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# Clarification of "Deemed Export" Controls under FEFTA
# - Revision of Service Notification -

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## I. Introduction

Efforts to enhance national security through economic measures have been on the rise in Japan in recent years. To control potential outflow of sensitive technologies which could compromise national security, the Japanese government has amended, effective May 1, 2002, the governmental notification known as the "Service Notification"[1] issued by the Ministry of Economy, Trade and Industry ("METI") on December 21, 1992. This amendment (the "Amendment") was issued in connection with the Foreign Exchange and Foreign Trade Act (the "FEFTA") to clarify the concept referred to as "deemed exports" which is embedded within Article 25(1) of FEFTA.

As a result of the Amendment even technology transfers within a corporation and technology transfers from universities to their foreign students, which were not covered by deemed export controls before the Amendment, have become subject to deemed export controls, provided that such transfers fall under the "Specific Categories" as described below.

This article comments on the deemed export controls and goes into selected details of the Amendment.

## II. Outline of Deemed Export Controls

The FEFTA specifies four types of foreign transactions to be controlled and/or coordinated in order to foster proper development of foreign transactions and the maintenance of peace and security both in Japan and abroad. The four types of foreign transactions are (1) Payment (Chapter 3), (2) Capital Transactions (Chapter 4), (3) Inward Direct Investments/Specific Acquisitions (Chapter 5), and (4) Foreign Trade (Chapter 6). Among these types, "deemed export controls" focused in this article constitute part of controls on service transactions included in (2) Capital Transactions above.

Article 25(1) of the FEFTA[2] addresses deemed export controls on "a transaction

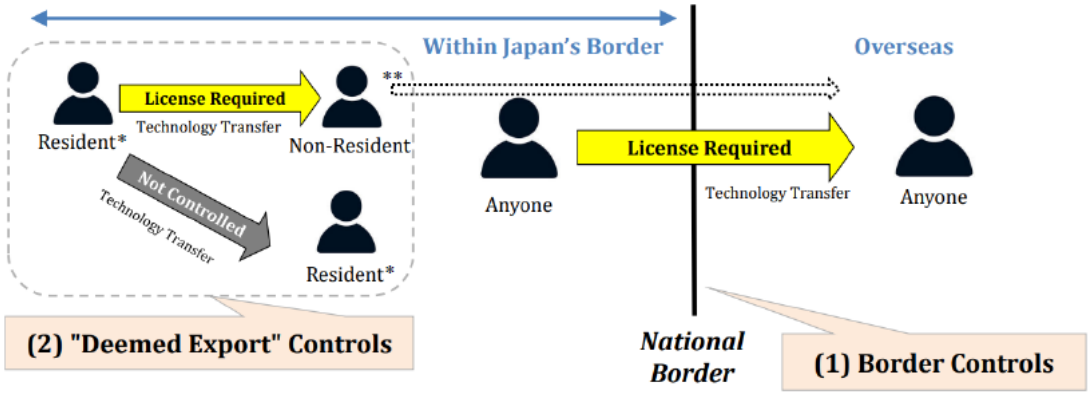
[1] *Regarding Transactions or Acts Involving Provision of Technologies that Requires Permission under the Provisions of Article 25(1) of the Foreign Exchange and Foreign Trade Act and Article 17(1) of the Foreign Exchange Order* (4TECB, No. 492, December 21, 1992).

[2] A tentative translation of Article 25(1) (available at: https://www.japaneselawtranslation.go.jp/ja/laws/view/3700) reads as follows:

A resident or non-resident that intends to conduct a transaction the purpose of which is to provide a

[conducted for] the purpose of [providing] specified technology to a non-resident belonging to a specified country,"[3] as well as border controls for transactions intended to provide specified technologies in a specified country,[4] and requires that any person who intends to conduct such transactions must apply for permission from METI. "Specified technologies" and "specified countries" referred to in Article 25(1) of the FEFTA are specified in Article 17(1) of the Foreign Exchange Order[5] and the table appended thereto.

○ Persons who were subject to Service Transactions Controls (Border Controls and Deemed Export Controls) before the Amendment.




*Foreign nationals whose period of stay in Japan has passed 6 months or who work at an office within Japan are treated as residents.

**High probability of eventually going out of the country and transferring of technologies overseas.

Source: *Regarding Security Export Control System* (Security Export Control Division, METI; 2022), page 12.

As described above, under the FEFTA, persons subject to deemed export controls are categorized as "residents" or "non-residents." The FEFTA defines "residents" as "natural persons domiciled or residing in Japan and juridical persons with principal offices in Japan" (non-residents' branch offices, local offices or other offices in Japan, irrespective of whether they have legal representative authority, are considered residents even when their principal office is located in a foreign state) (FEFTA, Art. 6, para. 1, item 5), and "non-residents" as "natural persons and juridical persons other than residents" (*id*, item 6). The FEFTA also

specified type of technology for designing, manufacturing, or using goods (hereinafter referred to as "specified technology") in a specified foreign country (hereinafter referred to as a "specified country"), which is specified by Cabinet Order as a transaction that is found to result in hindering the maintenance of international peace and security, or a resident that intends to conduct a transaction the purpose of which is to provide specified technology to a non-resident belonging to a specified country must, pursuant to the provisions of Cabinet Order, obtain the permission of the Minister of Economy, Trade and Industry for conducting the transaction.

