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# Equity Finance 2026

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**Japan: Law and Practice**

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# JAPAN




## Law and Practice

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## Contents

1. Equity Finance Techniques and Structures P.4
1.1 Early-Stage Venture Capital Financing p.4
1.2 Growth and Private Equity Financing p.4
1.3 Public Equity Markets p.5
1.4 Equity Restructurings p.5
1.5 Corporate Governance p.6
1.6 Mix of Debt and Equity Financing p.6

2. The Equity Finance Market P.8
2.1 Types of Equity Finance p.8
2.2 Equity Finance Providers and Potential Restrictions on Them p.8
2.3 Equity Finance Seekers p.10
2.4 Deal Flow and Size p.10
2.5 Private Equity Versus Public Equity p.11
2.6 Deal Sourcing and Market Players p.11
2.7 Exit Considerations and Realisations p.12
2.8 Equity Finance Versus Debt Finance p.12
2.9 Time Required for Equity Finance p.13

3. Regulation and Related Legal Issues P.14
3.1 Investment Restrictions p.14
3.2 Repatriation of Money and Limitations on Capital Flows p.14
3.3 AML and Sanctions Regulation p.15
3.4 Choice of Law and Jurisdictions p.15
3.5 Noteworthy Regulatory Trends p.16

4. Tax P.16
4.1 Withholding/Capital Gains Tax p.16
4.2 Other Taxes, Duties, Charges or Tax Considerations p.17
4.3 (Double) Tax Treaties p.17

5. Bankruptcy and Insolvency P.18
5.1 Impact of Insolvency Processes on Shareholder Rights p.18
5.2 Seniority of Investors in Distributions p.18
5.3 Length of Insolvency Process and Recoveries p.19
5.4 Rescue or Reorganisation Procedures p.20
5.5 Risk Areas for Equity Investors p.21

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# 1. Equity Finance Techniques and Structures

## 1.1 Early-Stage Venture Capital Financing

### Priced Preferred Rounds

Japanese venture financing typically uses the *kabushiki kaisha* (KK) and the class-share system under the Companies Act. Priced preferred share rounds are common from Series A onwards, although preferred shares are also used in some seed financings.

Documentation generally includes an investment agreement, a shareholders' agreement involving the company, founders and major investors, and a separate agreement on shareholder distribution for acquisition (*zaisan bunpai keiyaku*) involving the company and all shareholders, including founders. The latter typically contains drag-along rights and deemed-liquidation provisions applying the agreed liquidation waterfall to an M&A exit. The articles of incorporation are also amended to set out the preferred share terms.

A 1x participating liquidation preference remains common in Japan, although non-participating terms are also used. Other customary terms include anti-dilution protection and conversion into common shares for an initial public offering (IPO). Historically, conversion has generally occurred around the listing application, before listing. The Ministry of Economy, Trade and Industry (METI)'s 2025 supplementary guidelines (see **2.7 Exit Considerations and Realisations**) advocate conversion on the listing date, preserving preferred-share protections until listing occurs. Investor protections are provided through contractual rights and class-share provisions in the articles (see **1.5 Corporate Governance**).

### Convertible Equity Rather Than Convertible Loans

Hybrids are widely used at pre-seed and seed stage, but they take a distinctively Japanese form. Instead of convertible notes, most start-ups issue convertible equity structured as stock acquisition rights (*shinkabu yoyakuken*) sold for cash. The best-known template is J-KISS, an open-source form under which the investor pays the subscription price up front and receives the right to convert into the shares issued in the next priced round at a discount (typically 20%) and/or a valuation cap. The instrument is booked as net assets rather than debt, carries no interest or maturity default, and can be closed in days because no valuation negotiation or articles amendment is required.

Convertible bonds and true mezzanine are comparatively rare at early stage, appearing mainly where a bank-affiliated or corporate investor wants creditor status. Experience has shown that most rounds below roughly JPY100 million use J-KISS-type instruments or common shares; from Series A onwards priced preferred shares dominate. Venture debt is discussed in **1.6 Mix of Debt and Equity Financing**.

## 1.2 Growth and Private Equity Financing

### Growth Equity

Growth equity provides expansion capital to more established businesses, typically through minority investments. For start-ups, preferred shares and the investment and shareholders' agreements described in **1.1 Early-Stage Venture Capital Financing** remain relevant. Investor protections may include liquidation preferences, consent rights over specified matters and information rights, with terms negotiated for each investment.

### Private Equity Buyouts

Buyouts involve acquiring control, often through an acquisition vehicle funded with sponsor equity and acquisition debt. Japanese transactions include corporate carve-outs, business-succession acquisitions and public-to-private deals. For listed targets, a take private commonly involves a tender offer followed, where necessary, by a squeeze-out through a statutory share sale demand or share consolidation.

### How the Two Differ and Why

The principal distinction is the investment's purpose and the degree of control acquired. Venture and growth investments generally provide capital for business development while leaving investors with minority stakes; contractual and class-share rights therefore play an important protective role. Buyouts transfer control and enable the sponsor to direct governance and business strategy. Where acquisition debt is used, the target's capacity to service that debt is central to the structure. Growth equity thus retains features of venture financing while supporting businesses at a more developed stage.

## 1.3 Public Equity Markets

### The Listing Process

The Tokyo Stock Exchange (TSE) operates three markets for general investors – Prime, Standard and Growth – and the TOKYO PRO Market for professional investors. A domestic IPO on the general markets normally requires:

- audited financial statements for the two preceding fiscal years;
- an underwriting review by the lead manager;
- a TSE listing examination; and
- a securities registration statement under the Financial Instruments and Exchange Act (FIEA).

The standard TSE examination period is three months for Prime and Standard and two months for Growth. Book-building and subscription follow, with listing commonly occurring about one month after approval. Post-listing obligations include:

- statutory annual and semi-annual reporting;
- TSE quarterly financial and timely disclosure; and
- internal control reporting.

The Corporate Governance Code, streamlined in July 2026, applies on a comply-or-explain basis, with Growth companies subject to its basic principles.

### Relevance of the Public Markets

Public markets remain an important financing and exit route. Japan recorded 66 new listings on its general markets in 2025, compared with 86 in 2024; 41 were on Growth. This count includes transfers from TOKYO PRO Market to the general markets. IPO size increased: the median market capitalisation of Growth IPOs at the offer price rose from JPY5.9 billion in 2024 to JPY10.2 billion in 2025.

### The Decision to List

An IPO has historically been a prominent exit route for Japanese start-ups, offering shareholder liquidity, access to capital and greater visibility with customers and recruits. Companies must weigh these benefits against continuing disclosure and governance costs.

From financial year-ends falling on or after 1 March 2030, Growth companies listed for at least five years will be subject to a JPY10 billion market-capitalisation maintenance requirement, with an improvement period and transitional relief. This makes sustainable post-IPO growth an important consideration in deciding when to list.

Private-market financing options are also expanding. FIEA amendments enacted in July 2026 will, from 1 April 2027, raise the securities-registration exemption threshold from JPY100 million to JPY500 million, permit simplified registration statements for offerings of JPY500 million or more but below JPY1 billion, and broaden eligibility for professional-investor private placements. Earlier reforms, implemented in 2024–25, eased entry requirements for certain unlisted-securities intermediaries and trading platforms, supporting alternatives to an early IPO.

