STRATEGIC M&A TAX ADVICE

No Tax Paid by Soft Bank Group due to not only the Foreign Dividend Exclusion Rule but also the Book-value Principle.

August 17, 2019

Introduction

Media has reported frequently on the tax issues of Softbank Group (hereinafter, "**SBG**"). Here, we will analyze the structure of a series of transactions (hereinafter, the "**Transaction**") from the perspective of Japanese tax law.

Flow of the Transaction[1]

The Transaction began with the purchase by SBG of all of the shares of British chip designer Arm Holdings (hereinafter, "**HD**") for JPY 3.3 trillion. At the time, HD had a wholly-owned subsidiary named Arm Limited (hereinafter, "**AL**").

On March 23, 2018, HD transferred 75% (JPY 2.6 trillion) of AL's shares to SBG as a dividend. Due to this dividend, the value of the shares of HD declined significantly. SBG then transferred to its affiliated fund Softbank Vision Fund, etc. 78% of the shares of HD at the lower value (JPY 0.546 trillion[2]), thereby incurring a loss of 2 trillion yen.

The Rule of Foreign Dividend Exclusion and the Book-value Principle

In Japan, there exists a rule called the Foreign Dividend Exclusion which enables corporations receiving dividends from their foreign subsidiaries to receive a tax benefit. Under this rule, 95% of the dividend will be excluded from gross income. SBG treated 95% (JPY 2.4 trillion) of the dividend SBG received to be tax free. Also, Japanese tax law evaluates the property at the time of acquisition; therefore, SBG used the value of HD at the time of acquisition (JPY 3.3 trillion) in determining its loss (JPY 3.3 trillion × 78% - JPY 0.546 trillion ≒ JPY 2 trillion[3]) despite the fact that the value of HD's shares declined significantly after its transfer of AL's shares to SBG. In sum, it can be said that

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[1] Please refer to Exhibit A hereto.
[2] This amount has been calculated in accordance with the following method of calculation:
(JPY3.3 trillion – JPY2.6 trillion)×78% = JPY 0.546 trillion
[3] Please refer to Exhibit B hereto.

SBG took full advantage of (i) this Foreign Dividend Exclusion rule and (ii) Japan's tax principle of attaching great importance to the book value at the time of acquisition (the "**Book-value Principle**"), in this case.

The Reaction of Tax Authorities

Tax authorities do not appear to have taken any action except for pointing out that some of the tax losses recorded on the Transaction should be booked on a later date, meaning SBG had to pay no additional tax but only had to revise its tax filings. Surely the tax authorities have considered application of Article 132 of the Corporation Tax Act given the fact that SBG created the situation enabling itself to be free of any tax burden because of the Foreign Dividend Exclusion and the Book-value Principle. Article 132 states that tax authorities may reject the tax return of a corporation when it is considered that the corporation unreasonably reduced its tax burden as a result of M&A activity. However, after a series of investigations, they appeared to have concluded that Article 132 is inapplicable to the Transaction.

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EXHIBIT A

Order of transactions

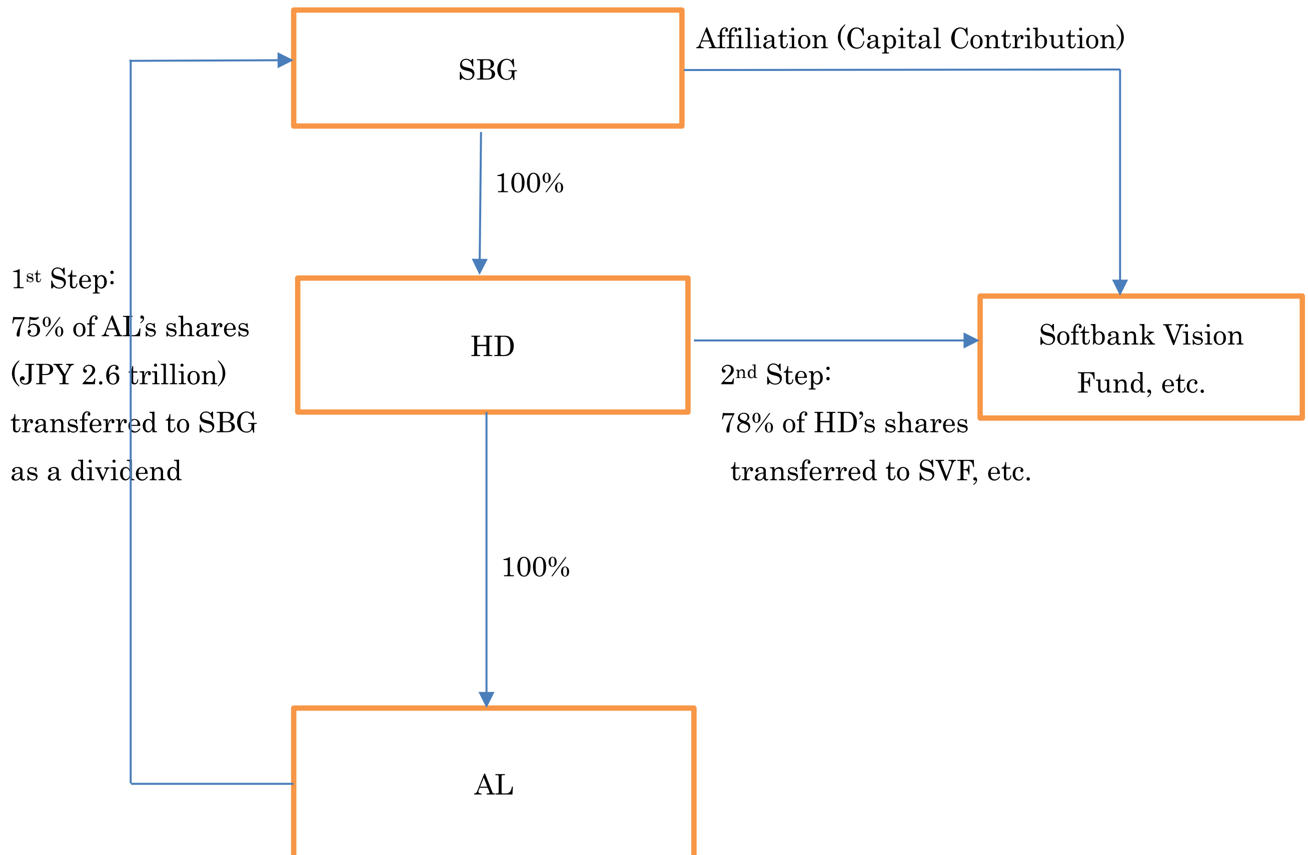

EXHIBIT B

Disposition by SBG, simple substance	**Accounting**	**Tax Treatment**
1st Step, herein above	The value of HD shares to be reduced to JPY 0.7 trillion.	The value of HD shares to remain at JPY 3.3 trillion.
2nd Step, herein above	No capital loss.	Capital loss of JPY 2 trillion occurred.