real estate security token offerings conducted under the "beneficiary certificate issuing trust scheme" is the most popular scheme for public security token offerings in Japan and the number of offerings using such schemes is increasing year by year. Among these offerings conducted from 2023 to 2024 (so far), two remarkable projects were closed both on December 22, 2023. One is KENEDIX Realty Token Dormy Inn Kobe Motomachi. The underlying asset of this trust is a hotel property located in Kobe and the project was conducted by Kenedix as the sponsor and SMBC Trust Bank as the trustee. Another is Ichigo Residence Token, where the underlying assets of this trust are six residential properties located in Tokyo and where the project was conducted by Ichigo Owners as the sponsor and Mitsubishi UFJ Trust and Banking Corporation as the trustee.

The securities offered in these projects are the first security tokens listed in "START", Japan's first secondary market for security tokens operated by the Osaka Digital Exchange and which started operations in December 2023. Since the first public real estate security token offering in Japan in 2021, investors had only been able to trade the security tokens through over-the-counter transactions with security firms with limited liquidity, and there had been calls for a secondary market for security tokens to serve as a driver for market expansion. These projects are thus significant since they led to the expansion of the secondary market for security tokens in Japan, which has enabled various stakeholders to develop and invest in new products for security token offerings.

A public offering of beneficial interests in a monetary trust under the "beneficiary certificate issuing trust scheme" was also closed on March 6, 2024. In this case, the trust money contributed by the retail investors (i.e., beneficiaries) is managed for the purpose of serving as the guarantee for part of a non-recourse loan for an existing public real estate security token offering conducted under the trust scheme, with Mitsui & Co. Digital Asset Management, Ltd. as the sponsor and Mitsubishi UFJ Trust and Banking Corporation as the trustee. Although the beneficiary interests in this monetary trust are not security tokens and not transferred via the blockchain system, this case deserves attention since it showcases a new possibility for utilizing existing public real estate security token offerings in another way.

Other real estate-related security token offering

A public offering of beneficial interests in a monetary trust was closed on August 31, 2023. In this case, the trust asset of the monetary trust is the trust beneficiary interest, the underlying asset of which is the loan receivables to certain residential properties, and the trust money contributed by the retail investors (i.e., beneficiaries) is managed to acquire such trust beneficiary interest. The beneficiary interests of the monetary trust are security tokens and are administered in the blockchain system.

Practice Area News

Publication of Interim Proposal for Revision of Collateral Legislation. On **January 20, 2023**, an interim proposal for the revision of collateral legislation in Japan was released and referred to the public for comment until **March 20, 2023**. The interim proposal includes various topics, such as the development of legislation regarding secured transactions such as security by way of assignment. Based on the comments, **the Committee on Collateral Legislation** is currently preparing a draft for the revision of collateral legislation.

In the Firm

• **Opening of Brussels Office.** In April 2024, we inaugurated our Brussels Office with the objective of providing comprehensive legal assistance and facilitating inbound transactions into Japan in collaboration with local European firms. (See **HERE**).

• **Establishment of the Management Committee.** On April 1, 2023, we established a Management Committee system, which facilitates our further growth and strategy by executing business and management-level decisions from a medium to long-term perspective.

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Risk Management

The Importance of an Effective Antimonopoly Act Compliance Program

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On December 21, 2023, the Japan Fair Trade Commission (the "JFTC") published the Guide for the Design and Implementation of an Effective Antimonopoly Act Compliance Program: Focusing on Responses to Cartels and Bid-rigging (the "Guide").

1. The overview of the Guide

Based on the results of the JFTC's surveys and analyses of companies' compliance with the Act on Prohibition of Private Monopolization and Maintenance of Fair Trade (the "AMA"), the Guide outlines the ideal form of an effective compliance program, mainly in the area of cartels and bid rigging, and introduces reference cases in which companies are actually working on such compliance programs.

Also, the Guide outlines best practices to help individual companies design and implement an effective AMA compliance program with cartel and bid-rigging in mind.

2. The components of the compliance program

The Guide provides four components of an effective antitrust compliance program.

The first component is "Overall Efforts for Compliance Related to the AMA." It includes **(i)** commitment and initiative of the top management **(ii)** assessing the risk of AMA violations in accordance with the respective situations of companies and responding to the identified risk in accordance with risk-based approach, **(iii)** design and implementation of policies and procedures for promoting AMA compliance, **(iv)** design of organizational structure and adequate allocation of authority and resources, and **(v)** integrated efforts by corporate groups.

