

# On Foreign-affiliated Companies Adopting the Form of Limited Liability Company in Japan

— Focusing on Accounting System of Company Law —<sup>1</sup>

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《Table of contents》

- I. Introduction
- II. Outline and examples of foreign-affiliated companies<sup>2</sup> in Japan
- III. Differences in the calculation document and auditors system; between the Stock Company and the Limited Liability Company
- IV. How should we do it?
- V. Conclusion

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1 This paper is based on the lecture content of the author in a seminar held at the Kyungpook National University in Daegu, Republic of Korea, on March 14, 2019. Holding this seminar, Prof. Dr. Seongho Bae of Kyungpook National University, School of Business Administration, his colleagues and many assistants gave me a great deal of support. I express my appreciation for writing it here.

2 “Foreign-affiliated companies” in this paper are based on the definition in “Survey on Trends in Foreign-Affiliated Companies” implemented by the Ministry of Economy, Trade and Industry in Japan. In this survey, companies that fall under any of the following requirements are foreign-affiliated companies:’ The survey covers companies that satisfied the following conditions as of the end of March of each year. (a) A company in which more than one third of shares or holdings is owned by foreign investors, and in which the principal foreign investor’s direct investment ratio is more than 10%. (b) A company funded by a domestic company (in Japan) in which more than one third of shares or holdings is owned by foreign investors, in which the total ratio of the foreign investors’ direct and indirect investment is more than one third of the shares or holdings of the company concerned, and in which the principal foreign investor’s direct investment ratio is more than 10%.’ For details, refer to the website of the Ministry of Economy, Trade and Industry (<http://www.meti.go.jp/>).

## I . Introduction

It is said that the purpose of accounting in a company is as such below<sup>3</sup>: 1. To ensure company continuity (sometimes it is called in Japan as ‘Going Concern’), 2. To appropriately distribute property owned by the company and 3. To clarify the responsibility for those who are entrusted with management from the shareholder, who is the substantial owner of the company. However, the law does not need to be involved in the above-mentioned first one because even if the law is once revised, ‘to ensure company continuity’ is fundamentally to be executed by the company’s voluntary efforts, which means, law amendment cannot make companies get a great deal of profit and the economic situation improve. Therefore, the purpose of the accounting system required under one legal system is as such concluded below: 1. To determine the limit of property distribution which the company has, 2. To disclose the information toward shareholders and cooperate creditors<sup>4</sup>.

However, under the Japanese Companies Act<sup>5</sup>, whereas the Stock Company shall publish the Financial Statements (Art. 440-

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3 KURASAWA Yasuichiro, ‘Shouhou no Kiso (revised ver.)’, Zeimukeirikyokai, 1991, ISBN4419015675, p.165.

4 EGASHIRA Kenjiro, ‘Kabushiki Kaisha Hou (7<sup>th</sup> ed.)’, Yuuhikaku, 2017, ISBN9784641137868, p.599, TANAKA Wataru, ‘Kaisha hou’, Tokyo University Press, 2016, ISBN9784130323727, pp.365.

5 Companies Act, Act No. 86 of 2005; in this paper, unless otherwise specified, the provisions of Companies Act shall be quoted with only the number of articles.

In this paper, as refer to Japanese statutory law, we referred to the web site (<http://www.japaneselawtranslation.go.jp/>) operated by the Ministry of Justice. However, the contents of this website are not an official statement, so be sure that you need to read the contents of the original text written in Japanese in order to know more accurate information on the text.

1<sup>6</sup>), the Limited Company is not be obligated to publish them. Therefore, regardless of the size of capital amount, it may be possible to adopt the form of a Limited Company unless they need to separate ‘ownership and management’ and unless they plan to release shares. In other words, even a company that has socially extremely significant influence does not have to undergo accounting audits by adopting the form of a Limited Liability Company, resulting in “*escaping from audit*”.

In this paper, with consideration of foreign-affiliated companies that adopt a Limited Liability Company format in Japan, we will consider whether “large-scale Limited Liability Company” auditing to publish them or not.

## II. Outline and examples of foreign-affiliated companies in Japan

About 2.7 million corporate enterprises in Japan are said to exist in 2015<sup>7</sup> and the outstanding amount of direct investment in Japan is 28,554.5 billion yen in 2017<sup>8</sup>. In 2017 the Ministry of Economy, Trade and Industry conducted a survey under the name “Foreign-affiliated

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6 Article 440 (1) A Stock Company shall give public notice of its balance sheet (or, for a Large Company, its balance sheet and profit and loss statement) without delay after the conclusion of the annual shareholders meeting pursuant to the provisions of the applicable Ordinance of the Ministry of Justice.

