Asia and Pacific Law

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This article highlights selected 2005 legal developments in Japan, the Republic of the Philippines, the Republic of Korea (South Korea), the Kingdom of Thailand, and the Socialist Republic of Vietnam.

I. Japan

Japan continued on its course of legal reform, substantially amending statutes affecting a broad range of areas, including corporate governance and securities regulation; mergers and acquisitions; postal mailing, saving, and insurance privatization; bankruptcy reform; dispute resolution procedures; civil justice; and data privacy protection. The policy objectives underlying the reforms center on the need to rehabilitate Japan's economy, which is recovering from a decade-old recession, and to establish a stronger position in the global capital marketplace. Many of the legal developments in Japan in 2005 reflect these priorities.1

1. As Japan continues its liberalization of mergers-and-acquisitions rules, it finds itself embroiled in an ongoing and well publicized debate over how best to attract, regulate, and tax direct foreign investment, including cross-border acquisitions and contested takeovers. After years of political wrangling, Japan's national legislature, the Diet, passed comprehensive legislation in 2005—a major overhaul of the Commercial Code that dates back to 1899.

Japan's new Bankruptcy Code took effect in 2005, and its long awaited income tax treaty with the United States, ratified just last year, saw its first full year of use by residents of both countries.

In mid-October 2005, the Japan Parliament finally passed a controversial set of bills that will privatize Japan Post—Japan's three trillion dollar postal system that has long housed not only government-operated mail and delivery services, but also one quarter of Japan’s household savings deposits and life insurance policies. The 2005 law calls for Japan Post to begin a ten-year privatization process starting in October 2007, with its
A. New Companies Law

On June 29, 2005, Japan's national legislature (the Diet) passed legislation substantially revising Japan's company laws. The 2005 Companies Law, along with an accompanying Coordination Law whose purpose it is to implement the Companies Law, constitutes the most sweeping revision of Japan's Commercial Code since World War II. With 979 articles, the new legislation broadly amends and integrates several existing laws covering Japan's various business entities, including rules applicable to their incorporation, their internal governance, and their power to engage flexibly in restructuring transactions. More specifically, three separate laws are being consolidated into the new Companies Law, including:

1. Part H of the Commercial Code that governs joint stock corporations;
2. the Limited Liability Act that governs non-public share companies; and

It is widely expected that most of the new law's provisions will become effective between April and June 2006, although a cabinet enforcement order stipulating the exact implementation to be spun off into four private stock companies that will respectively manage the mail delivery services, the network of post office branches, savings deposits, and life insurance services, all of which were previously owned and run by the national government. The four stock companies will be owned by a holding company in which the government will maintain a one-third stake.

Judicial remedies were expanded in 2005 as Japan's new Administrative Litigation Law took effect. The new law substantially broadens a plaintiff's constitutional standing, and thus a plaintiff's ability to obtain judicial review of so-called administrative guidance issued by Japan's bureaucratic ministries. Non-legal binding, but highly influential, administrative guidance has been a strong and enduring feature of the Japanese legal system, and the inability to obtain judicial review of decisions by Japan's powerful ministries has long been a source of contention in postwar Japan.

Japan follows the Civil Law tradition, and there has not heretofore been a right to a jury trial, as that term is understood in common law jurisdictions. But a unique law was passed in 2005 that will allow lay persons—Japanese citizens—to participate more fully in Japan's criminal justice system by sitting on judicial panels that decide the guilt or innocence of accused persons. Also in 2005, Japan's new Privacy Protection Law took effect, prohibiting private entities' misuse of personal data. Finally, Japan is making headway in diversifying and expanding its legal community by:

1. allowing more of its law school graduates (i.e., greater than the typical 2% of annual test takers) to actually pass Japan's arduous national bar exam and (2) by opening the door more widely to foreign attorneys who can now, for the first time, legally partner with Japanese lawyers working in Japan.

Although, to a large extent, the melange of statutory reforms and ambitious government initiatives adopt or mimic foreign models, it is not clear to what degree Japan's sweeping legal reforms and transplanted foreign statutes will overcome traditional practices and often conflicting values, which still linger at the foundations of Japanese legal thinking. It is hoped that the new laws will serve as effective catalysts for change—allowing Japan's economy to better compete in the international arena, and freeing its institutions from a mire of irrational regulations and cozy relationships that have proved crippling in Japan's recent past. See, e.g., Edward J. Lincoln, Arthritic Japan - The Slow Pace of Economic Reform (2001).

2. KAISHA HO [Companies Law], LAW NO. 86 OF 2005 [HEREINAFTER COMPANIES LAW].
4. SHOHO, LAW NO. 48 OF 1899, PART II (AS AMENDED) [HEREINAFTER COMMERCIAL CODE].
5. YUGEN KAISHA HO [LTD LIABILITY COMPANY ACT—LAW RELATING TO YUGEN KAISHA], LAW NO. 74 OF 1938 (AS AMENDED) [HEREINAFTER LIMITED LIABILITY COMPANY ACT].
6. KABUSHIKI KAISHA NO KANSA NI KANSURU SHOHO NO TOKUREI NI KANSURU HORISU [ACT REGARDING EXCEPTIONAL RULES OF THE COMMERCIAL CODE CONCERNING AUDITING, ETC., OF STOCK CORPORATIONS], LAW NO. 22 OF 1974 (AS AMENDED).
mentation date has yet to be issued. The new law provides that its effective date can be no later than January 26, 2007, which is eighteen months after the legislation was first promulgated. The following summarizes key provisions of the new Companies Law, many of which will affect foreign investors and others doing business with Japanese companies.

1. Overview of Statute

The new Companies Law, in a sense, is the keystone legislation capping off a series of almost annual revisions to Japan's Commercial Code, which began in the early 1990s. Since the collapse of its bubble economy, Japan has been incrementally amending its company laws to legalize holding companies, tax-free spin-offs, employee stock options, stock-splits, tracking stock, and other restructuring and financing tools, in an effort to equilibrate its financial sector, attract more foreign investment, and infuse market principles into its rigid Germanic-style corporate governance system. The new Companies Law further liberalizes the mechanics of corporate restructuring, further deregulates financing methods, and further eases Japan's transition from its stakeholder model of corporate governance to a more shareholder-oriented one. Moreover, unlike prior amendments to the Code, which tended to spell out required corporate practices in detail, the sweeping 2005 amendments establish only the minimum requirements and safeguards, allowing corporations to formulate more stringent rules in their articles of incorporation if they so choose. This new principles-based approach of the statute is expected to transfer more power over corporate affairs to the shareholders because any amendment to a firm's articles of incorporation requires special shareholder approval.

Under the new Companies Law, the language of Japan's Commercial Code is modernized to make it more accessible to users. Part II of the Commercial Code is presently written in a rather arcane, literary style of Japanese. The new law essentially rewrites the myriad of provisions in a more colloquial style using the *hiragana* and *kanji* alphabets, and then combines them all with the related laws into one streamlined statute.

When submitting this legislation to Japan's Cabinet, Japan's Ministry of Justice gave four objectives for its comprehensive proposal: (1) to ensure the effectiveness of corporate governance and speed Japan's transition to a more shareholder-oriented form of company management; (2) to enhance the efficiency and transactional flexibility of Japanese corporations, allowing them to reorganize themselves and to compete more readily in the global marketplace; (3) to diversify the means whereby corporations are financed; and (4) to harness the opportunities created by electronic information technology. Ironically, despite these stated policy objectives, some of the provisions in the bills have triggered a larger debate over the extent to which Japan—long characterized as a closed and insular society—is ready and willing to participate in global capital markets where inefficient enterprises are allowed to fail, rather than being propped up by governmental institutions, and where acquirers—be they Japanese or foreign—can gain control of Japanese corporations that appear undervalued or poorly managed in the short term. In passing the 2005 Companies Law, Japanese lawmakers apparently hope to redefine the meaning of capitalism and company in the context of twenty-first century Japan.