[3]FEFTA, Art. 25, para. 1, the latter of the two types of controlled transactions.

[4]*Id*, the former of two types of controlled transactions.

[5]Cabinet Order No. 260 of Oct.11, 1980.

provides that, if it is not clear whether a person is a resident or non-resident, the applicable category will be determined pursuant to the criteria set out by the Minister of Finance (*id*, para. 2).

Such criteria for determining residency are stipulated in the governmental notification known as the "Notification of Interpretation"[6] as follows:

| | | |
|---|---|---|
| Japanese Nationals | Resident | Japanese nationals (considered to be a resident as a basic rule) |
| | | Japanese nationals who depart Japan and stay abroad for the purpose of working at Japan's diplomatic posts abroad. |
| | Non-resident | Japanese nationals who depart from Japan and stay abroad for the purpose of working at an office located in a foreign country (including overseas branches and locally-incorporated affiliates associated with Japanese juridical persons and international organizations). |
| | | Japanese nationals who depart Japan for the purpose of staying in a foreign country for two years or more and stay abroad. |
| | | Japanese nationals who have departed from Japan and stayed abroad for two years or more and do not fall within the two categories above. |
| | | Japanese nationals who fall under any of the three categories listed above and are temporarily staying in Japan (e.g., for business communication or during vacation) for less than six months after their return. |
| Foreign Nationals | Resident | Foreign nationals who work at an office located in Japan. |
| | | Foreign nationals who have stayed in Japan for 6 months or more after their entry. |
| | Non-resident | Foreign nationals (considered to be non-residents as a basic rule). |
| | | Foreign nationals who engage in public service of a foreign government or an international organization. |
| | | Diplomats or consular officers and their assistants or employees (only those who are appointed or employed in foreign countries). |
| | | United States armed forces[7] and persons and entities related thereto, including members and civilian components of the United States armed forces, dependents thereof, non-appropriated fund organizations, military post offices, military bank facilities and contractors. |
| | | United Nations armed forces[8] and persons and entities related thereto, |

[6] *Regarding Interpretation and Implementation of Foreign Exchange Laws and Regulations* (No. 4672, issued by International Bureau, Ministry of Finance on Nov. 29, 1980).
[7] As defined in Cabinet Order No. 127, 1952.
[8] As defined in Cabinet Order No. 129, 1954.

| | | |
|---|---|---|
| | | including members, civilian components, family members, non-appropriated fund organizations and military post offices, and persons or entities designated by the Minister of Finance as agreed between the government and United Nations armed forces. |

As described in the table above, according to the Notification of Interpretation, not only Japanese nationals are treated (as a basic rule) as residents, but also foreign nationals who work in offices located in Japan are categorized as residents. Therefore, before the Amendment, as a basic rule, technology transfer between Japanese and foreign nationals conducted internally within a company fell outside deemed export controls. In addition, in some cases, technology transfers from universities or other research institutions to foreign nationals who stayed in Japan for 6 months or more were not considered subject to deemed export controls because, in accordance with the Notification of Interpretation, such foreign nationals were categorized as residents.

## III. Outline of the Amendment

### 1. Background

Before the Amendment, transactions subject to deemed export controls, i.e., transactions conducted for "the purpose of [providing] specified technology to a non-resident belonging to a specified country" (FEFTA, Art. 25, para. 1), were defined and implemented narrowly under the deemed export controls rules, and residents were required to apply for permission only when they transferred technologies "directly" to non-residents.

Meanwhile, in an interim report issued on June 10, 2021 by the Subcommittee on Security Export Control Policy under the Industrial Structure Council's Trade Committee, which included comments for clarifying the implementation of deemed export controls rules, it was pointed out that the above-described way of control (i.e., the way of implementation before the Amendment) might be inadequate in cases where sensitive technologies flowed out internationally by means of transfer through persons. The report also suggested that, even when technologies were transferred to a resident, if such resident was under a strong influence of a non-resident to the degree that such transaction could be considered effectively as a transaction through which technological information was transferred from the resident to such non-resident, such technology transfer should be clearly included in the scope of deemed export controls.

### 2. Changes introduced by the Amendment

Responding to the comment made in the above-mentioned interim report, the government amended the Service Notification by clarifying that, even when technology is domestically transferred to a resident, such transfer will be subject to deemed export controls as "a

transaction [conducted for] the purpose of [providing] specified technology to a non-resident belonging to a specified country" (FEFTA, Art. 25, para. 1), as long as the case falls within the "Specific Categories," which refer to situations where the resident to whom technology is transferred is strongly influenced by a non-resident to the degree that such transaction can be considered effectively as a transaction through which technological information is transferred from resident to non-resident.