The second component is "Specific measures to prevent violations." It includes **(i)** design and implementation of internal rules for contacts with competitors, **(ii)** providing trainings on the AMA, **(iii)** design and operation of a consultation system on the AMA, and **(iv)** design and implementation of internal disciplinary rules for AMA Violations.

The third component is "Specific Measures to Detect AMA Violations at an Early Stage and Take Appropriate Actions." It includes **(i)** conducting audits on the AMA, **(ii)** design and operation of a whistleblowing system, **(iii)** introduction of an Internal Leniency System about the AMA and **(iv)** appropriate response to suspected violations of the AMA.

The fourth component is "Periodic Evaluation and Update of the Program." It requires companies to evaluate the effectiveness of the AMA compliance program and update the program periodically.

3. What companies should do

In Japan, a company which violated the AMA may face severe sanction including criminal penalties, administrative sanctions, civil claims for damages, and reputation damages. In recent years, the JFTC has strengthened its resources to enforce against cartel and bid-rigging, leading to iconic enforcement cases such as bid-rigging related to Tokyo Olympics and Paralympic Games resulting in criminal sanction, and cartel among power companies where the JFTC imposed record-high administrative penalty. As the risks associated with the AMA are getting more serious for companies, companies should properly establish and operate AMA compliance programs as described above to avoid or reduce such risks. The Guide released by the JFTC will be a good starting point for companies to establish an effective AMA compliance program in Japan, and thus, companies should refer to this Guide when they consider their compliance system.

However, as is the case in any compliance programs, there is no "one-size-fit-all" AMA compliance program, and companies need to establish a tailor-made program responding to market reality. Thus, with an assistance from outside antitrust counsels, companies are expected to first conduct antitrust risk analysis in Japan, and then, create effective AMA compliance program in response to the identified risks.

Practice Area News

The Amendment of the Financial Instruments and Exchange Act. On **November 20, 2023**, the Financial Instruments and Exchange Act was amended and as a result, the quarterly reports system was abolished as of **April 1, 2024**. The amendments consolidated quarterly financial statements into a single report, made the submission of semiannual reports mandatory, and extended the period for public inspection of semiannual reports, extraordinary reports, and other documents.

The Amendment of the Guidelines for Preventing Bribery of Foreign Public Officials. In **February 2024, The Ministry of Economy, Trade, and Industry (METI)** amended the Guidelines for Preventing Bribery of Foreign Public Officials. The amended Guidelines include updates based on the amendment of the Unfair Competition Prevention Act as of **April 1, 2024**, as well as revisions to small facility payments, judicial precedents, and the description of the establishment of an anti-bribery system for foreign public officials.

The New Law about Security Clearance. On **May 17, 2024**, The new law about security clearance was promulgated. The law provides for the designation of critical economic and security information, restrictions on who may handle such information, investigations to assess the suitability of the handlers and the penalties for the leaks of such information. The law has a significant impact on various companies.

The Bill about DBS. The Japanese government submitted the bill about Disclosure and Barring Service (DBS) on **March 19, 2024**. The bill requires schools and licensed nurseries etc. to take measures of preventing sexual violence against children by teachers or other employees. The bill also provides for the system in which the schools and licensed nurseries etc. ask **the Children and Families Agency** about convictions for sexual offenses of the applicants.

In the Firm

• London Office starts operation.

M&P has started operation of an office in London on April 1, 2024. It provides timely legal service to European companies and serves as a close contact point for European clients.

• Ho Chi Minh Office starts operation.

M&P has started operation of an office in Ho Chi Minh City on April 1, 2024. It provides optimal solutions based on Vietnamese law and the local business environment.

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Tax

Outline of 2024 Tax Reform

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The Diet passed the bill implementing the 2024 tax reform proposals on 28 March 2024 ("2024 Tax Reform"). The following is an overview of the major reforms and revised provisions in the 2024 Tax Reform.

• Tax-qualified Contributions In-kind

Under the current tax regime, a contribution in-kind by which a Japanese company transfers its foreign assets to a foreign company satisfies one of the conditions for being treated as a tax-qualified (tax-deferral) contribution in-kind. Under the 2024 Tax Reform, a contribution in-kind by which a Japanese company transfers intangible assets to a foreign company will be excluded from the scope of a tax-qualified contribution in-kind regardless of where the intangible assets are located.

• Criteria for pro forma standard taxation

The corporate enterprise tax ("CET") is a tax paid to the metropolitan/prefectural government (i.e., local tax) and is normally levied at 7% of taxable income. However, the "pro forma standard taxation", which applies only to companies with a stated capital exceeding JPY100 million, has been introduced into the CET since 2004. Under the 2024 Tax Reform, even if a company that was subject to the pro forma standard taxation in the previous year reduces its capital to below JPY100 million in the current year, it will remain subject to the pro forma standard taxation if the sum of its stated capital and capital surplus in the current year exceeds JPY1 billion.