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2. Revision of Japan’s Business Entities

The Companies Law fundamentally revamps the types of entities available for doing business in Japan, which will cause many companies to reevaluate their choice of business entities.

a. Repeal of Yūgen Kaisha Law

Japan’s Commercial Code has sanctioned the yūgen kaisha (YK) form for closely-held companies since 1938. Yet the form has not been a favorite among small businesses, many of which operate as small kabushiki kaisha (KK) (i.e., joint-stock companies). Generally, companies incorporated under the YK Law can have no more than fifty shareholders, whose liability is limited but whose freedom to transfer shares is restricted. Although shareholders are free to transfer their shares among themselves, shares cannot be transferred to non-shareholders unless prior approval is obtained at a general meeting of shareholders.

Currently, a relatively low percentage of Japan’s market capital is invested in the YK form. In Japan, it is considered more prestigious to operate one’s small- to mid-size business as a KK. Because KK shareholders can alter their management structure by agreement, there is little substantive difference between the managerial flexibility available to small KKs as compared to the flexibility available to YKs. Thus, the Companies Law will eliminate the YK form as of the new law’s effective date, and existing YKs will automatically become Japanese Tokurei Yugen Kaisha (TYK)—a special kind of KK. Proponents of the YK repeal argued that the entity creates needless complexity without offering distinct advantages over KKs to small businesses. Moreover, because the new Companies Law will make it easier to incorporate as a joint stock company (i.e., as a KK), even fewer small businesses will have the incentive to incorporate as YKs. Critics of repeal maintained that eliminating the YK will prove too disruptive to small businesses since about 60 percent of the business entities in Japan are currently operating in the YK form. Although the new Companies Law will abolish the YK form going forward, the TYKs, as reformed, will still be allowed to use the YK designation in their names, and will not be required to liquidate and reincorporate, which would entail high transaction costs. After the effective date of the Companies Law, no new YKs or TYKs may be formed.

The repeal of the YK law has raised some special tax issues for U.S. taxpayers. Many U.S. persons have been investing or doing business in Japan in the YK form because that particular entity is listed as an eligible entity under the U.S. Entity Classification Regulations, which means that the U.S. taxpayers can elect to have the YK treated as either a flow-through partnership (i.e., not taxable at the entity level) or a taxable corporation for U.S. tax purposes. The KK entity is a per se corporation under U.S. tax law and does not have the ability to elect its tax status. Because existing YKs will automatically be reformed as TYKs (i.e., a special kind of KK) as of the effective date of the new Companies Law, U.S. tax practitioners asked the U.S. Internal Revenue Service (IRS) to issue grandfathering rules allowing U.S. investors in, or shareholders of, existing YKs to keep their preferred U.S. tax characterization going forward, even though the entity’s characterization will have

9. See Commercial Code, supra note 4; see also discussion infra at text accompanying Part I.A.2.a.
11. Id.
On January 9, 2006, the IRS publicly ruled that a Japanese YK that becomes a TYK as a result of the new Companies Law will remain eligible to elect its tax status for purposes of the U.S. Entity Classification Regulations.13

b. Relaxation of Joint Stock Company Regulations

The new Companies Law makes it easier for small companies to incorporate as KKS.14 The KK is the most popular form for large enterprises in Japan, and its fundamental features are similar to the publicly-traded corporation under Delaware law, although there are differences. For one thing, until amendments were adopted in 1999, KK shareholders could only recover their investment by selling their shares. Stock redemptions were severely curtailed. But, in 1999, stock redemptions were liberalized—a key development since redemptions are usually a requisite element in tax-free corporate reorganizations in many industrialized countries.

In order to facilitate the creation of new businesses, the Companies Law reduces the minimum initial capitalization requirements for new KKS from the current ten million yen to just one yen.15 This change represents an about face from Commercial Code amendments passed in 1990 that raised the paid-in capital requirements.16 Legislation enacted in February 2003 allowed public corporations to be established with a stated capital of only one yen, but firms that incorporated pursuant to that provision were required to increase their stated capital accounts to higher thresholds within five years of their incorporation dates. Unlike the 1993 amendment, the 2005 Companies Law allows companies to maintain a nominal capital account beyond the five-year start-up period, but stipulates that in order to protect the interests of creditors, companies with net assets of less than three million yen cannot pay dividends to shareholders.17

It is expected that, in practice, few, if any, corporations will operate with a capital account of just one yen. In effect, the new law grants much more discretion to the incorporating entrepreneurs, and is expected to encourage more of them to conduct their businesses in the corporate form—or as a public corporation (a KK) or as a new LLC (godo kaisha).18

Other amendments relax the rules applicable to a KK if the company satisfies certain criteria indicating that it is closely held. The Companies Law allows smaller, closely-held

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14. Until the 2005 Companies Law becomes effective in 2006, joint stock companies are governed by Part II of the Commercial Code, Law No. 48 of 1899, as amended.
16. In 1990, Japan's Commercial Code was amended to raise the minimum capitalization requirements for new public corporations (kabushiki kaisha) from 350,000 or 400,000 yen (the amount depended on the method of incorporation) to 10 million yen. See Commercial Code, supra note 4, at art. 168-4. At the same time, the minimum capitalization requirements for new closely-held corporations (yugen kaisha) were also raised in 1990, from 100 thousand yen to 3 million yen. See Limited Liability Company Act, supra note 5, at art. 9.
17. The 2005 Companies Law also eliminates the necessity of applying for a court appointed inspector upon incorporation, so long as the non-cash contributions are valued at not more than five million Japanese yen.

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KKSs to operate with just one director, instead of three—the minimum applicable to most KKSs under the present Commercial Code. Moreover, the Companies Law relaxes auditing requirements for smaller KKSs, allowing them to substitute the requisite statutory auditor with an accounting participant (kaikei san-yo) who will be responsible for preparing financial statements in cooperation with the small KK's director(s). The kaikei san-yo will be required to qualify as either certified public accountants or tax accountants.

c. Introduction of New Limited Liability Company (Godo Kaisha)

The new Companies Law sanctions a new type of business entity possessing a character somewhat reminiscent of the American limited liability company or LLC as it is known for short. Under the new statute, the new Japanese entity—a godo kaisha (GK)—combines a partnership's managerial flexibility and ability to make non-pro rata allocations, with a stock corporation's critical attribute of limited liability for its equity members.

One of the big advantages of the GK form is that, unlike a KK, a GK will not be required to establish a board of directors or hold regular member meetings to handle the GK's affairs, although articles of association must be prepared and publicly filed. Instead, each member is responsible for the daily management of the GK, unless the articles of association establish otherwise. Decisions are to be made by majority vote of all the GK members, giving weight to each of their per capita contributions. But the articles of association may provide that some members serve as GK managers, in which case decisions may be made by a majority of the designated managers.

Although the new GK form is patterned on the American LLC model, there are some critical differences, including divergent tax treatment. A key feature of an LLC organized under one of the American states' laws is that the LLC is not necessarily subject to U.S. federal income tax at the entity level. Rather, a U.S. LLC is an eligible entity for purposes of the U.S. Entity Classification Regulations and may opt to be treated as either a tax-transparent partnership or a U.S. corporation subject to tax. Although Japan's National Tax Authority has not yet formally announced the tax treatment of the newly sanctioned GK entity, it is widely expected that it will not be accorded pass-through taxation under Japanese law, but will instead be subject to tax at the entity level. That means that the GK's profits will be subject to a combined national and local income tax rate of up to 42 percent. Moreover, a GK's members could conceivably be subject to a combined national and local income tax rate of up to 50 percent on distributions of the GK's net profits.

Whether a GK will be viewed as a taxable entity by foreign tax authorities depends on the foreign jurisdiction's characterization of the entity. For U.S. tax purposes, it is likely

21. Id. at art. 576-1.
22. Id. at art. 590-1.
23. Id. at art. 591-1.
24. See Treas. Reg. § 301.7701-3(b).
25. Whether the new godo kaisha entity should be subject to tax at the entity level was extensively debated by Japan's Tax Research Commission. See Minutes of December 8, 2004, Modernization of Corporation, Legislative Council, Ministry of Justice, http://www.moj.go.jp/SHINGI/041208-1.html (Japanese only).
26. The new Companies Law creates a second new type of entity—the limited liability partnership—that does offer the benefit of pass-through taxation. METI submitted the Limited Liability Partnerships Bill to the Diet on Feb. 4, 2005. See discussion of the proposed LLP Law, infra.
that a GK will be treated as a default corporation under the U.S. Entity Classification Regulations since none of its members have unlimited liability.\textsuperscript{27} Thus, in the absence of further guidance by the U.S. Treasury Department, a GK’s U.S. tax classification, as a tax-transparent entity or a taxable corporation, may be elected by the U.S. taxpayer.