## 1.4 Equity Restructurings

### Down Rounds and Recapitalisations

Down rounds may trigger anti-dilution adjustments under existing preferred-share terms. Changes to liquidation preferences or other rights may also be negotiated, subject to applicable corporate approvals and contractual consents. Applying an existing adjustment formula does not itself require an amendment to the articles; changes to class rights may require shareholder and class approvals.

### Capital Reductions and Sponsor Injections

Accumulated losses may be covered by reducing stated capital and applying the resulting other capital surplus against the deficit through a separately approved appropriation of surplus. The capital reduction generally requires a special shareholder resolution and a creditor objection period of at least one month; an ordinary resolution suffices at an annual meeting where the reduction does not exceed the statutory deficit. These accounting adjustments neither increase net assets nor extinguish shareholders' rights. A restructuring may separately eliminate or dilute existing equity and introduce sponsor funding, through a court-approved plan or an out-of-court transaction with the requisite approvals.

### Debt-to-Equity Swaps

A debt-to-equity swap converts debt into equity without providing fresh cash. Where implemented as a

contribution in kind, no court-appointed inspector is required if the claim is due and its agreed contribution value does not exceed the debtor company's carrying amount of the corresponding liability. Valuation and tax treatment require care: a swap may generate taxable debt-forgiveness income.

For TSE-listed companies, third-party allotments involving voting-right dilution of 25% or more, or a change in controlling shareholder, generally require an independent opinion on necessity and appropriateness or a procedure to confirm shareholders' intentions.

## 1.5 Corporate Governance

### Statutory Framework

The Companies Act sets the baseline. Directors are generally appointed and removed by a majority of the voting rights held by shareholders present at a quorate shareholders' meeting, subject to statutory exceptions and any higher approval threshold in the articles. Amendments to the articles, mergers and share issuances on particularly favourable terms generally require a special resolution supported by at least two thirds of the voting rights represented at a quorate meeting. In non-public companies, share issuances generally require a special resolution even without particularly favourable terms, unless validly delegated. Business decisions and execution are allocated among directors, the board and executives according to the company's governance structure.

The Act permits class shares with different voting rights and class-consent requirements over specified matters. Non-public companies – those whose shares are all transfer-restricted – have additional flexibility, including shareholder-specific arrangements in the articles concerning dividends, distributions of residual assets and voting rights, and, except in companies with nominating and other committees, class rights to elect directors.

### Contractual Overlay

In practice, equity holders rely on a shareholders' agreement layered over the articles. Such agreements are valid and binding among the parties, but a breach does not invalidate the corporate act itself; remedies are damages and, in some cases, injunctions. Investors therefore embed the protections that matter most – vetoes and, in venture deals, director appointment rights – in the class-share terms, and leave the rest to contract.

### Typical Investor Rights

Typical rights include the following.

- *Information* – Monthly management accounts, audited annual financial statements within a fixed period, annual budgets, inspection rights and a board observer seat, with confidentiality undertakings.
- *Decision-making* – Board seats for lead investors; prior consent of an investor majority (or named investors) over reserved matters such as share and option issuances, changes to the articles, borrowings above a threshold, M&A, disposals of material assets or IP, related-party transactions and changes of business; founder covenants on full-time commitment, non-competition and IP assignment.
- *Exit* – A best-efforts obligation on the company and founders to achieve an IPO by a target date; tag-along and drag-along rights (drag typically requires an investor majority plus founder consent); rights of first refusal over founder shares; a buy-back right against founders for serious breach, which METI's model agreements have encouraged parties to limit to wilful misconduct; and the liquidation preference itself.

For listed companies, the Corporate Governance Code and TSE rules add requirements such as one-third independent directors on the Prime market and minority protections where a controlling shareholder exists.

## 1.6 Mix of Debt and Equity Financing

### Market Practice

Shareholder loans are used alongside equity in joint ventures and private equity structures, with repayment and subordination terms tailored to the financing arrangements. Japan Finance Corporation offers subordinated capital loans that financial institutions may treat as equity for credit-assessment purposes, subject to programme conditions.

### Venture Debt

Venture debt is a form of debt financing provided to VC-backed, growth-stage start-ups by banks, their affiliates or venture debt funds, typically accompanied by stock acquisition rights (warrants), and is increasingly used in Japan. Unlike conventional loans, which rely on existing cash flow and collateral, venture debt relies on the borrower's prospects of raising further equity. It is therefore often provided at or shortly after an equity financing round, complementing rather than bridging equity financing. Start-ups can extend their runway with limited dilution, but must repay principal and pay interest, and excessive borrowing may deter investors in subsequent rounds. Warrants typically cover relatively few shares and are therefore less dilutive than convertible debt.

The Japanese market remains less developed than that of the USA. However, banks have begun offering loans with stock acquisition rights as standard products, bank-affiliated and independent venture debt funds have been established, and later-stage companies have obtained large syndicated loans and committed credit facilities. Typical loans range from JPY100 million to JPY300 million or more, with terms of two to five years, and interest rates lower than those in the USA. The enterprise value charge introduced in May 2026 (see **2.8 Equity Finance Versus Debt Finance**) is expected to provide credit support comparable to the all-asset security commonly used in the USA.

Under Japanese law, venture debt is structured either as a loan with stock acquisition rights or as a subscription for bonds with stock acquisition rights. Only banks and other licensed financial institutions or registered money lenders may extend loans as a business, whereas no money-lending registration is required merely to subscribe for bonds, making the latter more accessible to funds and operating companies. For loans with stock acquisition rights, a key issue has been whether the rights constitute "interest" under the Interest Rate Restriction Act and the Act Regulating the Receipt of Contributions, Receipt of Deposits and Interest Rates, and therefore count towards the statutory interest rate caps. A February 2026 report by a study group with the Japanese Bankers Association as secretariat states that, under typical product structures, the rights may constitute interest and sets out methods for valuing them and converting their value into an annual interest rate. It also indicates that the rights may be treated as not constituting interest where the lender pays fair value for them or where they are held as security and waived upon repayment of the loan. Banking groups exercising the rights must also comply with the 5% voting rights limits under the Banking Act and the Antimonopoly Act.

### Legal Considerations

A loan is not automatically subordinated merely because the lender is a shareholder. Its ranking depends on security, contractual subordination and applicable insolvency rules. Repayments and security grants may be challenged under statutory avoidance provisions. Shareholder-creditors may participate in civil rehabilitation as creditors, although voting rights are subject to statutory limitations, including those applicable to contractually subordinated claims.

Related-party loans require an assessment of directors' conflicts of interest. Where the Companies Act's conflict-of-interest provisions apply, material facts must be disclosed and approval obtained from the shareholders or, in a company with a board, the board. Money-lending registration requirements should also be checked, although qualifying intra-group and joint-venture loans benefit from exemptions.

Loans by foreign investors with terms exceeding one year may constitute inward direct investment under the Foreign Exchange and Foreign Trade Act (FEFTA) if the statutory thresholds and other conditions are met. Prior notification may be required, particularly where the borrower operates in a designated sector (see **3.1 Investment Restrictions**).

### Tax Considerations

Interest is generally deductible, unlike dividends, but remains subject to applicable limitations. These include thin-capitalisation rules, generally based on a 3:1 ratio of relevant debt to the foreign controlling shareholder's equity interest, and earnings-stripping rules limiting deductions for in-scope net interest exceeding 20% of adjusted taxable income, subject to exemptions and carryforward rules. Cross-bor-

der related-party interest must satisfy arm's length requirements.