7 According to the data published by the Statistics Bureau, which is positioned as an external bureau of the Ministry of Internal Affairs and Communications in Japan. (<http://www.stat.go.jp/>), ‘NIHON NO TOUKEI (Data in Japan)’ Chap7-7, ‘Accounting situation of corporate enterprise’.

8 Japan External Trade Organization, JETRO, ‘JETRO invest Japan Report 2018’. [https://www.jetro.go.jp/ext\\_images/invest/ijre/report2018/pdf/report2018\\_1.pdf](https://www.jetro.go.jp/ext_images/invest/ijre/report2018/pdf/report2018_1.pdf)

company trend survey”, where 3217 foreign-affiliated companies responded. Although, among these foreign-affiliated companies, the number of companies adopting the form of a Limited Liability Company is unknown, let us at first illustrate some famous companies that adopt the form of a Limited Liability Company among foreign-affiliated companies in Japan as such below;

### 1. AMAZON. COM, INC <sup>9</sup>

AMAZON. COM, INC was founded in the United States in 1994 by Jeffrey P. Bezos<sup>10</sup>. In Japan, that corporation was founded in July 2000<sup>11</sup>.

Annual Year	AMAZON. COM, INC	Amazon Japan G.K. (in Japan)
2016	\$135,987 (100%)	\$10,797 (7.4%)
2017	\$177,866 (100%)	\$11,907 (6.7%)
2018	\$232,887 (100%)	\$13,829 (5.9%)

[Tab.1 Sales of AMAZON. COM, INC and Amazon Japan G.K. (unit: *million*) ]

As shown in Table 1 above, the sales of Japanese corporation, Amazon Japan G.K.<sup>12</sup> is \$10,797 million in 2016, \$11,907 million in 2017 and \$13,829 million in 2018<sup>13</sup>. Worldwide sales of Amazon,

9 Regarding the business situation data of AMAZON.COM, INC, Electric Data Gathering, Analysis and Retrieval, EDGAR, in the U.S.A. <https://www.sec.gov/edgar.shtml> AMAZON.COM, INC (10-K), Commission File No. 000-22513. Below, in this paper, quoting with only the number of pages of this file.

10 Previous note 9, p.5.

11 According to the homepage of AMAZON JAPAN G.K. <https://www.amazon.co.jp/b?node=5121598051>.

12 Japanese ‘G. K.’ is an abbreviation for ‘Goudou Kaisha’ and means ‘Limited Liability Company’ as is stipulated in Article 575-1 of the Japanese Company Law.

13 Previous note 9, p.69.

AMAZON. COM, INC, is \$ 135,987 million in 2016, \$ 177,866 million in 2017 and \$ 232,887 million in 2018. Therefore, sales in Japan in the whole Amazon will be 7.4% in 2016, 6.7% in 2017 and 5.9% in 2018, respectively.

## 2. APPLE, INC<sup>14</sup>

Annual Year	APPLE, INC <sup>15</sup>	APPLE JAPAN G.K. <sup>16</sup>
2016	215,639 (100%)	16,928 (7.9%)
2017	229,234 (100%)	17,733 (7.8%)
2018	265,595 (100%)	21,733 (8.2%)

[Tab.2 Sales of APPLE, INC and Apple Japan G.K. (unit: *million*)]

As shown in Table 2 above, the sales of Japanese corporations, APPLE JAPAN G.K. is \$16,928 million in 2016, \$ 17,733 million in 2017 and \$21,733 million in 2018<sup>17</sup>. Worldwide sales of APPLE, INC, is \$215,639 million in 2016, \$229,234 million in 2017 and \$265,595 million in 2018. Therefore, sales in Japan in the whole Apple will be 7.9% in 2016, 7.8% in 2017 and 8.2% in 2018, respectively.

## 3. WALMART, INC<sup>18</sup>

Lastly, Seiyu is a Limited Liability Company that develops supermarkets in Japan. The company operated a supermarket by the Seibu Department Store etc. from the 1950's, but it became a

14 Previous note 9, Apple Inc. (10-K), Commission File Number: 001-36743, 2018.

15 Previous note 14, p.21

16 Previous note 14, p.26

17 Previous note 14, p.69.

18 Previous note 9, WALMART, INC. (10-K), Commission file number 001-6991, 2018.

subsidiary company of WALMART in the U.S. in 2005.