The new Japanese GK will have the following additional attributes: single-member GKs are permissible;\textsuperscript{28} the GK’s articles of incorporation may be amended only by the unanimous consent of all the GK’s members, regardless of the amount of capital invested by each member;\textsuperscript{29} the addition of new members or the transfer of an existing member’s interest is conditioned upon the consent of all the GK’s members, unless the GK is managed by a group of members, in which case the managing group’s unanimous consent is required;\textsuperscript{30} profits of the GK may be allocated on a basis that is disproportional to the value of capital contributed by each member (i.e., services may be taken into account), so long as the GK’s articles of association so provide, and any distributions do not exceed the GK’s net profits;\textsuperscript{31} and managing members owe fiduciary responsibilities to the GK. Moreover, a manager may be held liable for damages caused to any third party due to such manager’s willful misconduct or gross negligence in the course of operating the GK, and any member may file a derivative lawsuit against a managing member of the GK.

d. Introduction of the Limited Liability Partnership (Yūgen Sekinin Jīgyō Kumiai)

Japan’s Commercial Code has long sanctioned two different kinds of partnerships: (1) the \textit{gomei kaisha}, or unlimited partnership, which has some features comparable to a general partnership organized under the Uniform Partnership Act in the United States and (2) the \textit{gosbi kaisha}, or limited partnership, which has both general partners with unlimited liability and limited partners who are liable only to the extent of their contributions so long as they do not participate in management. During the postwar era, these two partnership forms have played a very limited role in Japan because neither, for a variety of reasons, has proved very useful in practice. The \textit{gomei kaisha} is impractical because all the partners must be natural persons and no partner may be engaged in the same type of business as the company unless all the other partners consent. Moreover, partners must share gains and losses in strict accordance with their respective capital accounts, and the entity itself is subject to tax.

The \textit{gosbi kaisha}, or limited partnership, has proved slightly more useful than the \textit{gomei kaisha}. But due to restrictions on the \textit{gosbi kaisha}’s partners’ activities, the rigidity of its allocation rules, and its two-tier tax structure, the \textit{gosbi kaisha} is still a much less flexible entity than its more modern counterparts in other countries. Indeed, until the year 2005, Japan had never legally sanctioned a business entity with the following combination of attributes: (1) limited liability for all the partners; (2) the ability to make special allocations of gains and losses that are disproportionate to the partners’ relative equity interests in the partnership; and (3) pass-through taxation so that the entity itself is not subject to tax.

Recognizing that Japan could use a more flexible partnership entity in order to help revitalize Japan’s business sector, the Diet passed a separate law on May 6, 2005, authorizing

\begin{itemize}
\item \textsuperscript{27} GKs are not on the list of per se corporations in the U.S. Entity Classification Regulations. See Treas. Reg. § 301.7701-2(b)(8)(vi).
\item \textsuperscript{28} Companies Law, supra note 1, art. 641, ¶ 4.
\item \textsuperscript{29} \textit{Id.} at art. 637.
\item \textsuperscript{30} \textit{Id.} at arts. 585-1 & 585-2.
\item \textsuperscript{31} \textit{Id.} at art. 628.
\end{itemize}
a new kind of limited liability partnership (LLP). This separate law took effect on August 1, 2005. Unlike its predecessors, the new LLP form combines the attributes of limited liability, non-pro rata allocations, and pass-through taxation. In this regard, the new LLP entity is much more similar to the U.S. LLC than the new GK entity; the GK entity will likely be treated as an entity directly subject to Japanese tax, whereas the new Japanese LLP is definitely not taxable under Japanese law, although its partners are subject to tax on their distributive shares of profits and non-cash contributions to the LLP.

In the last two decades, the engines of Japan’s economy have evolved from capital intensive industries like steel and car production to human-capital-intensive industries like telecommunications and information technology. Recognizing this change, Japan’s Ministry of Economy, Trade and Industry proposed the LLP entity for the purpose of facilitating joint ventures between businesses with capital and individuals or smaller businesses with mostly good ideas and know-how. Thus, the LLP is expected to be a beneficial way to formalize: research and development ventures between small entrepreneurs and large corporations or institutions; ventures between non-profit or academic institutions and for-profit corporations; and ventures between information-technology professionals and financiers.

The new LLP entity has the following attributes and parameters:

- Partners in an LLP are not all required to be natural persons—some may be other entities. All partners have the right and obligation to participate in the management of the LLP, although some management duties may be delegated to specific partners;

- The LLP agreement may provide that partners have disparate voting and managerial rights;

- Each partner of the LLP is liable only to the extent of that partner’s contribution to the LLP;

- The LLP is required to take certain measures to protect the interests of creditors, such as publicly registering the partnership agreement, publicly disclosing financial information, refraining from making distributions in excess of the partnership’s assets, and including the designation LLP in its name; and

- The LLP may make special allocations of specific items of partnership income and loss that are not proportionate to the partners’ respective equity interests in the LLP. But, special allocations are not common in practice because such allocations often trigger deemed gift and deemed sale issues under Japanese tax law.

As with the GK entity, whether a Japanese LLP will be treated as a taxable entity under foreign law depends on the foreign tax authorities’ characterization of the entity. For U.S.

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32. Yugen Sekinin Jigyo Kumiai [Limited Liability Partnership Act], Law No. 40 of 2005 [hereinafter LLP Act]. Hereinafter, the limited liability partnership, which the Act authorizes, will be referred to simply as an LLP. Like the 2005 Companies Law, the LLP Act also amends Part II of the Japan’s Commercial Code. But the two sets of amendments were contained in two separate bills. METI’s English explanation of the proposed LLP bill is available at http://www.meti.go.jp/english/information/data/LLPe.html.

33. LLP Act, supra note 32, at art. 13.

34. Id.

35. Id. at art. 15.

36. Id. at art. 57.

37. Id. at art. 31.

38. Id. at art. 34.

39. LLP Act, supra note 32, art. 9.
tax purposes, the LLP is not a per se corporation under the U.S. Entity Classification Regulations; rather, its default status will likely be a corporation, but eligible to elect to be taxed as either a U.S. partnership or a U.S. corporation.40

In what could be a trap for the unwary, Japan's new Tax Reform Act, passed by the Diet on March 30, 2005, provides that foreign partners in Japanese partnerships, including the new LLPs, who do not have a permanent establishment in Japan will be liable for a 20 percent withholding tax on the partnership's distributions and deemed distributions of profits that are allocable to the foreign partner.41 If the partnership fails to distribute its net income by the end of the second month following the close of its taxable year, then the partnership will be deemed to have distributed its profits for purposes of this provision.42 The new withholding provision is generally effective for calendar-year partnerships beginning in 2006.43

II. The New Japan-U.S. Income Tax Treaty: Fully Effective (Finally) in 2005

Although there were a number of significant tax law developments in Japan and the rest of Asia during the year 2005, one of the most consequential, from a legal and economic perspective, is that the long-awaited Japan-United States Tax Treaty44 became fully effective on January 1, 2005.45 The new treaty, with its accompanying Protocol, replaces an archaic, thirty-three-year old tax treaty between Japan and the United States that had been in force without amendment since 1972.46 The new treaty between Japan and the United States represents "a critically important modernization of the economic relationship between the world's two largest economies."47 Moreover, many of the new treaty's provisions suggest an important and fundamental change in Japan's international trade and tax policy that may serve as a catalyst for tax policy reform in other Asian countries looking to remove unnecessary barriers to cross-border trade and investment. Although most of the new treaty's provisions did not become effective until January 1, 2005, its relatively quick ratification in March 2004, allowed certain key provisions, such as the newly reduced withholding tax rates on dividends, interest, and royalties, to become effective on July 1, 2004—six months prior to the general effective date, January 1, 2005.