Japanese-source loan interest paid to a non-resident or foreign corporation generally attracts 20.42% withholding tax, subject to applicable exemptions or treaty relief. A subsequent loan waiver may generate taxable debt-forgiveness income, depending on available exclusions and loss relief (see **1.4 Equity Restructurings**).

## 2. The Equity Finance Market

### 2.1 Types of Equity Finance

#### Scope of the Term

In Japan, "equity finance" is generally understood to mean raising risk capital through the issuance of shares under the Companies Act, most commonly by way of third-party allotment and, less frequently, by way of allotment to existing shareholders (rights offerings) or public offerings. In practice, the term also covers instruments that convert into shares, as well as sales of existing shares to financial sponsors.

#### Methods in the Private Market

The following methods are used in the private market.

- Class (preferred) shares carrying liquidation preferences, anti-dilution protection, consent rights and put/drag arrangements have become standard from Series A onwards. Common shares remain typical at the seed stage.
- Convertible instruments: paid share acquisition rights (*yūshō shinkabu yoyakuken*) are the principal hybrid instrument (see **1.1 Early-Stage Venture Capital Financing**). Bonds with share acquisition rights are used for larger investments.
- Mezzanine capital (preferred shares and subordinated loans) is used mainly within LBO capital structures and in restructurings, rather than in growth-stage financing.

#### Market Maturity

The buyout segment is the most developed. The venture segment is comparatively small. The public market is mature but shrinking in terms of deal numbers (see **2.4 Deal Flow and Size**).

### 2.2 Equity Finance Providers and Potential Restrictions on Them

#### Providers of Equity Capital

The following provide equity financing.

- Global and Japanese independent venture capital (VC) firms, corporate venture capital (CVC), bank-affiliated and securities-affiliated VC funds, university-affiliated VC funds, and government-affiliated investors such as the Japan Investment Corporation (JIC) and the Development Bank of Japan (DBJ). CVC investors have a particularly strong presence in Japan. In October 2026, the leading US venture capital firm Andreessen Horowitz (a16z) opened an office in Japan.
- Global and Japanese private equity (PE) buyout firms. Global PE and alternative investment firms, including Blackstone, Carlyle, KKR and other major firms, are highly active in Japan, accounting for eight of Japan's ten largest PE investments in 2025 (considering only M&A transactions involving take-privates or carve-outs; see the JFSA's *Progress Report 2026*). Many Japanese PE firms have particular strength in small and mid-sized transactions, including business succession deals, and have generally managed smaller funds than their global counterparts, although some have also led large-cap transactions.
- Institutional and other investors committing capital to VC and PE funds as limited partners. These include public pension funds such as the Government Pension Investment Fund (GPIF), corporate pension funds, university endowments, life and non-life insurers, banks (including megabanks, regional banks and trust banks), co-operative financial institutions (including Norinchukin Bank), Japan Post Bank, Japan Post Insurance, JIC, DBJ, operating companies, family offices and high net worth individuals.
- Operating companies acquiring strategic minority or majority stakes through acquisitions or capital and business alliances, and angel investors. Equity crowdfunding platforms act as intermediaries connecting small issuers with individual investors, rather than as providers of capital themselves.

### Recent Changes

Fund formation in 2025 exceeded that of the previous year in terms of both number and total amount, but typical fund sizes decreased, with the total being driven up by a small number of very large funds. Investors have become more selective, and capital is concentrating in companies that can demonstrate traction.

### Growth of Japanese PE Firms

Japan has substantial capital available for investment in private markets. Household financial assets reached a record JPY2,519 trillion (approximately USD15.74 trillion at JPY160/USD) at the end of June 2026 (Bank of Japan), and the GPIF manages approximately JPY318 trillion (USD1.99 trillion at JPY160/USD). Nevertheless, relatively little capital flows into PE, VC and the broader start-up ecosystem, and many funds remain small.

The JFSA's Progress Report 2026 for Advancing Asset Management Services in Japan (24 July 2026) presents the views of major Japanese and global PE firms and major domestic LP investors. Most PE firms noted that domestic LP investors impose lower per-fund commitment limits than overseas investors, while many also observed that domestic LP investors favour diversification across multiple funds. Banks, in particular, make small commitments to numerous funds to secure LBO lending opportunities. Commitments per fund are typically only a few billion yen, with many institutions capping them at around JPY5 billion. Domestic LP investors account for an average of 73% of commitments to Japanese PE funds below JPY150 billion, compared with 36% for larger funds, reflecting Japan's narrower investor base and smaller institutional commitments. According to the interviews conducted by the JFSA, Japanese LP investors are predominantly banks subject to the capital adequacy requirements implementing Basel III in Japan, whereas overseas LP investors include larger pension funds, sovereign wealth funds, university endowments and insurers. Major Japanese PE firms argue that excessive diversification hinders competition and growth, and encourage LP investors to concentrate commitments in stronger managers.

Domestic LP investors, however, emphasise that larger transactions require different expertise, stronger value-creation capabilities and greater resources, including support for portfolio companies' overseas expansion. They also caution that rapid fund growth may undermine the repeatability of past performance. A major bank questioned whether Japanese PE firms can enhance the value of globally operating companies with revenues of JPY1 trillion as effectively as global PE firms.

The report recommends that Japanese PE firms seeking growth clarify their investment strategies, strengthen their organisations and demonstrate their capabilities through objective evidence. Domestic LP investors should assess managers on substance, allocate more capital to capable firms and build co-investment expertise. The government plans to strengthen asset-owner functions and the LP investment and co-investment capabilities of JIC and DBJ, rationalise bank investment restrictions, introduce a private-asset-focused investment trust framework with appropriate investor protections, and improve market infrastructure, including industry-wide PE benchmarks.

### Restrictions on Shareholders

There are no general restrictions on who may hold shares in a Japanese company, and there is no statutory minimum or maximum number of shareholders for private companies. The main constraints are as follows.

- *Foreign Exchange and Foreign Trade Act* (*FEFTA*) – Investments in designated business sectors require prior notification (see **3.1 Investment Restrictions**).
- *Sector-specific caps* – Principal examples include limits on the voting rights held by foreign nationals and entities to less than one fifth for terrestrial basic broadcasters (less than one third for basic broadcasting station providers) and less than one third for NTT and Japanese air carriers. These rules operate not by prohibiting the acquisition itself, but by allowing the issuer to refuse to record foreign shareholders exceeding the cap in its shareholder register.
- *Antimonopoly Act* – In principle, banks and insurance companies may not hold more than 5% and 10%, respectively, of the voting rights in a domestic company, and share acquisitions exceeding

statutory thresholds require a business combination filing.
- *Financial Instruments and Exchange Act* (*FIEA*) – Holding more than 5% of the shares of a listed company triggers an obligation to file a large shareholding report and, from 1 May 2026, any acquisition resulting in a holding of more than 30% of the voting rights requires a tender offer, including where the acquisition is made through on-market purchases.

## 2.3 Equity Finance Seekers

### Seekers of Equity Capital

The following are observed seeking capital in Japan.