• Global Minimum Tax in Japan

In line with the OECD's discussion on the implementation of the Global Minimum Tax, the Income Inclusion Rule (i.e., IIR) was introduced in the 2023 tax reform. In the 2024 tax reform, certain revisions, such as the introduction of the Qualified Domestic Minimum Top-up Tax (i.e., QDMTT) safe harbor rule and expansion of companies eligible for the CbCR safe harbor, have been made based on the OECD's administrative guidance issued in 2023. However, the implementation of the Undertaxed Payments Rule (i.e., UTPR) and the QDMTT have not been included in the 2024 Tax Reform and these rules are expected to be included in a 2025 tax reform proposal.

• Exemption Criteria for Foreign Business Operator for JCT

Under the Japanese Consumption Tax ("JCT") Act, a business operator is treated as a taxable business operator for a fiscal year if its taxable transactions for JCT purposes in the "base period" (the fiscal year before the last year) exceed JPY 10 million. Under the 2024 Tax Reform, a foreign business operator that has been established in its country for more than two years will be treated as a taxable business operator for JCT purposes if the foreign business operator's share capital is at least JPY 10 million (or equivalent) at the time of commencing its business in Japan.

• Platform Taxation for JCT

While digital contents (e.g., online games) are usually sold to Japanese users via digital platforms; since the digital contents are normally provided by offshore developers to the end-users directly, the developers are required to collect and pay applicable JCT to the Japanese tax authorities under the JCT Act. However, it was observed that offshore developers often did not follow the JCT rules. As a countermeasure against non-compliance with the JCT rules by offshore developers, new JCT collection rules have been introduced in the 2024 Tax Reform where digital platform operators with a transaction volume of JPY 5 billion or more between offshore developers and Japanese users will be responsible for collecting and paying the JCT on behalf of offshore developers.

Practice Area News

Tax and Customs Authorities Cooperatively Strengthen JCT Enforcement. On **7 February, 2024**, the heads of the **Tokyo Regional Taxation Bureau** and **Tokyo Customs** jointly announced that they would strengthen enforcement of JCT in relation to unlawful treatment of export goods. Goods to be exported are generally exempt from JCT normally imposed on domestic transactions, but many cases of fraudulent JCT refunds using fictitious exports have been observed.

Grace Period under Electronic Books Maintenance Act has Expired. The amended Electronic Books Maintenance Act came into effect from **January 2022** and tax-related documents and electronic storage of tax-related documents became mandatory. Although 2 years of the grace period was set for allowing not to electronically store documents stored on paper, that grace period expired at the **end of 2023**, making electronic storage of all tax-related documents mandatory in principle.

Information Exchange between Tax Authorities. The latest report on information exchange under double tax treaties of **National Tax Agency ("NTA")**, published in **January 2024**, revealed the number of voluntary provision/reception of information of taxpayers to/from foreign tax authorities has nearly doubled compared to the previous administrative year. In addition, the number of instances where taxpayer's information was shared with foreign tax authorities per their requests has also approximately doubled from the previous administrative year.

Publication of FAQ for New Standard Tax Deduction for Individual Income Tax. Under the 2024 tax reform, a new standard tax deduction regime has been introduced for individuals with an income of JPY 18 million or less. Since most individuals in Japan generate only salary income that is subject to withholding tax, there were concerns that this regime would complicate the withholding tax handling. **NTA** published a FAQ on **5 February, 2024** concerning the new standard tax deduction regime, including detailed guidance on withholding tax handling.

In the Firm

• **Expansion of Transfer Pricing Team.**
We are pleased to announce the addition of Harumi Yamada to our team as Senior Tax Director. She brings with her a wealth of knowledge in transfer pricing and international tax, including 27 years working with the National Tax Agency in Japan.

• **Award** DLA Piper's tax practice group has been ranked Band 2 in the "Global: Multi-Jurisdictional Firm Ranking" in Chamber's Global Guide 2024, being recognized as "a global firm with a truly international footprint."

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TMT

Recent Developments for Ride-hailing in Japan

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Overview

On March 29, 2024, the Ministry of Land, Infrastructure, Transport and Tourism ("MLIT") established a new regime allowing for the provision of paid transportation services by local private vehicles and non-professional drivers under the management of taxi business operators ("Private Vehicle Utilization Business"), and issued a guideline ("Guideline") regarding permits for the provision of such services under the Road Transport Act.