A. Lower Source-State Withholding Rates on Investment Income

The 1971 treaty had set maximum withholding tax rates on cross-border investment income that were significantly higher than the rates reflected in most U.S. tax treaties with

42. Id.
43. Id. at supplement, art. 3.
45. Some of the articles became effective prior to the default effective date of January 1, 2005.
The new treaty greatly reduces these reciprocal withholding rates (even eliminating them in certain cases), and in a couple of instances, reducing the rates below those set forth in the U.S. Model Treaty—an archetype the United States routinely uses as a starting point in tax treaty negotiations. Clearly, the final agreement represents a remarkable and "unprecedented departure from Japan's historic tax treaty policy."\(^4\)

Article 12 of the new treaty completely eliminates Source-State taxation of royalty income "beneficially owned by a resident of the other Contracting State."\(^4\) The new treaty allocates the right to tax royalties solely to the Residence State, which can tax them on a net basis in the same manner as other business profits. Treating royalties in the same manner as business profits removes a source of dispute in tougher cases where it becomes difficult to distinguish royalty income from other types of income. Although article 12 defines royalties broadly, it excludes, unlike the 1971 treaty, gains derived from the alienation of property that would give rise to royalties, regardless of whether such gains resulted from the productivity, use, or further alienation of the property. Instead, those gains are dealt with under article 13 (Gains), even though article 13 gains are also generally exempted from Source-State taxation. Royalties, for article 12 purposes, also do not include income from the lease of personal property. Nor do royalties include income from computer software unless consideration was paid for the use, or right to use, the software. The fact that the software transaction is characterized as a license for copyright purposes is not dispositive of whether it generates royalty income for treaty purposes.

The new treaty completely eliminates Source-State withholding tax on broad categories of interest.\(^5\) The most significant of these is the elimination of Source-State withholding tax for interest earned by financial institutions, which includes interest beneficially owned by a bank, an insurance company, a registered securities dealer, and certain other qualified deposit-taking entities. Interest paid to a resident creditor on debt arising as part of a credit sale of equipment or merchandise is also exempt from withholding tax, as is interest earned from pension funds.

The new treaty also reduces the withholding rates imposed on qualified dividends, imposing three different rate structures, depending on the payee's level of stock ownership in

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\(^4\) See id.

\(^5\) See Japan-U.S. Tax Treaty, supra note 44, at art. 12. Only beneficial owners that are residents of the Other Contracting State may claim the treaty reduced rates on royalties, interest, and dividends. See id. at arts. 10(2)-(3), 11(2), & 12(1). Although beneficial ownership is a critical prerequisite to claiming treaty-reduced withholding rates, the text of the new Japan-U.S. Treaty, like other treaties, does not attempt to define the term beneficial owner. Rather, the U.S. Treasury's Technical Explanation clarifies that one must look to the internal law of the Source-State to determine the beneficial owner which, according to the Technical Explanation, is generally the "person to which royalty income is attributable for tax purposes under the laws of the State of source." Press Release, United States Department of the Treasury, Department of the Treasury Technical Explanation of the Convention between the Government of the United States of America and the Government of Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Gains, Signed at Washington on November 6, 2003, available at http://www.ustreas.gov/press/releases/reports/tejapan04.pdf. Identifying the beneficial owner remains one of the most difficult problems in tax treaty interpretation.

\(^5\) See Japan-U.S. Tax Treaty, supra note 44, at art. 11. Like the old 1971 Treaty, the new Treaty allows the Source State to impose a withholding tax on interest payments. This represents a departure from recent tax treaties the United States has negotiated in which the Residence State was granted the exclusive right to tax all qualified cross-border interest income. The maximum allowable withholding rate under the new Japan-U.S. Treaty is 10% if paid to a resident of the Other Contracting State that beneficially owns the interest—the same maximum rate that applied under the 1971 Treaty.
In general, the Source State can impose a withholding tax of 10 percent on portfolio dividends received by a resident of the Other Contracting State who qualifies as the beneficial owner on the date when entitlement to the dividend is determined. If the beneficial owner of the dividend is a company that owns, directly or indirectly (i.e., through tiers of entities resident in either Contracting State), at least 10 percent of the voting stock of the payor company, then the withholding tax can not exceed 5 percent under the new treaty. Notwithstanding these provisions, the new treaty provides for a 0 percent withholding rate for dividends paid if the beneficial owner of the dividend is a company that has owned, directly or indirectly, greater than 50 percent of the voting stock of the payor during the twelve-month period ending on the date on which entitlement to the dividend is determined and one of three alternative tests is satisfied. Under the additional requirement, the payee company must either: (1) meet the “publicly traded” test set forth in the Limitation-on-Benefits (LOB) article; (2) meet both the “ownership/base erosion” and “active trade or business” tests described in the LOB article; or (3) be granted express eligibility by the Competent Authorities pursuant to the LOB article.

B. Transfer Pricing

Compared to the old 1971 treaty, the new Japan-U.S. Treaty gives more ammunition to tax authorities attempting to police non-arms' -length transfer pricing. Most importantly, the diplomatic notes to the treaty, which were exchanged between the U.S. Secretary of State and the Japan Minister of Foreign Affairs on the date the treaty was signed, expressly incorporate the Transfer Pricing Guidelines, promulgated by the Organisation for Economic Co-operation and Development (OECD), as a source of authority in applying the new treaty. Thus, the pricing methods of each Contracting State may be applied under the treaty only to the extent they are consistent with the OECD Guidelines. Moreover, the new treaty injects transfer pricing principles into the text of several of its articles, including the Royalties article, the Interest article, and article 9 dealing with Associated Enterprises.

51. See id. at arts. 10(2)(a)-(b) & 10(3). Under the 1971 Treaty, the Source-State could impose a maximum 10% withholding tax on dividends paid to companies resident in the Other Contracting State that beneficially owned at least 10% of the stock of the payor company. Portfolio dividends (i.e., those paid to resident individuals or companies owning less than 10% of the payor) could be taxed at a maximum withholding rate of 15%.

52. The complete elimination of Source-State withholding taxes on certain intercompany dividends is not the U.S. Model Treaty position, and U.S. Treasury officials have publicly stated that these rates are appropriate only if “the treaty contains anti-treaty-shopping rules that meet the highest standards and the information exchange provision of the treaty is sufficient to allow [confirmation] that the requirements for entitlement to this benefit are satisfied.” See 2003 Tax Treaty Hearing, supra note 47.

53. See Japan-U.S. Tax Treaty, supra note 44, at art. 22(1)(c).

54. See id. at art. 22(1)(f).

55. See id. at art 22(2).

56. See id. at art 22(4).


58. See Japan-U.S. Tax Treaty, supra note 44, at arts. 12(4) (royalties), 11(8) (interest), and 9(1)-(3) (Associated Enterprises). Paragraph 3 of article 9 appears to extend the time frame within which a Contracting State must initiate an examination of the enterprise in order to make a transfer pricing adjustment. According to the
C. LIMITATION-ON-BENEFITS ARTICLE

The 1971 Japan-U.S. Tax Treaty did not contain any Limitation-on-Benefits (LOB) article. The complete absence of this anti-abuse provision meant it was easier for third-party residents to take advantage of the treaty. The new treaty contains a fairly elaborate LOB article, comparable to the rules contained in recent U.S. tax treaties. The main purpose of the LOB article is to identify investors whose ostensible residence in the other Contracting State can be justified by factors other than a purpose to derive treaty benefits. The new treaty sets forth several elaborate objective tests, including the familiar base-erosion, active-trade-or-business, and resident owner tests, for this purpose.