There are three Specific Categories, each in relation to persons, as specified below:

[Quoted from the amended Service Notification (not an official translation)]

(1) Any person who has entered into an employment, delegation, services or any other contract with a juridical person or other organizations established under foreign laws and regulations (collectively, "Foreign Organizations"), or with a foreign government, an agency thereof, a foreign local government, central bank, political party or other political organizations (collectively, "Foreign Governments") (together with Foreign Organizations, "Foreign Organizations and Governments"), and acts under directions and/or orders from such Foreign Organizations and Governments, or is under obligations to exercise due care of a good manager in relation to such Foreign Organizations and Governments, in accordance with the above-described contract (excluding the following cases):

(a) Where the above-mentioned person has entered into an employment, delegation, services or any other contract with a Japanese juridical person and acts under directions and/or orders from such Japanese juridical person or is under obligations to exercise due care of a good manager in relation to such Japanese juridical person in accordance with such contract, and it is agreed between such person or the Japanese juridical person and the relevant Foreign Organizations or Foreign Governments that the Japanese juridical person's directions and/or orders to such person, or such person's obligations to the Japanese juridical person to exercise due care of a good manager, prevail over the relevant Foreign Organizations' or Foreign Governments' directions and/or orders to such person or such person's obligations to the Foreign Organizations or Foreign Governments to exercise due care of a good manager; or

(b) Where the above-mentioned person has entered into an employment, delegation, services or any other contract with a Japanese juridical person and acts under directions and/or orders from such Japanese juridical person or is under obligations to exercise due care of a good manager in relation to such Japanese juridical person in accordance with such contract, and has entered into an employment, delegation, services or any other contract with any "Affiliated Foreign Juridical

Person" (meaning a foreign juridical person or other legal entity which directly or indirectly holds 50% or more of the voting rights in such Japanese juridical person, or 50% or more of the voting rights in which are held, directly or indirectly, by such Japanese juridical person; the same applies hereinafter) and acts under directions and/or orders from such Affiliated Foreign Juridical Person or is under obligations to exercise due care of a good manager in relation to such Affiliated Foreign Juridical Person in accordance with such contract.

(2) Any person who receives or has entered into an agreement to receive a large amount of money or any other substantial profits (meaning an amount of money or other forms of profits to the value that accounts for 25% or more of the person's annual income) from any Foreign Government.

(3) Any person who receives instructions or requests from Foreign Governments in respect of that person's activities in Japan.

Below are some practical examples of each Category:

Category (1): technology transfer to a Japanese company's employee who also works for a foreign company (excluding foreign-affiliated companies) not affiliated to it, and technology transfer to a Japanese company's director or company auditor who is also appointed as a director or a company auditor of such a foreign company.

Category (2): technology transfer to a student who receives funding from a foreign government for studying abroad, and technology transfer to a researcher who participates in a science and engineering talent acquisition program organized by a foreign government, receiving a large amount of research funding and/or payment for living.

Category (3): a person who conducts any activity in Japan on a specific assignment given by Foreign Governments. It is expected that, in practice, the transferor will be informed by METI of persons who potentially fall under this Category because, considering the nature of this Category, it should be difficult for transferors to discern whether the intended transferee falls under this Category, especially when the transferor is a private entity.

Consequently, in accordance with the Amendment, prior permission is required to transfer sensitive technologies subject to controls under the FEFTA to any natural person who falls within the Specific Categories, even when such person is a "resident."

### 3. Screening for the applicability to Specific Categories

When engaging in transactions intended for transferring technologies, the transferor must ascertain whether any of the Specific Categories applies to the intended transferee, to the extent that this can be confirmed as a result of exercising ordinary care. The transferor will be deemed to have exercised ordinary care if screening is performed in accordance with Appended Table 1-3 to the Service Notification (titled as "Guidelines for determining the applicability to the Specific Categories"), in which case the transferor will not be subject to criminal or administrative sanctions or penalties under the FEFTA, even when the transferor has missed the fact that the Specific Categories apply to the transferee.

For readers' information, the gist of Appended Table 1-3 to the Service Notification is summarized in the table below:

| | **If the transferee is not under the transferor's directions/orders:** | **If the transferee is under the transferor's directions/orders:** | **Applies to all cases** |
|---|---|---|---|
| **Categories (1) and (2)** | When it is evident that the transferee falls within the Specific Categories from information shown in documentation that is usually obtained during transactions involving technology transfer in accordance with the prevailing commercial practice (e.g., a written agreement). | When applicability of the Specific Categories is ascertained by implementing the following methods:<br>**Upon hiring:**<br>By self-declaration.<br>*Not required if already employed at the time of the enforcement of the amended Service Notification.<br>**During employment:**<br>By imposing obligations to report when becoming applicable to the Specific Categories. *Including cases where acting under conflict of interest, e.g., a job on the side, is prohibited or subject to application under the rules of employment. | When METI informs the transferor of potential applicability to Specific Categories. |
| **Category (3)** | When it is evident that the transferee falls under the Specific Categories from information shown in documentation that is usually obtained during transactions involving technology transfer in accordance with prevailing commercial practice (e.g., a written agreement). | | |

Source: *For Clarification of "Deemed Export" Control* (Trade Control Department, METI), page 10.