Annual Year	WALMART, INC <sup>19</sup>	SEIYU G.K.
2016	500,343 (100%)	No data
2017	485,873 (100%)	No data
2018	482,130 (100%)	No data

[Tab.3 WALMART, INC and SEIYU G.K. (unit: *million*)]

As shown in Table 3 above, sales of WALMART are 500,343 million dollars in 2016, \$485,873 million in 2017, and \$482,130 million in 2018, respectively. According to the company profile of the joint company Seiyu's homepage<sup>20</sup>, the Seiyu G.K. has 335 stores nationwide, as of January 1, 2019, but their amount of sales is unknown.

#### 4. Summary

While three examples are given above, all sales of these companies can only be grasped indirectly through the Electric Data Gathering, Analysis and Retrieval (*EDGAR*) in the U.S.A. Therefore, as for the grasp of sales in Japan, it is only announced as domestic sales through the EDGAR system. There are cases where annual sales in Japan can be inferred, such as AMAZON JAPAN, G.K. and APPLE JAPAN, G.K., but there are also cases where it is impossible to even guess such as Seiyu, G.K.

As described above, in the present situation, it is currently the some cases that the enterprise having a great significance in society never releases its sales. In this way, in order to confirm

19 Previous note 14, p33.

20 <https://www.walmartjapanseiyu.com/>

whether the circumstance that financial situation of the company is not disclosed is legal under the Japanese law, an overview of the provision of law on accounting documents and accounting audits on Japanese Limited Liability Companies should be confirmed. Therefore, in comparison with the provisions concerning the calculation documents of the Stock Companies, let us first confirm the provisions concerning the financial statements and the accounting auditor of the current law in Japan.

### **III. Differences in the calculation document system; between the Stock Company and the Limited Liability Company**

#### **1. In case of the Stock Company**

The Stock Company shall prepare the financial statements and the business report and the supplementary schedules thereof<sup>21</sup>. Then, it need to make public notice on the balance sheet<sup>22</sup>. In the case of breaching this obligation to public notice, it will be punished by a non-penal fine of 1 million yen or less<sup>23</sup>. In fact, however, it is said that most of the

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21 Art.435 (2) A Stock Company shall prepare Financial Statements (meaning balance sheets, profit and loss statements and other statements prescribed by the applicable Ordinance of the Ministry of Justice as necessary and appropriate in order to indicate the status of the assets and profits and losses of a Stock Company) and business reports for each business year and supplementary schedules thereof pursuant to the applicable Ordinance of the Ministry of Justice.

22 Art. 435 (1) A Stock Company shall give public notice of its balance sheet (or, for a Large Company, its balance sheet and profit and loss statement) without delay after the conclusion of the annual shareholders meeting pursuant to the provisions of the applicable Ordinance of the Ministry of Justice.

23 Art. 976 (1) (ii) Article 976 of the Companies Act stipulates that in case of breach of obligation to public notice, they shall subject to a fine of not more than 1 million yen.

small or medium-sized Stock Company are not in compliance with the obligation of public notice<sup>24</sup>. With regard to stored accounting documents, the company shall respond to requests for inspection, etc. in response to requests from shareholders and creditors<sup>25</sup>.

In addition to this, the Large Company<sup>26</sup> and Companies with Committees shall have an accounting auditor<sup>27 28</sup>. The accounting auditor, as well as directors, is appointed by a resolution of the Shareholders Meeting. The authority of the accounting auditor includes (1) accounting audit authority, (2) reporting obligation, and (3) opinion statement at the shareholders meeting.

## 2. In case of the Limited Liability Company

In the case of a limited liability company, it is necessary to prepare accurate accounting books in a timely manner, and important documents on accounting books and their business must be preserved

24 Previous note 4, TANAKA, p.396.

25 Art. 442 (iii) The shareholders and creditors may submit the following requests at any time during the business hours of the Stock Company...