D. Fiscally Transparent Entities

One of the most complex problems that countries have to deal with in their bilateral tax treaties in recent years has been the deliberate manipulation of fiscally transparent entities in order to derive treaty benefits. Tax planners have increasingly employed entities that are classified inconsistently by two or more countries—so called hybrid entities—to avoid paying tax in either country. The texts of older treaties do not spell out what persons may be entitled to treaty benefits when income is derived through a fiscally transparent entity and there remains a lot of confusion as to who is actually liable to tax. This confusion over tax liability, in turn, affects the determination of residency for treaty purposes. Moreover, with respect to hybrid entities, the older treaties' texts do not clarify whether the laws of the Source State or the Residence State govern entity classifications for purposes of applying the tax treaty. Like other recently negotiated tax treaties, the new Japan-U.S. Tax Treaty attempts to resolve these problems in article 4, its Residence article.60

The Technical Explanation to the new treaty defines a “fiscally transparent entity” as one in which the income is normally taxed at the beneficiary, member, or participant level—not the entity level. Paragraph 6 of the Residence article sets forth the general rule that one must look to the internal tax laws of the Residence State to determine whether or not an entity is fiscally transparent. It is the Residence State’s characterization that counts, and in almost all cases one is to ignore the Source State’s characterization of the entity if it conflicts. The primary operational rule of the treaty with respect to fiscally transparent entities is that when an item of income is derived from the Source State through an entity organized in the Residence State, and that entity is treated as fiscally transparent under the internal tax laws of the Residence State (e.g., as a partnership or tax-transparent trust or flow-through LLC), the entity will be entitled to treaty benefits (e.g., favorable treaty withholding rates) only to the extent its beneficiaries, members, partners, or participants are qualified residents of the Residence State and otherwise qualify for treaty benefits under other provisions of the treaty.

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59. See id. at art. 22.
60. See id. at art. 4(6) (dealing with fiscally transparent entities).
E. Other Amendments

The new treaty has quite a few other provisions that differ from the old 1971 treaty. Under the 1971 treaty, Japanese corporations with unincorporated branches in the United States were considered exempt from all U.S. branch taxes, which generally bear a rate of 30 percent. But under the new treaty, the United States is allowed to impose its branch profits tax at a reduced 5 percent rate in certain instances.

The Mutual-Agreement-Procedure article and the Exchange-of-Information article have been clarified and elaborated in the new treaty. The latter article requires the competent authorities of Japan and the United States to exchange information that is relevant to carrying out the provisions of the treaty or the domestic laws of either country concerning taxes of every kind. The information-exchange provisions of the new treaty generally follow those included in the U.S. Model Treaty. Their inclusion in the new Japan-U.S. Treaty was made possible by a recent change in Japanese law.

III. Republic of the Philippines

Significant legal developments in the Philippines include new statutes, executive orders, and administrative regulations in the following areas: taxation, securitization, and citizenship and immigration.

A. Taxation

The Philippine government is pursuing a tax reform agenda in order to solve the country's budget deficit problem.

1. No Audit Program

On March 7, 2005, the Philippine Bureau of Internal Revenue (BIR) issued Revenue Regulation 6-2005 to institute a No Audit Program (NAP). The NAP seeks to increase tax collections by encouraging taxpayers to voluntarily declare and pay higher taxes. Under

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61. See I.R.C. §§ 884(a), (f) (2005). The so-called branch profits tax, enacted by the United States in 1988, is intended to replicate the tax that would be imposed under U.S. tax law if the U.S. branch were a separately incorporated domestic subsidiary. The United States also imposes a second-level tax on interest paid to foreign recipients by a foreign corporation with substantial amounts of earnings that are effectively connected to a U.S. trade or business. See id. § 884(f).


63. See id. at art. 26.

64. The Philippine legal system is a hybrid system that bears features of the civil law and common law systems. Philippine laws are codified; but judicial decisions have binding effect. Under the Civil Code of the Philippines, sources of Philippine laws include: (a) the Constitution of the Philippines; (b) statutory enactments; (c) administrative and executive acts, orders, and regulations; (d) judicial decisions; and (e) customs. Civil Code, art. 2-12, R.A. 386, as amended (Phil.).


the NAP, qualified taxpayers will be exempt from tax audit and investigation if their tax payments for a particular taxable year are higher than their payments for the previous taxable year by specified percentages (e.g., 20 percent).  

2. **New Tax Laws**

The Thirteenth Congress of the Philippines \(^68\) enacted three pieces of tax legislations: the Attrition Act of 2005 \(^70\), the Sin Tax Law \(^71\), and the EVAT Law. \(^72\) The Attrition Act creates a rewards and incentives fund \(^73\) and a revenue performance evaluation board to improve the revenue collection performance of the BIR and the Philippine Bureau of Customs. The Sin Tax Law and the EVAT Law introduce substantive amendments to the National Internal Revenue Code of 1997 (the Tax Code). The Sin Tax Law increases the excise tax rates imposed on alcohol and tobacco products. \(^74\) The government projects that this law will yield additional annual revenues between PhP eight to fifteen billion. \(^75\)

The EVAT Law temporarily increases corporate income tax rates, \(^76\) and reclassifies transactions and services subject to and exempt from value added tax (VAT) and other percentage taxes. \(^77\) The validity of the law was assailed before the Philippine Supreme Court.  

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\(^{68}\) See Mem. 6-2005, supra note 67, § 5.  
\(^{69}\) Convened on July 26, 2004.  
\(^{73}\) If the BIR and the BOC miss their revenue targets by less than 10%, the revenue and collection districts that exceed their respective allocations of the revenue target shall be entitled to rewards and incentives amounting to 10% of the excess over its allocated targets. See R.A. 9335, supra note 71, §§ 4-5.  
\(^{74}\) See R.A. 9334, supra note 70, §§ 1-5. The rates prescribed will be adjusted every two years until 2011.  
\(^{76}\) Among other changes, the law increases the corporate income tax rate from 32% to 35%; however, this rate will be reduced to 30% effective Jan. 1, 2009. See R.A. 9337, supra note 72, § 1. As to intercorporate dividends received by a nonresident foreign corporation from domestic corporations, the EVAT Law continues to impose a final withholding tax of 15% provided that the country in which the nonresident foreign corporation is domiciled allows a credit against tax due from the nonresident foreign corporation taxes deemed to have been paid in the Philippines equivalent to 20% (which is an increase from the 15% prescribed before the amendment); but beginning Jan. 1, 2009, the foreign country's credit against the tax shall be equivalent to 15%. Id. § 2.  
\(^{77}\) The EVAT Law now imposes VAT on transactions that were previously exempt or previously subject to other percentage taxes, including but not limited to: sale of nonfood agricultural products, marine products, and forest products in their original state; sale of cotton and cotton seeds in their original state; sale or importation of coal, natural gas, and petroleum products (except lubricating oil, processed gas, grease, wax, and petrolatum); services rendered by doctors and lawyers; sale of electricity by generation, transmission, and distribution companies other than sale of power or fuel through renewable sources of energy; common carriers...
Court. It was argued that the EVAT Law constitutes an undue delegation of legislative powers in that it authorizes the Philippine President to raise the VAT rate from 10 percent to 12 percent upon the occurrence of specified conditions. But the Supreme Court dismissed the argument and held that the law only authorizes the President to ascertain "facts upon which enforcement and administration of the increase rate under the law is contingent" and that "the entire operation or non-operation of the 12 [percent] rate [is left] upon factual matters outside the control of the executive." On October 19, 2005, the Secretary of Finance promulgated the Consolidated Value Added Tax Regulations of 2005 to implement the new law. The government estimates that the EVAT Law will raise additional revenues of as much as PhP eighty-one billion annually. The World Bank has commended the passage of the new law.

B. Securitization

On May 25, 2005, the Congressional Oversight Committee on the Securitization Act approved the Implementing Rules and Regulations (IRR) of the Securitization Act of 2004 (Securitization Act). Enacted in 2004, the Securitization Act provides for the regulatory framework for securitization and the creation of a favorable market environment for a range of asset-backed securities (ABS).