The Private Vehicle Utilization Business regime has been seen as partially lifting ride-hailing restrictions in Japan, not only increasing convenience for local residents and tourists alike, but also expanding and creating business opportunities for, among others, taxi business operators and taxi hailing application providers, as well as creating income-generating opportunities for citizens.

The Road Transport Act generally prohibits paid transportation by private vehicles (i.e., vehicles which are not used for business purposes), with exceptions granted in limited circumstances: **(1)** when urgently needed due to a disaster, **(2)** when municipalities or non-profit organizations registered by the MLIT, provide transportation for local residents, tourists, etc., and **(3)** when it is necessary to ensure public welfare, and permitted by the MLIT, to conduct transportation within specified regions or periods (Article 78 of the Road Transport Act).

The Guideline permits paid transportation by private vehicles under the aforementioned category "(3)" in cases of insufficient taxis in certain regions, times or periods. It is important to note that the new regime does not generally endorse ride-hailing in Japan, since the Private Vehicle Utilization Business presupposes that taxi business operators (as opposed to individuals) conduct the relevant transportation business and are responsible for managing and supervising non-professional drivers, and because it is limited to specific regions and times and a certain number of vehicles. Discussions regarding the legal framework generally allowing ride-hailing for business entities other than taxi business operators are slated to be held through June 2024, as outlined in the "Interim Summary of Digital Administrative and Fiscal Reform."

Requirements for permission

In order to conduct the Private Vehicle Utilization Business, corporate taxi business operators are required to apply for permission to the competent transport bureau authority. Upon receiving the application, it will be examined to determine whether it meets the following requirements; if it is found to meet these requirements, permission will be granted.

1. Target areas, periods, time slots, number of shortage of vehicles
2. Qualification
3. Management and operational systems
4. Financial capacity for damages

The details of each requirement are provided in the Guideline.

For the permission of the Private Vehicle Utilization Business, several conditions are imposed, and the permission period is set to 2 years. Violation of these conditions inherent in the granted permission may result in administrative penalties such as suspension of business or revocation of permission.

Further developments

It is expected that the use of private vehicles for paid passenger transportation will increase under both the Private Vehicle Utilization Business and the system of Private Paid Passenger Transportation. While there has already been a great deal of discussion regarding the legalization of ride-hailing businesses in Japan compared to other countries, there will be further consideration of the general legal framework for non-taxi ride-hailing business operators through June 2024. Therefore, it is essential to continue monitoring the progress and direction of, and legislative developments issuing from, these discussions.

Practice Area News

AI Guideline for Business. In **April 2024, the Ministry of Economy, Trade and Industry** and **the Ministry of Internal Affairs and Communications** integrated and updated the existing AI related guidelines and compiled the AI Guideline for Business Ver1.0. The AI Guideline for Business describes various precautions for each of three AI business actors; AI developer, AI provider and AI business user.

AI and Copyright. In **March 2024, the Agency for Cultural Affairs of Japan** published its report, titled "Perspectives regarding AI and Copyright". The report discusses, among other things, **(i)** copyright infringement during development and learning of AI, **(ii)** copyright infringement during using AI and **(iii)** copyright protection on outputs generated by AI. This is an important paper to understand how the Copyright Act of Japan would apply to business of (generative) AI.

Recent Trends in DAO. The Japanese government has been looking to "web3" as an engine of growth of the Japanese economy. In **April 2024, the Financial Services Agency** published amendments to the Cabinet Office Order on Definitions under Article2 of the Financial Instruments and Exchange Act to encourage establishment of DAO. Also, in "web3 white paper 2024" published by the Liberal Democratic Party, the ruling party in Japan, several proposals are provided.

Sealing Representative's Home Address. In **April 2024, the Ministry of Justice** published a ministerial order for amendments to the Regulations on Commercial Registrations to establish a new option for sealing a part of a representative's home address provided in a certificate of commercial registration. The new option only applies to a stock company (*Kabushiki Kaisha*) and will be effective on and after October 1, 2024.

In the Firm

• ALB Asia Super 50 TMT Lawyers 2024.

Keiji Tonomura has been selected as one of the 50 most highly recommended TMT practitioners in the ALB Asia Super 50 TMT Lawyers 2024.

• Appointment of New Managing Partner.

Effective January 1, 2024, Soichiro Fujiwara was appointed as the new Managing Partner of our firm, succeeding the exceptional tenures of Fumihide Sugimoto and Hiroki Inoue, who will serve as Co-Chairs.

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Incoherent Approaches to the EU's Business Service Ban against Russian Subsidiaries of EU Companies

The restrictive measures imposed by the European Union (EU) against Russia have evolved into an unprecedented sanctions regime of prohibitions affecting virtually every economic sector across the EU. With thirteen sanctions packages as of April 2024, these measures were frequently tightened since the beginning of Russia's illegal war of aggression against Ukraine in February 2022.