- Early-stage companies – They must invest ahead of future growth and often lack stable cash flow to service debt, so equity and convertible instruments play a central role.
- Growth-stage companies preparing for listing – They raise funds in pre-IPO rounds from growth and crossover investors.
- Mature, often family-owned, mid-sized companies facing business succession issues – These companies typically sell control to a sponsor rather than issuing new shares. The average age of company presidents in Japan reached a record high of 60.8 in 2025, and the Small and Medium Enterprise Agency estimates that approximately 2.45 million SME owners will eventually be over 70 years old, approximately half of whom have not identified a successor.
- Listed companies – Equity fundraising by listed companies is relatively modest, and they rely more heavily on retained earnings and bank borrowing.

### Factors Driving the Choice Between Debt and Equity

The availability of collateral and stable cash flows is the dominant factor. As Japanese banks remain willing to lend against real estate and personal guarantees at interest rates that are still historically low (albeit now rising), asset-rich companies tend to prefer debt. Beyond that, the decisive questions are whether the owners will accept dilution and external governance, and whether the shareholders are seeking liquidity (in which case a sale of existing shares, rather than an issuance of new shares, is preferred).

### Most Active Segment

By value, the most active segment is sponsor-led acquisitions of mature companies (carve-outs, take-privates and business succession deals). By deal count, seed and early-stage venture rounds predominate.

## 2.4 Deal Flow and Size

### Venture and Growth Financing

Japanese start-ups raised approximately JPY761.3 billion, excluding debt, in 2025, broadly flat year on year. While the average per company was approximately JPY310 million, the median fell to JPY62.4 million, indicating an increase in small bridge rounds alongside concentration in a small number of large financings.

### Buyout Private Equity

Private equity deal value in 2025 reached JPY4.8 trillion (approximately USD30 billion), an increase of around 30% from 2024, exceeding JPY3 trillion for the fifth consecutive year. Deals of over JPY100 billion accounted for approximately 70% of value. Exit value increased to a record JPY2.4 trillion.

### Public Markets

IPO numbers are discussed in **1.3 Public Equity Markets**. Delistings resulting from going-private transactions such as management buyouts (MBOs) reached a record 125 companies, and the number of TSE-listed companies fell to 3,782.

### Latest Data (First Half of 2026)

Start-up fundraising in the first half of 2026 amounted to approximately JPY377.9 billion (excluding debt), an increase of 12% year on year; however, excluding a single very large AI-related financing, growth was only about 2%, and funding for later-stage (Series C) companies contracted. While M&A exits increased, IPOs declined further. In the public markets, 128 TSE delistings had already been confirmed for 2026 by early September 2026, exceeding the total for the whole of 2025.

### Drivers and Outlook

Governance reforms and the TSE's request for "management that is conscious of cost of capital and stock price" continue to drive carve-outs and take privates.

The buyout market is expected to remain robust and the venture market to remain selective, while secondary transactions and transactions combining primary and secondary components continue to increase.

## 2.5 Private Equity Versus Public Equity

### Private Equity

Recent trends in this segment are as follows.

- Take-private deals now account for approximately half of deal value, driven by governance reforms and pressure from institutional investors and activist shareholders.
- Returns have been strong compared with other markets, attracting new entrants and pushing up entry multiples in competitive processes.
- Carve-outs of non-core divisions are recovering, following guidance from METI and the TSE encouraging listed corporate groups to divest non-core businesses.

### Public Equity

The following recent trends have been observed.

- The number of listed companies declined for the second consecutive year as IPOs decreased and delistings reached a record high.
- Shareholder engagement and activism have become routine, and some issuers are choosing to go private to escape listing costs and ongoing scrutiny.
- As the TSE has embarked on reforms to reduce small-cap listings, IPOs are becoming larger (see **1.3 Public Equity Markets**).

### Which Segment Is More Important

The public markets remain dominant, both in terms of overall scale and as a benchmark for valuations and founders' goals. However, the centre of gravity of deal activity has shifted decisively to the private segment, which is now where corporate restructuring in Japan is being executed. For equity investors, this means that attractive opportunities increasingly lie in private transactions involving listed or formerly listed assets.

## 2.6 Deal Sourcing and Market Players

### How Deals Are Sourced

Deals are typically sourced in the following ways.

- *Start-ups* – Venture investment deals are sourced primarily through trusted referrals from existing investors, accelerators, university technology transfer offices, industry events and the like. Founder and investor networks tend to play a more important role than intermediated processes.
- *Large buyouts and carve-outs* – These are conducted through competitive auctions run by investment banks, increasingly involving structured processes and sell-side due diligence.
- *Mid-market and business succession deals* – Regional banks, accounting firms and specialist M&A intermediaries are the main sourcing channels, and proprietary deal sourcing through long-standing relationships with companies is highly valued.
- *Listed targets* – Since METI published its Guidelines for Corporate Takeovers in August 2023, unsolicited and semi-solicited acquisition proposals have become considerably more accepted. In July 2026, METI supplemented the guidelines by publishing a summary of key points and a Q&A, reflecting their increasingly frequent use in actual transactions.

### Pool of Advisers and Investors

Japan has a deep pool of professionals capable of handling both domestic and cross-border transactions, including leading domestic law firms, foreign law firms with offices in Japan, domestic and foreign investment banks, major accounting firms, and providers specialising in financial, tax and business due diligence.

### Practical Considerations

In practice, the availability of personnel to staff a deal, and language, can be more of a constraint than the capabilities of the professionals themselves. Transaction documents, data rooms and management meetings are often conducted in Japanese, and advisers and management personnel who can work fluently in both Japanese and English are limited. It is common for sponsors without a presence in Japan to partner with domestic investors or advisers, and regional financial institution networks are one of the important channels for sourcing SME business succession deals.

## 2.7 Exit Considerations and Realisations

### Typical Exit Routes

Typical exit routes are as follows.

- *Trade sales to operating companies or secondary sales to other sponsors* – By deal count, this is now the most common method of realisation for venture portfolios, and secondary buyouts are an increasingly important route for financial sponsors.
- *IPOs* – Traditionally the standard exit for Japanese venture investors and still the route that produces the highest headline valuations, although the number of listings has fallen and the qualitative hurdles have risen.
- *Buybacks by founders or the company* – These are often provided for in investment documentation, but recent METI guidance recommends against imposing personal liability on founders where the company and the founders are properly separated.
- *Secondary sales of unlisted shares* – Traditionally limited by constraints in market infrastructure, but infrastructure is being developed. Since 1 May 2025, amendments to the FIEA have made it possible to register for "special intermediary business for unlisted securities" (*hijōjō yūka shōken tokurei chūkai tō gyōmu*), a category of Type I Financial Instruments Business subject to lighter regulation. This business is specialised in intermediating transactions in unlisted securities principally with specified investors (professional investors) and, in principle, does not involve accepting deposits of money or securities from customers. Separately, under amendments that took effect on 21 November 2024, proprietary trading systems (PTS) that handle only unlisted securities and have a limited trading volume (aggregate trading value of no more than JPY60 billion per quarter) may now be operated on the basis of a Type I Financial Instruments Business registration without obtaining PTS authorisation. These amendments are expected to encourage new entrants and invigorate the secondary market for start-up shares.

### Recent Developments

The revised continued-listing criteria for the TSE Growth Market have made small listings less attractive, steering companies towards M&A or towards remaining private for longer.