(i) If the Financial Statements, Etc. are prepared in writing, requests for inspection of such documents or copies of such documents;

26 Art.2 (vi) "Large Company" means any Stock Company which satisfies any of the following requirements:

(a) that the amount of the stated capital in the balance sheet as of the end of its Most Recent Business Year (hereinafter in this (a) and (b) below referring to the balance sheet reported to the annual shareholders' meeting under the provision of Article 439 in cases provided for in the first sentence of such Article, and referring to the balance sheet under Article 435 (1) in cases where the first annual shareholders' meeting after the incorporation of the Stock Company has not yet been held) is 500,000,000 yen or more; or

(b) that the total sum of the amounts in the liabilities section of the balance sheet as of the end of its Most Recent Business Year is 20,000,000,000 yen or more;

27 Art. 328 (1) A Large Company (excluding a Company which is not a Public Company and a Company with Committees) shall have a board of company auditors and an accounting auditor.

28 Art. 327 (5) A Company with Committees shall have an accounting auditor.



for 10 years<sup>29 30</sup>. In addition, the Limited Liability Company must prepare the financial statements for each business year, and the obligation to preserve these for 10 years is imposed<sup>31</sup>. Regarding these documents, while no obligation to give public notice is imposed, it is necessary to respond to requests for inspection, etc. of partners, creditors, etc.<sup>32 33</sup>. Limited Liability Company is consisted only of Partners and they are also responsible for the business of that company<sup>34</sup> so that it can be expressed that *ownership and management* are not yet separated on this type of company. Therefore, in the case of Limited Liability Company, there is no regulation of the accounting auditor. This means that it is not illegal without conducting accounting

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29 Membership companies include three kinds of companies: General Partnership Company, Partnership Company and Limited Liability Company (G.K.: Goudou Kaisha in Japanese). c.f.) previous note 12.

Cf.) Art. 575 (1) In order to incorporate an General Partnership Company, Limited Partnership Company or Limited Liability Company (hereinafter collectively referred to as “Membership Company”), persons who intend to be its partners must prepare articles of incorporation which must be signed by or record the names of and be affixed with the seals, of all partners.

30 Article 615 (1) A Membership Company must prepare accurate accounting books in a timely manner as prescribed by the applicable Ordinance of the Ministry of Justice.

31 Art. 617 (4) A Membership Company must retain its financial statements for ten years from the time of the preparation of the same.

32 Art. 618 (1) Partners of a Membership Company may submit the following requests at any time during the business hours of such Membership Company:

(i) If the financial statements are prepared in writing, request for inspection or copying of such documents;...

33 Art. 625 Creditors of a Limited Liability Company may make the requests listed in each item of paragraph (1) of Article 618 with respect to its financial statements (limited to those prepared within the preceding five years) at any time during the business hours of the Limited Liability Company.

34 Art. 590 (1) A partner shall execute the business of the Membership Company, unless otherwise provided for in the articles of incorporation.

audits in the Limited Liability Company, and that the accounting audit by the accounting auditor is limited to an ‘arbitrary audit’. Therefore, under the current provisions of Companies Act, even if Limited Liability Company were to classified as a large company it does not need to have an accounting auditor.

	Stock Company	Limited Liability Company
Document types to be created	Calculation documents (balance sheet, income statement, statement of changes in shareholders' equity and individual notes), business report and supplementary schedules thereof (Art. 435-2. etc)	Calculation documents (balance sheet, income statement, statement of changes in employee capital etc. and individual notes)(Art.617-1)
Retention period	Save for 10 years (Art.435-4)	Save for 10 years (Art.615)
Request for inspection of financial statements	Obligations to respond to requests from shareholders and creditors (Art.442-3)	Obligation to respond to requests for inspection from partners and creditors (Art.618、Art.625)
Obligation to public announcement	Obligation to publish balance sheet (Art.440-1)	No obligation
Obligation to set up the accounting auditor	Large Company must have an accounting auditor (Art.327-5)	No need for an accounting auditor to be established. (arbitrary audit)

[Tab.4 Regulation of the calculation system between Stock Company and L.L.C]

### 3. Summary

In short, under current Japanese Companies Act, the Limited Liability Company does not need to have an accounting auditor. In addition, although the Limited Liability Company has an obligation to preserve the accounting documents within the company, there

is no obligation to publish them. Therefore, it is legitimate under the Japanese Companies Act that a foreign-affiliated company that has an extremely large business scale as exemplified above does not publish a statement of financial statements and does not established an accounting auditor.

However, the current law is not always the ideal company law. So let us examine which institution should be desirable as below.

#### **IV. How should we do it?**

##### **1. Should we impose an obligation to publish the financial statements to a large-scale Limited Liability Company?**

Under the current Companies Act, for a Limited Liability Company, no obligation to publish the financial statements such as the balance sheet is imposed. Therefore, even if the Limited Liability Company does not publish the financial statements, it can be said that it is legal under the Company Law. This is a system that responds to the request to keep the contents of the financial statements within the company in the case of Stock Company. Also, partners and creditors may also exercise their right to request the inspection of the financial statements to the Limited Liability Company so that there is no point lacking protection of stakeholders.