Among the many measures, ranging from financial sanctions and extremely broad import and export bans to investment prohibitions and a price cap on Russian crude oil, the sanctions also include a ban on the provision of certain services. Specifically, Article 5n of Regulation (EU) No 833/2014 prohibits EU entities from offering a variety of services to Russian companies, including accounting, management consulting, engineering, legal advisory, IT consultancy, and advertising services. Since late 2023, the ban has been expanded to include enterprise management software, limiting Russian companies' access to business services and software essential for running their business. The restrictions are not without nuances, providing for certain exemptions and derogations. For example, services necessary for legal defense, public health, or other emergencies may be exempt, whereas authorisation may be obtained for services necessary for humanitarian purposes or for ensuring critical energy supply within the Union.

Principally, the prohibitions apply with respect to all Russian legal persons. However, until June 20, 2024, services provided to Russian entities owned or controlled by companies from an EU member state or a partner country (Australia, Canada, Iceland, Japan, Liechtenstein, New Zealand, Norway, South Korea, Switzerland, the UK, or the US) are exempt from the restrictions. After this date, however, EU parent companies and external service providers require authorisation to provide restricted services to "privileged" Russian subsidiaries and joint ventures.

While the content of these prohibitions is the same for all EU member states, the services ban demonstrates that the application of the sanctions can diverge significantly. In Germany, the competent Federal Office for Economic Affairs and Export Control (*Bundesamt für Wirtschaft und Ausfuhrkontrolle, **BAFA***) has chosen to avoid the bulk of individual license applications that would otherwise have certainly hit the authorities until June 20, 2024. In February 2024, it issued the national General Authorization No. 42, which allows for the provision of restricted business services to "non-sensitive" recipients in Russia in general terms. German companies only need to register with BAFA and meet reporting requirements, rather than apply for individual licenses.

This approach, while pragmatic, has sparked controversy. The European Commission stated in an April 2024 update of its Frequently Asked Questions on the Russia sanctions that general authorisations are not permissible, emphasizing the need for case-by-case assessments. This could discourage other EU member states from issuing similar authorisations and, as far as we know, Germany stands alone with its approach. As a result, BAFA's general license, while generally welcomed by German businesses, creates inequalities for companies in other member states, especially in light of long processing times they face when requesting authorisations.

This inconsistent application and enforcement, also observed in other areas, potentially undermines the efficacy of the sanctions regime. At the same time, such fragmentation presents a challenging environment for businesses, which need a keen understanding of both the letter and the spirit of the sanctions, as well as the varied landscape of national administrative practice.

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Directive on Penalties for Sanctions Violations. On **April 12, 2024**, the **Council of the EU** approved a **Directive** for EU-wide rules on penalties for sanctions violations. It requires certain infringements to be treated as criminal offences and sets maximum penalties (e.g. imprisonment and high fines). Once it enters into force after publication in the Official Journal, Member States will have one year to transpose it into national law.

EU Economic Security Package. On **January 24, 2024**, the **European Commission** published a **package of five planned initiatives** aiming to enhance the EU's economic security. The package is viewed by the Commission as a comprehensive approach to strengthen the EU's response capacity to various risks arising by growing geopolitical tensions and profound technological shifts linked to FDI into the EU, outbound investments, as well research security and dual-use goods..

Development of European FDI Rules. In **September 2023**, Germany released its evaluation **report** of the current FDI legal framework which was followed shortly after by the **European Commission's Annual FDI Report**. Both underline that there is an ongoing need for an effective screening of FDI. Accordingly, further tightening of foreign direct investment regulations is to be expected at both EU and German level. Other countries (such as Sweden and the Netherlands) have recently also started screening FDI.ae.

Outbound Investment. On **August 9, 2023, U.S. President Biden** signed an Executive Order to control outbound investments to China. It is designed to prevent this country from using U.S. investments to develop military, surveillance, intelligence, and cyber capabilities. The EU has already announced its intention to create a similar instrument to control European investments in third countries. See **HERE** if the U.S. outbound investment screening might be a model for the EU.

• About BLOMSTEIN.

We are one of the leading boutiques for international trade law in Germany, ranked in Tier 1 by legal directories such as JUVE and Legal 500. We are also listed as best for investment control, customs, and sanctions law.

• New Appointments and Recognitions.

- Leonard von Rummel and Christopher Wolters have been promoted to Counsel in January 2024.
- Laura Louca and Leonard von Rummel are named as "Rising Star" in Legal 500's recent ranking in foreign trade.

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