METI's expanded guidelines on start-up investment agreements (published on 30 September 2025) encourage parties to revisit the Japanese practice of imposing IPO best-efforts obligations and founder buyback obligations, and to treat M&A as an equally legitimate exit. In May 2026, METI followed this with guidance on start-up M&A addressed to both sellers and buyers, recommending that companies plan for IPO and M&A in parallel from an early stage.

Mixed rounds combining the issuance of new shares with the sale of existing shares have become established as a capital structuring technique, and standalone secondary transactions are also beginning to emerge.

### Special Considerations

Drag-along and tag-along rights are purely contractual rights and are not easy to enforce against dissenting shareholders, so shareholders' agreements need to be drafted carefully. The acquisition of 100% of a listed company is typically structured as a tender offer (the first step) followed by a squeeze-out of the remaining shareholders (the second step). For the second step, a demand for share cash-out (*kabushiki tō uriwatashi seikyū*) is available, in principle, to a special controlling shareholder holding 90% or more of the voting rights (aggregating holdings of certain wholly owned subsidiaries, or such higher percentage as may be specified in the articles of incorporation); otherwise, a share consolidation approved by a special resolution of the shareholders' meeting is typically used. For MBOs and acquisitions of minority interests by controlling shareholders, the TSE's Code of Corporate Conduct, as amended with effect from 22 July 2025, requires obtaining the opinion of a special committee and enhanced disclosure. The tax treatment of exits (see **4. Tax**) should be considered at the time of investment.

## 2.8 Equity Finance Versus Debt Finance

### Which Segment Is More Important

For mature companies, bank borrowing is the principal means of external financing. Equity, on the other hand, plays an important role in growth investment, strengthening the financial base, business turnarounds, sponsor acquisitions and the like. Companies

choose their funding mix by weighing both the repayment burden and dilution.

### Recent Changes

Domestic interest rates are rising, and borrowers are reassessing the relative cost of debt.

The Act on the Promotion of Business-Based Lending, which took effect on 25 May 2026, introduced the enterprise value charge (*kigyō kachi tanpoken*), a security interest over the value of the business as a whole. Under this regime, the security interest is created and managed through an enterprise value charge trust company, and it may also be used by non-banks as well as banks as lenders. Restrictions have been placed on the use of personal guarantees from management in connection with the enterprise value charge, with the aim of encouraging lending based on the future prospects and cash flows of the business.

### Factors Driving the Company's Decision

The following factors drive company decisions:

- availability of collateral and guarantees;
- tolerance for dilution and external governance;
- whether the company needs a partner and not just capital; and
- for listed companies, the market's reaction to dilutive issuances and the TSE rules applicable to third-party allotments.

### Factors Driving the Investor's Decision

Equity investors are ultimately buying an exit and therefore seek a reliable path to realisation and governance rights to protect it. Lenders look for cash flow and collateral. In LBOs, the same sponsor group may provide both. Japanese law has no general financial assistance rule that uniformly prohibits a target company from guaranteeing or providing security for acquisition financing. However, because upstream guarantees and security raise issues in relation to directors' duties while minority shareholders remain, the target company typically provides security only after the acquisition vehicle has come to hold 100% of its shares. The treatment of shareholder loans in insolvency is discussed in **5.2 Seniority of Investors in Distributions**.

## 2.9 Time Required for Equity Finance

The time required varies considerably depending on whether the necessary information is readily available, whether the terms are standardised, and whether the consent of existing shareholders and regulatory steps are required. The timeframes below are not statutory periods, but practical guides for planning a deal.

### Private Rounds

Timeframes for private rounds are as follows.

- Seed rounds using standard templates such as J-KISS can often be completed within a few weeks.
- Priced rounds from Series A onwards using class shares typically take several months from term sheet to closing, most of which is spent on due diligence and negotiating the investment agreement and shareholders' agreement.
- In a public company, a resolution of the board of directors is usually sufficient, but, unless a securities registration statement has been filed, notice or public announcement must be given to shareholders at least two weeks before the payment date.
- In a public company, where an allotment of shares would result in the subscriber holding a majority of the voting rights, notice or public announcement must be given to shareholders at least two weeks before the payment date, and, if shareholders holding 10% or more of the voting rights object, an ordinary resolution of the shareholders' meeting is required. For investments aimed at acquiring control of a listed company, this needs to be factored into the timetable.

### Buyouts and Take Privates

These typically take several months or longer, with the timeline driven more by due diligence, financing and regulatory clearances than by Companies Act procedures. Business combination filings under the Antimonopoly Act (with a waiting period of 30 days in principle), FEFTA filings, tender offer procedures (with a minimum tender offer period of 20 business days), review by a special committee as required for MBOs and the like, securities disclosure, and obtaining consents under existing contracts must all be built into the schedule in parallel with contract negotiations.

### IPOs
IPOs often take several years from the start of preparations (see **1.3 Public Equity Markets**).

### Key Challenges
The main challenges are as follows.

- *Regulatory timing* – FEFTA filings (see **3.1 Investment Restrictions**) must be built into the schedule, and questions as to whether a company falls within a designated business sector now arise for many technology start-ups.
- *Valuation gaps* – In a selective market environment, these prolong negotiations and increase reliance on bridge instruments.

## 3. Regulation and Related Legal Issues

### 3.1 Investment Restrictions
#### Foreign Investment Screening
The Foreign Exchange and Foreign Trade Act (FEFTA) is Japan's principal foreign investment screening framework. Subject to exemptions, prior notification is generally required for acquisitions of any shares in an unlisted company operating in a designated sector, or acquisitions resulting in holdings of at least 1% of a listed company's shares or voting rights, including relevant related-party holdings. The statutory waiting period is 30 days, but may be shortened or extended to a maximum of five months.

Exemptions depend on the investor, sector and investment size. Conditions include restrictions on board appointments, proposals to transfer or discontinue designated businesses, and access to confidential technical information. No exemption is available for acquisitions of unlisted shares in core-sector companies. Post-investment reporting may be required even where prior notification is unnecessary.

#### Sector-Specific Restrictions
Separate foreign-ownership restrictions apply to certain businesses, including broadcasting, aviation and NTT. Financial-sector investments may also trigger major-shareholder approval or notification requirements applicable to both domestic and foreign investors.

#### 2026 Reforms and Transaction Planning
Amendments promulgated in June 2026 extend screening to certain indirect acquisitions and domestic investments made under specified foreign influence, formalise procedures for risk-mitigation measures, and introduce powers to address investments in non-designated sectors by specified high-risk investors. The principal reforms take effect on 4 January 2027, with the implementing rules fully applicable from 3 February 2027. Those rules also refine the sectors subject to screening and remove prior-notification requirements for certain director reappointments.

Investors should assess the target group's activities, their eligibility for exemptions and the proposed governance arrangements early in the transaction. Where necessary, investors should consult the relevant sector ministries and, as appropriate, the Ministry of Finance before filing, and reflect the anticipated review process in closing conditions and the transaction timetable.

### 3.2 Repatriation of Money and Limitations on Capital Flows
#### Cross-Border Remittances
Japan generally permits dividends, redemption proceeds and share-sale proceeds to be remitted abroad, subject to FEFTA sanctions and applicable reporting requirements. Payments exceeding JPY30 million generally require a post-payment report by the payer, subject to exemptions. Banks also conduct regulatory checks, which should be factored into the payment timetable.