However, it can be said that the financial situation of a large company has a great influence on society, and furthermore, in particular, for a large-scale Limited Liability Company, a company in a weak position must subordinate to a company in a superior position. It seems that there is a problem in that it is practically impossible to request the inspection of the calculation documents from the creditors.

For example, when a Limited Liability Company requests financing for a bank to raise funds, it will voluntarily release the financial situation within the company, but in the opposite case, if the company is in a dominant trading position, it seems that it effectively block the request for inspection of the calculation documents from the counter-company.

Therefore, in this sense, in particular for a large-scaled Limited Liability Company, it is desirable to reorganize the system to impose obligation to publish the financial statements.

## **2. Should a large Limited Liability Company be required to audit the accounting auditor?**

On the other hand, I think that it is impossible to obligate Limited Liability Company to establish an accounting auditor. Certainly, as it is socially influential, it is desirable to oblige accounting audits experts as part of social responsibility. In fact, in Japan, it is obligatory to establish an accounting auditor for a large Stock Company or a Stock Company with committees. One of the reasons why establishing an accounting auditor in a large Stock Company is that the company size is large and, for companies with committees, it is stated that a highly specialized audit is necessary because a wide range of authority delegation is allowed to the executive officer<sup>35</sup>. In addition to this, there is also a legislative way in a country, where a limited liability company having a certain size or more must appoint an accounting auditor<sup>36</sup>. For these reasons, it can be said that it is

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<sup>35</sup> Previous note, TANAKA, p.147 and p149.

<sup>36</sup> For example, in France, there are provisions that it is necessary to appoint an accounting inspector if two or more of the three indicators of balance sheet total, sales, and workers are satisfied. See the essay by Chiaki UCHIDA, 'Account Auditor's responsibility to the company in France (1)' HOUSEI RIRON, NIIGATA Univ. ISSN0286-1577, vol.44-4, p163.

desirable to have an accounting auditor for a limited liability company having more than a certain size.

However, the institutions of the Limited Liability Company introduced in 2006 is a system that came from an example from the American L.L.C, where, in that company, the partner performs business operations in principle. What this means is that in a Limited Liability Company, ownership and management are unseparated, and the organ of the company is not clear. In addition, as it is understood from the wide range of autonomy of the articles of incorporation, it is a company form that allows almost free system design from the framework of various corporate law systems. Once we suddenly set up an accounting auditor there is no choice but to say that obliging the establishment of an institution is incompatible with the idea of the original Limited Liability Company. Therefore, there is no need to adopt the direction of system reorganization in the form of establishing an accounting auditor at a Limited Liability Company in Japan.

## V. Conclusion

In this paper, we briefly discussed the obligation to publish financial statements and the necessity of accounting audit at a Limited Liability Company, taking a foreign-affiliated company that adopts the form of a Limited Liability Company in Japan as an example. To summarize my argument, it is as follows.

First of all, the current practice of not making public announcement of financial statements at a Limited Liability Company is that it is legal under Japanese corporate law. This is true even if the

Limited Liability Company is a foreign-affiliated company.

Next, as a desirable institutional design, it is necessary for the *Large* Limited Liability Company to oblige publication of the financial statements.

Finally, in the case of a Limited Liability Company, since the institutional design of that is not as such, it is impossible to enforce the establishment of the accounting auditor irrespective of its scale.

The Limited Liability Company is a company form newly adopted by the establishment of the Companies Act in 2005. There, the autonomy of the articles of incorporation is widely acknowledged, so it has the characteristic that the free will of the founders is easily reflected. Indeed, the number of newly established Limited Liability Company is increasing steadily. It can be said that this will continue to carefully watch the trend of whether or not this will be an escape or departure from legal regulations of the existing Corporate Law.

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Stock Com	76,570	95,363	86,222	79,902	80,535	80,244	80,862	81,889	86,639	88,803	90,405	91,379
L.L.C	3,392	6,076	5,413	5,771	7,153	9,130	10,889	14,581	19,808	22,223	23,787	27,270

[Tab.5 Trends in the number of newly founds corporation  
with Stock Companies and Limited Liability Companies.]

According to Homepage of Ministry of Justice Japan, Registration statistics