Securitization is "the process by which assets are sold on a without recourse basis by the [s]eller to a [s]pecial [p]urpose [e]ntity (SPE) and the issuance of [ABS] by the SPE which depend, for their payment, on the cash flow from the assets so sold and in accordance with [a] [p]lan [for securitization]." Under the Securitization Act, assets that may be securitized by air and sea in the Philippines. Id. §§ 4-5, 22. But the EVAT Law exempts from VAT certain transactions, including but not limited to: educational services rendered by duly accredited private educational institutions; sale, importation, or lease of passenger or cargo vessels and aircraft, including engine, equipment and spare parts. Id. §§ 6-7.


79. These conditions are: (a) VAT collection as a percentage of Gross Domestic Product (GDP) of the previous year exceeds 2 4/5% or (b) national government deficit as a percentage of GDP of the previous year exceeds 1 1/2%. See R.A. 9337, supra note 72, § 4.

80. See ABAKADA GURO, supra note 78.


82. ld.


85. ld.

86. SPE’s may be either a special purpose corporation or a special purpose trust created for the purpose of securitization and to which the seller makes a true and absolute sale of assets. See id. at art. II, § 5.

87. ld. at art. I, § 3(a). The plan must be approved by the Philippine Securities and Exchange Commission (SEC).
include loans, receivables, housing loans, and other debt instruments. 88 The aggregate principal amount of the value of ABS to be issued, the principal amount of each class within the ABS, and the denominations thereof shall not be lower than PhP five thousand in which the asset-backed securities will be issued. 89

To create such favorable market environment for ABS, the Securitization Act exempts from certain taxes the sale and transfer of assets to the SPE 90 and the original issuance of ABS and other securities related solely to such securitization transactions. 91 Moreover, a SPE (created pursuant to a SEC-approved plan) will not be classified as a bank, quasi bank, or financial intermediary and will therefore not be subject to gross receipts tax and other relevant taxes. 92 The IRR brings the Securitization Act into operation, providing for, among other things, the mechanism for the approval of securitization plans, 93 the registration of ABS, 94 the transfer of assets and security, 95 and the dissolution of the SPE. 96

C. CITIZENSHIP AND IMMIGRATION

On October 17, 2005, the Bureau of Immigration issued Memorandum Circular No. AFF 05-002 (the Circular) to simplify the application process for reacquiring Philippine citizenship under the Citizenship Retention and Reacquisition Act of 2003 (the Act). 97 The Act was enacted to allow qualified natural born Filipinos who have lost their Philippine citizenship to reacquire Philippine citizenship without having to renounce their foreign citizenship. 98 Until the Circular was issued, however, the Bureau of Immigration required 99

88. See id. at art. I, § 3(c). The SEC or the Bangko Sentral ng Pilipinas (Central Bank of the Philippines) may in the future allow the securitization of other receivables; but future revenues of national or local governments arising from royalties, fees or interests may not be securitized.
89. See id. at art. II, § 6(c).
90. The sale or transfer of assets to the SPE, including the sale or transfer of any and all security interests thereto, if made in accordance with the Plan, is exempt from VAT and documentary stamp tax (DST). See R.A. 9267, supra note 84, at art. IV, § 28. Except for registration fees with the SEC, all applicable registration and annotation fees to be paid, related or incidental to the transfer of assets or the security interest thereto, shall be 50% of the applicable registration and annotation fees. Id. The transfer of assets by dation in payment (dacion en pago) by the obligor in favor of an SPE shall not be subject to capital gains tax under the Tax Code. Id.
91. The original issuance of ABS and other securities related solely to such securitization transaction, such as, but not limited to, seller’s equity, subordinated debt instruments purchased by the originator, and other related forms of credit enhancement shall be exempt from VAT, or any other taxes imposed in lieu thereof, but subject to DST. See id. at art. IV, § 29. But all secondary trades and subsequent transfers of ABS, including all forms of credit enhancement in such instruments, shall be exempt from DST and VAT, or any other taxes imposed in lieu thereof. Id.
92. See id. at art. IV, § 30.
93. Id. at art. II, § 6.
94. Id. at art. II, § 7.
95. Id. at art. II, § 12.
96. R.A. 9267, supra note 84, at art. II, § 15.
98. See id. § 5.
applicants to submit birth certificates certified by the National Statistics Office—a requirement that overseas Filipinos found too cumbersome. The new Circular is a welcome development for millions of migrant Filipinos worldwide, as it only requires any one of the following documents: old Philippine passport, Philippine birth certificates, Philippine voter’s affidavits or Philippine voter’s identification card, marriage contracts indicating the Philippine citizenship of the applicant, or such other documents that are acceptable to the evaluating officer. This will further the objective of encouraging overseas Filipinos to resettle and reinvest in the Philippines.

IV. The Republic of Korea (South Korea)

A. Collective Investment Scheme Act—Expansion of Asset Management Business

The Collective Investment Scheme Act (CISA), which consolidated the Securities Investment Trust Business Act, the Securities Investment Company Act and some parts of the Korean Securities and Exchange Act, went into effect in 2004. The CISA expanded the scope of permitted asset management businesses and the scope of the covered assets, while emphasizing investor protection. At the end of 2004, it was then further amended to permit the establishment of Private Equity Funds (PEF).

The CISA regulates virtually all forms of asset management, and allowed the scope of advisory services and discretionary investment to become broader. Additionally, the CISA expanded the scope of the covered assets to include over-the-counter derivative products, real estate agricultural products, livestock, marine products, lumber, minerals, energy products, and any other products similarly derived. The CISA also emphasizes investor protection. For example, the CISA requires a financial service company to establish a system for general meetings of beneficiaries and mandates a corporate director system for investment companies. Investment in the same class of assets and transactions between related parties are also limited. The CISA will also affect foreign financial institutions that provide services to Korean residents. Under the CISA, the Financial Supervisory Commission (FSC) will allow foreign discretionary investment service providers and foreign investment advisers, if registered, to provide services to Koreans without having a physical presence in Korea.

The amendment to the CISA permits PEF to invest funds for the purpose of influencing the control over the target company's management and corporate governance. PEF must hold more than 10 percent of the target company's equity or otherwise influence its management. To protect unsophisticated investors, the amendment prohibits PEF from soliciting funds from the general public and sets the minimum amount to participate in PEF at two billion won (approx. US $2 million) for an individual and five billion won (approx. US $5 million) for a business entity.
B. Korea Stock Exchange Act—Enhanced Corporate Governance

The Korea Stock Exchange Act (KSEA) amendments went into effect in mid-2004, to enhance corporate governance. The changes applied to companies whose securities are listed on the Korean Stock Exchange (KSE) or that are registered with the Korean Securities Dealers Association. The primary changes include: requiring a listed company's representative director to sign a certificate that disclosure documents are true and correct; imposing liability on de facto directors\textsuperscript{104} for damages from untrue statements or omissions of material facts in disclosure documents; requiring at least one member of the audit committee to be an accounting or finance expert; and prohibiting a company from lending assets to major shareholders, directors, and auditors.\textsuperscript{105}

In 2004, the Ministry of Finance and Economy (MOFE) issued regulations to promulgate the enhanced corporate governance under the KSEA. The regulations provide that:

(a) before signing a certificate that disclosure documents are true and correct, a listed company's representative director must review and examine whether material information is misrepresented or omitted and whether its internal audit system is being operated in compliance with laws and regulations, before signing a certificate that any disclosure document is true and correct.

(b) The regulations also require any accounting or finance expert to satisfy one of the following criteria: a certified public accountant with more than five years of experience; a person who has master's or higher degree in accounting or finance and more than five years of experience at a research institute or college; a person who has more than five years of experience as an executive officer or ten years as an officer and executive officer at a public or registered company; or a person who has more than five years of experience at certain government agencies or certain financial institutions.

(c) As an incentive for the reporting of the misuse of nonpublic information or price manipulation, informants may be awarded up to 100 million won (US $100,000).

(d) The regulations also introduce an exception to the prohibition of a company lending assets to major shareholders, directors, and when a loan of up to fifty million won (US $50,000) is made for housing, education or health.