#### Corporate Law Limits
For a *kabushiki kaisha*, dividends and cash share buybacks, including cash redemptions of preferred shares, are generally subject to the Companies Act's distributable-amount limit and applicable corporate approvals. These restrictions apply equally to domestic and foreign shareholders.

Reducing stated capital or capital reserves may increase distributable surplus, but requires the applicable corporate procedures, generally including creditor protection with an objection period of at least one month. The reduction does not itself authorise a pay-

ment to shareholders: a separate dividend or other lawful distribution procedure is required.

### Structuring Options

Depending on the company's financial position, options include capital or reserve reductions followed by lawful distributions, or partial funding through shareholder loans, subject to tax and insolvency considerations. Allocating subscription proceeds to capital reserves alone does not create distributable surplus. An exit through a third-party share sale avoids the company's distribution limits. Withholding tax is addressed in **4.1 Withholding/Capital Gains Tax** and **4.3 (Double) Tax Treaties**.

## 3.3 AML and Sanctions Regulation

### AML/KYC Requirements

Japan's Act on Prevention of Transfer of Criminal Proceeds requires banks, securities firms and other covered financial businesses to conduct customer due diligence for specified transactions, identify corporate customers' beneficial owners, retain records and report suspicious transactions. Enhanced checks apply to prescribed high-risk transactions, including those involving foreign politically exposed persons. The Financial Services Agency (FSA) AML/CFT Guidelines also require risk-based customer management. Lawyers undertaking covered work are subject to separate client-identification and record-keeping rules established by the Japan Federation of Bar Associations.

### Effect on Equity Financings

An ordinary issuer does not become subject to the Act's customer due diligence obligations merely by issuing shares. However, banks and securities firms involved in a financing must fulfil their own obligations and may request identity documents, ownership charts and information on the transaction's purpose and source of funds. Complex ownership structures can lead to additional enquiries and affect account-opening, onboarding and closing timetables.

Parties should identify the participating institutions' documentation requirements early and allow time for verification. FEFTA sanctions screening is also relevant, as designated payments and capital transactions may require permission and may not be permitted.

## 3.4 Choice of Law and Jurisdictions

### Governing Law

Parties may choose the law governing their investment and shareholders' agreements. However, Japanese corporate law governs matters such as the validity of share issuances, class-share rights and shareholder resolutions of Japanese companies. Choosing Japanese law for the contractual documents facilitates alignment with these rules and the articles of incorporation.

### Courts

Parties may agree on a Japanese court, such as the Tokyo District Court, for contractual disputes. Statutory exclusive jurisdiction takes precedence: actions challenging shareholder resolutions, for example, generally belong before the district court at the company's registered head office. Proceedings are conducted in Japanese, without civil juries or US-style discovery.

Recognition of a foreign judgment requires finality, jurisdiction recognised under Japanese law, proper service or the defendant's appearance, consistency with Japanese public policy, and reciprocity. Compulsory enforcement also requires a Japanese enforcement judgment.

### Arbitration and Mediation

Contractual disputes capable of settlement may be referred to arbitration under a valid arbitration agreement. Corporate-status disputes, such as actions to annul shareholder resolutions, generally require court proceedings.

Japan's Arbitration Act is based on the UNCITRAL Model Law, and Japan is a party to the New York Convention. Amendments effective from April 2024 introduced court enforcement mechanisms for tribunal-ordered interim measures, subject to statutory requirements.

The Singapore Convention on Mediation also took effect for Japan in April 2024. Qualifying international mediated settlements may be enforced under its implementing legislation, but the parties must have

agreed to enforcement under the Convention or implementing legislation. Mediation remains an option for resolving contractual disputes by agreement.

### 3.5 Noteworthy Regulatory Trends

Key developments for equity investors in 2026–27 include the following.

- *Foreign investment screening* – The 2026 FEFTA amendments extend screening to certain indirect acquisitions and formalise procedures for risk-mitigation measures. Investors should assess acquisition structures and implementation dates early (see **3.1 Investment Restrictions**).
- *Fundraising reform* – FIEA amendments enacted in July 2026 ease offering-disclosure requirements and broaden access to professional-investor fundraising channels. The relevant reforms take effect on 1 April 2027, including an increase in the securities-registration exemption threshold from offerings below JPY100 million to those below JPY500 million (see **1.3 Public Equity Markets**).
- *Listing and governance* – The July 2026 Corporate Governance Code revision and the TSE's focus on capital efficiency are relevant to governance and exit planning. From March 2030, Growth market companies will generally need a market capitalisation of at least JPY10 billion once five years have elapsed since listing, subject to transitional arrangements.
- *Companies Act proposals* – The March 2026 interim proposal addresses virtual-only shareholder meetings, identification of investors behind nominee holdings, share-based remuneration and contributions in kind. These remain proposals, and their final scope and implementation timetable should be monitored.
- *Tax* – The defence special corporation tax applies to fiscal years beginning on or after 1 April 2026, at 4% of the relevant corporation-tax amount after an annual JPY5 million deduction. Japan's UTPR and domestic minimum tax also become relevant to in-scope groups. Tax measures and investment incentives are discussed in **4. Tax**.

## 4. Tax

### 4.1 Withholding/Capital Gains Tax

#### Dividends and Distributions

Dividends paid to non-resident individuals or foreign corporations without a Japanese permanent establishment (PE) are generally subject to final Japanese withholding tax at 20.42% for unlisted shares and 15.315% for listed shares. The 20.42% rate also applies to listed-share dividends received by non-resident individuals holding at least 3%. Treaty relief may reduce or eliminate withholding, subject to eligibility and procedural requirements (see **4.3 (Double) Tax Treaties**).

For resident individuals, listed-share dividends generally attract 20.315% withholding, with filing options and exceptions for substantial shareholders; unlisted dividends generally enter progressive taxation. Domestic corporations may qualify for dividend-received exclusions and, in certain cases, exemption from withholding. Otherwise, withholding is generally creditable against their tax liability.

Buybacks, redemptions and certain capital distributions may generate deemed dividends to the extent proceeds exceed the tax capital attributable to the relevant shares, subject to statutory exceptions.

#### Capital Gains and Collection

Resident individuals generally pay 20.315% on share gains. Domestic corporations include gains in ordinary taxable income, subject to corporation tax at a standard rate of 23.2%, plus local corporation tax, applicable local taxes and defence special corporation tax.

Investors without a Japanese PE are generally outside Japanese taxation on share gains unless a statutory exception applies. These include substantial-shareholding disposals under the "25/5 rule" and disposals of shares in real-estate-rich companies. The 25/5 rule broadly requires related-party holdings of at least 25% during the statutory look-back period and aggregate disposals of at least 5% during the relevant year. Treaties may restrict Japan's taxing rights. Gains attributable to a Japanese PE are separately taxable.

Taxable share gains of non-resident individuals generally attract 15.315%. For foreign corporations without a PE, the standard combined corporation tax and local corporation tax rate is 25.588%, before any applicable defence special corporation tax.

The payer or relevant paying intermediary accounts for dividend withholding. Taxable share gains are generally reported and paid by the investor; ordinary third-party share purchases do not generally require buyer withholding. Special-account withholding arrangements and deemed-dividend payments are exceptions.