C. KSEA Amendment—Protect Management from Hostile Mergers & Acquisitions

On January 17, 2005, in response to recent hostile mergers and acquisitions (M&A) activity, the KSEA was amended to provide adequate protection for corporate management against such attempts. Prior to the amendment, corporate management limited corporate options geared toward hostile takeover attempts. The amendment abolishes the prohibition on repeating a tender offer by persons who have previously made such an offer within the previous six months and allows new securities to be issued during a tender offer. Certain shareholders who own more than 5 percent in corporate equity are required to report the

\textsuperscript{104} A de facto director is a non-director who uses his or her influence over the company to control a director, conducts business under the name of a director, or conducts business under a title having apparent authority.

\textsuperscript{105} See Sai Ree Yun, Korea: Recent Developments in the Areas of Corporate and Securities Law, Competition Law, and Labor Law, in Updates from East Asia for Business Lawyers, 38 Int'l. Law. 609, 627 (2004).
purpose of holding the shares. Shareholders who acquire the shares for the purpose of influencing the control over the issuer must complete a long form holding report, while the shareholders who have no such controlling intent can still use a short form. A shareholder who had previously used a short form, but has now changed its holding purpose, must report the change of holding purpose to the FSC and KSE. A shareholder that has changed its holding purpose is now prohibited from acquiring additional shares and exercising voting rights for five days.

D. Securities Transaction Tax—Exemption Expanded

On October 1, 2004, the MOFE issued an amendment to the Enforcement Regulation of the Securities Transaction Tax Act (STTA), exempting the transactions of Korean company's securities and depository receipts (DR) on foreign stock exchanges that are similar to KSE or KOSDAQ. Without an exemption, transaction of securities and DRs issued by a Korean company are taxable under STTA. Previously, tax exemptions were limited to the securities and DRs transferred only on the New York Stock Exchange or NASDAQ. The amendment expands this exemption by permitting tax exemptions for transactions on the Tokyo Stock Exchange (TSE), London Stock Exchange (LSE), German Stock Exchanges (DAX), or any foreign stock exchanges with similar regulations and standard procedures as those of KSE or KOSDAQ. In addition to the TSE, the LSE, and the DAX, the MOFE's press release includes as examples Euronext, Hong Kong Stock Exchange, Taiwan Stock Exchange, Singapore Exchange Limited, and Luxembourg Stock Exchange.

V. The Kingdom of Thailand

Significant legal developments in Thailand include new statutes, laws, and administrative orders in the following areas: financial services, bankruptcy, taxation, accounting profession, hotel development, and emergency powers.

A. Financial Sector Master Plan

In 2004 the Thailand Cabinet approved the Financial Sector Master Plan (FSMP) designed to increase competition in the financial industry by eliminating regulatory restrictions. The FSMP classifies financial institutions as either commercial or retail banks. Commercial banks are allowed to provide all financial services except insurance, securities trading, and brokerage. Retail banks are required to focus on small and medium sized enterprises and lower income customers, and can “provide virtually all types of financial

106. Thailand has a civil law codified legal system based on the early twentieth century reforms of King Chulalongkorn. Most of the Codification was drawn from other civil law and common law systems, in addition to the traditional laws of Thailand. Thailand has a Constitution that is the supreme law of the land. Thai laws are normally drafted in broad terms that allow the relevant government ministry or agency broad powers to issue regulations.


108. Id. § 3(2.1.1).

109. Id. § 3(2.1.1.A).
transactions with the same exceptions as commercial banks." The key difference in determining if a bank is a commercial bank or a retail bank is the capital requirements: commercial banks have a minimum requirement of Bt five billion (US $125 million) and retail banks have a minimum Bt 250 million (US $6.25 million) of tier-1 capital. The FSMP will also allow foreign banks to operate as full branches under the same conditions as Thai commercial banks but without the option of opening branch offices or through subsidiaries. The FSMP will eventually oversee foreign banks requesting permission to open from three to five branch offices outside Bangkok.

B. THE BANKRUPTCY ACT

The Bankruptcy Act amended the requirements for discharging a debtor from bankruptcy. Under the new law a discharge in bankruptcy will be granted after three years if the debtor has not committed dishonest acts or already filed for bankruptcy in the past five years. Additionally, the Official Receiver may file a motion with the Central Bankruptcy Court seeking a stay of the period if the debtor is not cooperating with the Receiver in identifying estate assets or in the examination of assets and liabilities.

C. CAPITAL GAINS TAX

Under a Royal Decree, non-resident institutional investors holding bonds or debentures issued by the government, a government organization, or specific financial institution for the purpose of lending money to promote agriculture, commerce, or industry are exempted from withholding tax on interest income, discount income, and capital gains. Discount income is the difference between the redemption value and the selling price of a bond or debenture when first sold at a price below its redemption value. Foreign institutional investors are subject to a 15 percent tax on income derived from discount earnings and a 15 percent capital gains tax derived from securities investments unless a taxation treaty provided for a lower rate.

D. ACCOUNTANCY PROFESSION ACT

The Accountancy Profession Act was promulgated to develop accounting standards and control professional ethics. The Act should promote reliable corporate financial data to the business community.

110. Id. § 3(2.1.1.B).
111. Id. § 3(2.1.1.A).
112. Id. §§ 3(2.1.1.A) & 3(2.1.1.B).
113. Financial Sector Master Plan, supra note 107, § 3(2.1.2).
115. Id. § 10.
116. Id.
117. Royal Decree No. 429, B.E. 2548 (2005) and Ministerial Regulation 249.
118. Id.
119. Id.
E. Hotel Act

The Hotel Act is expected to control supply and demand of hotel rooms in specific areas and prevent the owners of apartments and condominiums from providing hotel-like services. The owners had until May 2005 to register in the appropriate category.\footnote{121}{Hotel Act, B.E. 2547 (2004).} Failure to do so could result in one year in jail, a fine, or both; day fines can be imposed for continuing to operate illegally.\footnote{122}{Id.}

F. The Emergency Powers Law

The Emergency Powers Law replaced martial law that was in place in the three southern provinces, Narathiwat, Pattani, and Yala, where over eight hundred people have been killed in the past two years.\footnote{123}{Emergency Decree on Public Administration in Emergency Situation, B.E. 2548 (2005).} The law gives Prime Minister Thaksin Shinawatra the power to tap phones, censor newspapers, and detain suspects without charge, and also expands the government's authority to impose curfews, ban public gatherings, close publications, limit travel, and confiscate property.\footnote{124}{Id.}

VI. The Socialist Republic of Vietnam

The Vietnamese legal system is a combination of communist legal theory and French civil law.\footnote{125}{Central Intelligence Agency, The World Fact Book: Vietnam, http://www.cia.gov/cia/publications/factbook/geos/vm.html (last updated Jan. 10, 2006) [hereinafter CIA Vietnam].} With no system of common law jurisprudence, the judicial branch is relatively weak resulting in arbitrary decisions.\footnote{126}{Economist Intelligence Unit, Vietnam Risk: Legal & Regulatory Risk, RISKWIRE VIETNAM, Mar. 18, 2004, Issue 101.} The Swedish government has been providing ongoing training to help strengthen the judiciary's capacity.\footnote{127}{Id.} In 2001, the United States entered into a Bilateral Trade Agreement with Vietnam that called for and allowed the United States to assist the Vietnamese government in implementing legal reforms.\footnote{128}{Id.}

In June 2004, the Vietnamese National Assembly passed seven pieces of legislation that attempt to improve the country's legal system and its effectiveness.\footnote{129}{Thai Thanh, NA Chairman Says Session Wraps Up In Success, SAIGON TIMES DAILY, June 16, 2004.} Three of these laws could influence foreigner investment in Vietnam. These three laws are the Civil Procedure Law, the Law on Bankruptcy, and amendments to the Law on Credit Organizations.

A. The Civil Procedure Law

The Civil Procedure Code (Code) went into effect on January 1, 2005.\footnote{130}{Vietnam Economy, The Civil Procedure Code, http://www.vnecconomy.com.vn/eng/index.php?param=article&catid = 16&id = 040818101400 (last visited Feb. 26, 2006).} With over 418 articles, the Code replaced and consolidated a number of older laws and ordinances, as well as provided a number of important new additions. The Code addresses issues such as ju-
risdiction of the courts, statutes of limitations, civil injunctive actions, and procedures for the litigation of civil cases.\textsuperscript{131}

1. \textit{Jurisdiction of the Courts}

The Code provides the People's Courts of Vietnam with jurisdiction to settle disputes and requests related to civil law, family law, commercial law, and labor law matters and issues.\textsuperscript{132} Many provisions previously existed but were spread out through a number of different ordinances so that a practitioner would have to check several places to ensure proper jurisdiction. Now legal procedures for everything except criminal matters and administrative decisions can be found in the Code. But the court system will continue to be divided into Civil, Economic, and Labor Courts. There are numerous changes in court jurisdiction. One important new addition to the jurisdiction of the courts is the power to determine the validity and enforceability of arbitration agreements. The courts are also given the power to settle issues stipulated in Vietnam's Ordinance on Commercial Arbitration.\textsuperscript{133} The Code makes changes to the types of matters that can be heard by the People’s Courts at the district and provincial levels. The value of the amount in dispute is no longer a deciding factor in which court may hear the case. Additionally, the provincial courts have jurisdiction over settlement of all arbitration cases, as well as recognition and enforcement of foreign arbitral awards and foreign judgments.\textsuperscript{134} Traditionally venue was proper in the domicile of the defendant or where the defendant's head office is located in the case of an enterprise.\textsuperscript{135} According to the Code, however, in a civil case involving economic disputes, the parties may now agree to submit the case to the domicile of the plaintiff or where the plaintiff's head office is located.\textsuperscript{136} In civil cases involving non-contractual damages, the plaintiff may bring suit in either their domicile, their head office, or where the event occurred.\textsuperscript{137}

The Code also lays out guidelines for the courts’ jurisdiction in cases involving foreign elements. Foreign elements are defined as when at least one party is not from mainland Vietnam, the transaction is governed by foreign law, or assets in dispute are located overseas.\textsuperscript{138} The following types of foreign element cases may now be heard in Vietnamese courts: defendants being foreign companies with management offices, branches, or representative offices established in Vietnam; defendants being foreigners who reside or work in Vietnam for a long time or who have assets in Vietnam; disputes involving foreign parties and disputes arising from transactions where the ground for establishment, change, or termination of the transaction is governed by Vietnamese law or where the transaction took place in Vietnam; transactions between Vietnamese parties where the ground for establishment, change, and termination of the transaction is governed by foreign law or where the transaction took place overseas; civil disputes in respect of immovable assets located in Vietnam; disputes arising from transportation contracts under which the transporters have

\begin{itemize}
\item \textsuperscript{131} Id.
\item \textsuperscript{132} Id.
\item \textsuperscript{133} Id.
\item \textsuperscript{134} Id.
\item \textsuperscript{135} Id.
\item \textsuperscript{136} Vietnam Economy, \textit{supra} note 130.
\item \textsuperscript{137} Id.
\item \textsuperscript{138} Id.
\item \textsuperscript{139} Id.
\end{itemize}
head offices or branches in Vietnam; and certain marriage and family disputes and other requests stipulated by the Code.

2. Statutes of Limitations

Prior to the implementation of the Code, the time in which a suit could be brought varied considerably. Economic disputes not covered by the Commercial Law had to be brought within six months, commercial disputes generally within two years, and there was no limitation period for most other civil disputes. The Code establishes a uniform two-year statute of limitations time period for all civil cases unless a law specifically provides otherwise.\(^{140}\)

3. Civil Injunctive Action

Civil injunction actions, also called temporary emergency measures, are actions that parties may request of the court to protect evidence, control the distribution of assets, or safeguard the rights of a person:\(^{141}\) assigning minors to persons or organizations for care, feeding, and education; compelling a party to partially provide child maintenance support; compelling the partial payment of compensation in the case of infringement to life or health; compelling employers to make advance payment of salary, wages, compensation, or payment to employees for work-related accidents or occupational disease; suspending decisions on the dismissal of employees; confiscating assets; prohibiting transfer of disputed assets; prohibiting change of status of assets; permitting harvesting and sale of farm produce or other products; blockading bank and other accounts at credit institutions, the state treasury, or other places where money is kept; blockading assets of obligors; prohibiting or compelling the parties concerned to perform a specific action; and other temporary emergency measures stipulated by law.

Prior to the introduction of the Code parties could request temporary emergency measures, but only once a legal proceeding was already in progress. Parties may now request temporary emergency measures at the time they submit their petition or during the legal proceeding. This is significant because parties are no longer powerless to prevent their rights from being violated before the matter comes before a judge. The courts may also make any of the first five measures listed in the preceding paragraph on their own motion.\(^{142}\)

4. The Litigation Process in Civil Courts

The new Code makes a number of changes in the way in which a civil case may proceed. Under the old rules only the legal representative of a party to a civil case had access to court files. Some courts would limit a party's representative to taking notes from the files and would not allow photocopies to be made. Now both parties and their legal representatives may view files, take notes, and make any required photocopies.\(^{143}\) Moreover, under prior law, the time that a party had to respond to a petition filed against them varied from seven days to no limit at all, depending on the type of dispute involved. Now the court has three working days to notify all parties, and the parties have fifteen days from notification.

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140. Id.
141. Id.
142. Vietnam Economy, supra note 130.
143. Id.
to respond.144 The time in which a party could appeal also varied depending on the type of
dispute but now parties have fifteen days from the date of decision to file an appeal.

The Civil Procedure Code is an important step by the Vietnamese government in their
effort to improve the effectiveness of the legal system in addressing issues. As companies
and investors enter Vietnam they are sure to encounter problems ranging from tort law
suits to contract disputes. If followed by the government, this Code will greatly increase
the ease and the efficiency with which civil matters get resolved.

B. THE LAW ON BANKRUPTCY

The new law on bankruptcy went into effect on October 15, 2004, and replaced the Law
on Bankruptcy of Enterprise of December 30, 1993. The law applies to Vietnamese enter-
prises and to co-operatives established and operated in Vietnam. The new law updates the
bankruptcy provisions by providing for disciplinary procedures for false requests to enter
into bankruptcy and providing measures for the conservation of assets when bankruptcy
proceedings are initiated.145 Specifically, the following transactions are deemed invalid once
bankruptcy has been filed:146 donations; gift of real assets and movable properties; payment
of debts before they are due; mortgages; and pledge of debts made within three months
before the date of handling a case by the court.

In addition, the Court has authority to take temporary emergency measures to preserve
the assets of the enterprise or co-operative. Such measures may include the freezing of bank
accounts, sealing stores, and protecting records.147

C. THE LAW ON CREDIT INSTITUTIONS

Amendments to the Law on Credit Institutions took effect on October 1, 2004, altering
the former law passed in 1997. Two of the largest changes involve foreign investment in
and ownership of credit institutions and the liberalization of lending policies. Prior to the
amendments, foreign credit institutions were limited to establishing joint ventures, opening
branches of foreign banks, and owning non-banking credit institutions. The new law allows
for the creation of 100 percent foreign-owned banking institutions.148 In addition, foreign
credit institutions may now purchase shareholdings in credit institutions already operating
inside the country.149 Lending policies have also been liberalized. For the first time a credit
institution will be allowed to make its own decision on what qualifies as loan security. This
should open the door to more creative lending practices in the country. The amendment
also provides credit institutions with the right to use and sell assets pledged as security.150

Although it is still the position of the government that state-owned credit institutions
take the lead in the Vietnamese monetary market, the market has been liberalized to allow
foreign credit institutions to operate.

144. Id.
146. Id.
147. Id.
149. Id.
150. Id.
D. Vietnam Modernization

Since 2001, Vietnamese authorities have been committed to modernizing the economy through structural reform. An overhaul of the process through which civil disputes are settled is an important step in achieving that goal. Bankruptcy, as unpleasant as it may be, must be dealt with and Vietnam has taken measures to protect creditors and help foster credit practices. These steps combined with the increased incentive for foreign credit institutions to enter the Vietnamese market help create an environment ripe for economic growth.

151. See CIA: Vietnam, supra, note 125.