## 4.2 Other Taxes, Duties, Charges or Tax Considerations

### Transaction Taxes

Japan imposes no securities transaction tax. Ordinary share transfer agreements are not subject to stamp duty, and share transfers are exempt from consumption tax. A KK's capital increase generally attracts registration and licence tax at 0.7% of the increase in stated capital, with a minimum of JPY30,000. Allocating up to half of subscription proceeds to capital reserve reduces this tax base. However, keeping stated capital at or below JPY100 million does not necessarily avoid size-based enterprise tax or secure small-company tax reliefs.

### Tax Incentives and Reliefs

The following are available, depending on investor eligibility.

- *Angel investment* – Qualifying individuals may deduct eligible start-up investments from income or share gains. Certain early-stage reinvestments qualify for exemption of reinvested share gains within statutory limits. Eligible investment losses may offset share gains and be carried forward for three years.
- *Open innovation* – Eligible corporate investors may deduct 25% of qualifying start-up share subscriptions from taxable income, subject to certification, investment thresholds, holding requirements and recapture rules. Separate relief is available for qualifying start-up acquisitions.
- *Stock options* – Tax-qualified options defer taxation until the acquired shares are sold, when gains are taxed as share gains. Annual exercise-price limits vary with the issuer's age and listing status, reaching JPY36 million for qualifying companies.
- *Corporate reliefs* – Eligible tax losses generally carry forward for ten years, subject to filing requirements and utilisation limits; a 50% annual taxable-income cap generally applies to larger companies, with exceptions. Qualifying reorganisations may defer taxation of relevant gains.

## 4.3 (Double) Tax Treaties

### Treaty Network

As at 1 August 2026, Japan's tax treaty network comprised 91 treaties and arrangements covering 157 jurisdictions. These included 78 comprehensive tax treaties covering 81 jurisdictions; the wider network also includes information-exchange and administrative-assistance instruments.

### Relief and Eligibility

Treaties may reduce Japanese dividend withholding to 10% or 15% for portfolio investors, with lower rates or exemption available to qualifying corporate shareholders, depending on ownership, holding-period and other conditions. Interest and royalty relief also varies by treaty.

Many treaties restrict Japan's taxation of share gains, but exceptions may cover real-estate-rich companies, substantial-shareholding disposals and gains attributable to a Japanese permanent establishment. The applicable treaty should therefore be checked against the investment and exit structure.

Relief depends on treaty residence, beneficial ownership where required, and applicable anti-abuse provisions, including principal purpose tests and limitation-on-benefits clauses. The BEPS Multilateral Instrument modifies covered treaties according to each treaty partner's elections and applicable commencement dates.

To obtain withholding relief at source, investors generally submit prescribed forms through the payer to the competent tax office by the day before the first payment, with residence certification and additional eligibility documents where required. Refund proce-

dures are available where tax was withheld at domestic rates.

## 5. Bankruptcy and Insolvency

### 5.1 Impact of Insolvency Processes on Shareholder Rights

#### Available Proceedings

Japan has two court-based liquidation proceedings – bankruptcy under the Bankruptcy Act and special liquidation under the Companies Act (available only to stock companies in liquidation) – and two court-based rehabilitation proceedings – civil rehabilitation under the Civil Rehabilitation Act and corporate reorganisation under the Corporate Reorganization Act. Out-of-court restructurings (private workouts) are also widely used; these are discussed in **5.4 Rescue or Reorganisation Procedures**.

#### Effect on Shareholders' Rights

Proceedings have the following effects on shareholders' rights.

- *Bankruptcy* – A bankruptcy trustee takes over the power to manage and dispose of the company's assets. Shareholders may receive a distribution of residual assets only after creditors have been paid in full, which is rare.
- *Civil rehabilitation* – The debtor retains the power to conduct its business and to manage and dispose of its assets (debtor-in-possession, or DIP, model). Shareholders retain their rights unless the rehabilitation plan provides otherwise. Where the company's liabilities exceed its assets, the debtor may, with the court's permission and without a resolution of the shareholders' meeting, submit a proposed rehabilitation plan providing for the acquisition of the rehabilitation debtor's shares, a reduction of stated capital or a share consolidation (Article 166 of the Civil Rehabilitation Act), or a proposed rehabilitation plan providing for an offering of transfer-restricted shares to a sponsor (Article 166-2 of the same Act). However, such proposed plans still require a vote by creditors and confirmation by the court. In sponsor-led rehabilitations, the acquisition and cancellation of existing shares is frequently combined with the issuance of new shares.
- *Corporate reorganisation* – A reorganisation trustee takes over the power to conduct the business and to manage and dispose of the assets. Shareholders form a separate voting class. Where the company's liabilities exceed its assets, shareholders have no voting rights on the proposed reorganisation plan. Whether existing shareholders lose their equity depends on the terms of the plan. It is common for a plan to provide for the acquisition and cancellation of all existing shares and the issuance of new shares to a sponsor.

#### Role of Shareholders in the Proceedings

Shareholders holding 10% or more of the voting rights may file a petition to commence corporate reorganisation proceedings, and shareholders may also file a petition to commence special liquidation. On the other hand, shareholders have no standing to file a petition for civil rehabilitation, which may be filed only by the debtor or a creditor. Shareholders may file an immediate appeal against a court's permission granted in lieu of shareholder approval. An example is permission for a business transfer in lieu of a resolution of the shareholders' meeting, which is granted only where the company's liabilities exceed its assets and the transfer is necessary for the continuation of the business.

### 5.2 Seniority of Investors in Distributions

#### Order of Priority in Bankruptcy Proceedings

The order is as follows.

- In bankruptcy, secured creditors, in principle, exercise their right of separate satisfaction (*betsu-joken*) and recover from the collateral outside the proceedings.
- From assets not subject to security interests, payments are made in the following statutory order of priority:
  - (a) estate claims (*zaidan saiken* – such as procedural costs, the bankruptcy trustee's remuneration, and certain tax and labour claims, which are paid as they fall due);
  - (b) preferential bankruptcy claims (mainly certain labour claims secured by a general statutory lien, as well as tax claims and social insurance premium claims);

(c) general bankruptcy claims;
(d) subordinated bankruptcy claims (such as post-commencement interest and late payment charges, and fines); and
(e) contractually subordinated bankruptcy claims.

- Shareholders rank last and receive a distribution of residual assets only if a surplus remains after all creditors have been paid; in practice, a surplus rarely arises. Preferred shares rank ahead of common shares only to the extent provided in the articles of incorporation. In addition, liquidation preferences agreed in a shareholders' agreement do not alter the statutory order of priority vis-à-vis creditors.

### Rehabilitation Proceedings

In civil rehabilitation proceedings, secured creditors may also enforce their security interests outside the proceedings as a right of separate satisfaction, but the court may order a stay of enforcement or permit the extinguishment of a security interest upon payment of an amount equal to the value of the collateral. In corporate reorganisation proceedings, secured claims are, in principle, brought into the proceedings as secured reorganisation claims and are paid in accordance with the reorganisation plan. Furthermore, in a reorganisation plan, shares with preferential rights to the distribution of residual assets are, by law, ranked above other shares.

### Loan Claims of Shareholders

Japanese law has no doctrine of equitable subordination. Shareholder loans are not automatically subordinated (see **1.6 Mix of Debt and Equity Financing**). However, contractual subordination provisions may apply and, in rehabilitation and reorganisation plans, differences in treatment may be made among claims of the same kind to the extent this does not impair fairness, so claims of controlling shareholders and other related parties may come under scrutiny.

### Unpaid Capital

In a Japanese stock company, subscribers for shares must, as a rule, pay the full subscription price, and a subscriber who fails to pay loses the right to become a shareholder. The concept of partly paid shares does not exist. This does not mean, however, that no liability can arise at all. Contractual commitments to subscribe for subsequent tranches may, depending on their terms, provide a basis for a claim, and a subscriber who has feigned payment bears statutory liability.

## 5.3 Length of Insolvency Process and Recoveries

### Duration of Proceedings

The standard schedules of the Tokyo District Court (which are the court's models, not nationwide averages of actual cases) indicate the following periods from filing of the petition to confirmation of the plan:

- civil rehabilitation – approximately five months;
- trustee-managed corporate reorganisation – approximately 11 months (approximately seven months on the expedited track);
- standard DIP-type corporate reorganisation – approximately seven months and two weeks (approximately five months on the expedited track); and
- small-scale DIP-type corporate reorganisation (introduced in April 2025 for companies with total liabilities of less than JPY5 billion) – approximately five months and two weeks.

Actual timeframes vary depending on the claims investigation, the selection of a sponsor, the existence of disputes and other factors.

Bankruptcy proceedings may take a few months in small cases, and several years in cases involving litigation, avoidance claims or complex realisation of assets. Private workouts often take a few months, but require the consent of all creditors whose rights are to be modified (see **5.4 Rescue or Reorganisation Procedures**).

A distinction must be drawn between the period until confirmation of the plan and the period until payments under the plan are completed. A rehabilitation plan may, in principle, provide for a repayment period of up to ten years, and a reorganisation plan for a repayment period of up to 15 years (or 20 years in special circumstances).

### Recovery by Shareholders

Given that shareholders rank behind creditors, they are unlikely to recover their investment where the company's liabilities exceed its assets. Where residual assets remain after payment of debts (eg, in the liquidation of a company whose assets exceed its liabilities), shareholders are entitled to receive distributions in accordance with the law and the articles of incorporation.

### Practical Implications

What matters in practice for equity investors is whether value can be preserved by acting before a petition is filed, and whether a sale or recapitalisation can be pursued on the basis of their rights under the shareholders' agreement while the business still has going-concern value.

## 5.4 Rescue or Reorganisation Procedures

### Private Workouts

Business rehabilitation is often first attempted out of court because court proceedings are made public and affect trade creditors, which risks damaging the value of the business. Rule-based frameworks include:

- Turnaround ADR, operated by the Japanese Association of Turnaround Professionals under the Industrial Competitiveness Enhancement Act;
- the SME Revitalization Councils (reorganised in April 2022 from the SME Rehabilitation Support Councils) and the Guidelines for Business Rehabilitation of SMEs; and
- rehabilitation involving the Regional Economy Vitalization Corporation of Japan (REVIC).

While these frameworks differ in scope and procedure, they generally cover only financial creditors and require the consent of all creditors whose rights are to be modified, so a plan cannot be implemented if even one creditor objects.

### Early-Stage Business Rehabilitation Act

The Early-Stage Business Rehabilitation Act, enacted in June 2025, is scheduled to take effect on 11 December 2026. The Act enables the modification of the rights of financial creditors of a business at risk of economic distress through the involvement of an impartial third party designated by the Minister of Economy, Trade and Industry (a designated verification and investigation body), a resolution of the target creditors and confirmation by the court. The resolution requires the consent of holders of at least three quarters of the total voting rights (which are allocated according to the amount of the target claims not covered by security) and, where a single creditor holds three quarters or more of the total voting rights, the consent of a majority in number of the voting creditors is also required. Trade claims are, in principle, not covered.

### Court Proceedings

Where court proceedings are unavoidable, civil rehabilitation is the most commonly used rehabilitation proceeding, and it is common for a sponsor to be selected before the petition is filed. A transfer of the business to a sponsor before the plan is approved requires the court's permission after hearing the opinions of creditors, and, where the company's liabilities exceed its assets, the transfer may be effected with the court's permission in lieu of a resolution of the shareholders' meeting. Corporate reorganisation proceedings, which are available only to stock companies, are used mainly where secured creditors need to be bound by the proceedings. Nevertheless, approximately 90% of insolvencies in fiscal year 2025 were bankruptcies, and liquidation proceedings account for the vast majority.

### Who Takes the Lead and the Role of Equity Investors

In civil rehabilitation proceedings and private workouts, management usually remains in control, while in corporate reorganisation proceedings a trustee runs the business, although under the DIP-type model incumbent management may be appointed as trustee. Creditors also play a central role through voting on the plan. Equity investors rarely take the lead; their realistic options are to provide rescue financing, to act as a sponsor themselves or introduce a sponsor, or to accept dilution.

The treatment of rescue financing depends on its form. New equity investment does not in itself constitute a common-benefit claim. As for loans in civil rehabilitation proceedings, borrowings made after the filing of the petition but before the commencement order may

be treated as common-benefit claims with the court's permission (or the approval of the supervisor in lieu thereof) under Article 120 of the Civil Rehabilitation Act, while Article 119 and other provisions of the same Act apply to borrowings made after the commencement order. Even when treated as common-benefit claims, such claims do not automatically take priority over existing security interests.

## 5.5 Risk Areas for Equity Investors

### Limited Liability as a Starting Point

Shareholders bear only limited liability and do not become liable for the company's debts merely because the investee company becomes insolvent. However, liability based on the receipt of unlawful distributions, acts subject to avoidance, independent contractual obligations, the investor's own wrongful acts or the like is a separate matter.

### Avoidance

A bankruptcy or reorganisation trustee, or a civil rehabilitation supervisor granted the necessary authority by the court, may avoid acts that are prejudicial to creditors – namely fraudulent acts, gratuitous acts, and preferential payments or grants of security made after the company became unable to pay its debts. Investors should anticipate that dividends, share buybacks, acquisitions (redemptions) of preferred shares and repayments of shareholder loans made while the company was in financial difficulty may be investigated and may have to be returned to the estate.

### Investor-Nominated Directors

A director nominated by an investor owes duties to the company independently of the investor, and any liability incurred by that director does not automatically become the liability of the nominating investor. In addition, under the Companies Act, a director who acted in bad faith or with gross negligence in performing their duties is directly liable to third parties, including creditors; and directors involved in, and shareholders receiving, distributions of surplus in excess of the distributable amount are liable to the company.

### De Facto Control

Depending on the nature and extent of an investor's actual involvement in management, liability as a de facto director may be asserted. Liability does not automatically arise merely from holding or exercising ordinary shareholder rights or contractual veto rights, but investors should exercise such rights in their capacity as shareholders and through properly constituted board procedures. In extreme cases, the courts may disregard the corporate personality (pierce the corporate veil).

### Other Risks

The effect of guarantees, additional investment obligations, representations and covenants under investment agreements, support letters (comfort letters) and the like is determined by their wording, conditions precedent and governing law. It cannot be said that they are automatically extinguished by insolvency, nor that performance can always be demanded unconditionally. Where an investor is also a lender, security granted immediately before the filing of a petition may be subject to avoidance.

### How Often Investors Are Sued

Litigation against purely financial investors is not common; trustees more often pursue directors and closely related parties. However, the exercise of avoidance rights against recipients of payments, including shareholders, is one of the standard tools available to trustees.

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