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Japan tax alert

Ernst & Young Tax Co.
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Supreme Court rules that Delaware limited partnerships are corporations under Japanese tax law - 17 July 2015

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In a tax dispute over whether a limited partnership established based on the laws of the state of Delaware ("Delaware LP") is a corporation for Japanese taxation purposes, the Supreme Court of Japan ("the Court") ruled on 17 July 2015 that a Delaware LP does in fact constitute a corporation under Japanese tax law. This alert will explain the ruling, focusing on the criteria for judging whether an entity established based on foreign law is a corporation for Japanese tax purposes and the application of such criteria.

I. Criteria for judging whether an entity is a corporation for Japanese taxation purposes

The Court laid out the following judgment criteria for whether an entity established based on foreign law is a corporation for Japanese tax purposes.

- (1) Whether or not it is apparent, without any doubt, from the wording of the provisions in the laws governing the establishment of entities such as the one in question and the workings of the legal system, that the entity in question is, according to laws of its country, granted, or not granted, legal standing equivalent to that of a corporation as defined under Japanese law.
- (2) Whether or not the entity in question is an entity attributed rights and obligations. Specifically, from the content and purpose of the provisions in the laws governing the establishment of entities such as the one in question, whether or not the entity can itself be a party to legal acts, and, whether or not such legal effects are recognized as attributable to the entity.

As for the relationship between the two criteria, it was decided that the more objective and clearly determinable (1) would be considered first, and that (2) would be considered if (1) did not provide a clear conclusion.

II. Application of criteria to the Delaware LP

As a result of applying the above criteria (1) and (2) to Delaware LPs, the Court held that a Delaware LP constitutes a corporation for Japanese taxation purposes.

First, regarding (1), Article 201(b) of the Delaware Revised Uniform Limited Partnership Act (“DRULPA”) stipulates that a Delaware LP, which is established based on DRULPA, becomes a “separate legal entity” at the time of establishment. However, the Court held that it was difficult to say that this clearly determined, without any doubt, whether or not a Delaware LP is granted legal standing equivalent to that of a corporation as defined under Japanese law.

Second, regarding (2), Article 106(a) and (b) of DRULPA stipulate that a Delaware LP may, with certain exceptions, carry on any lawful business, purpose or activity, whether or not for profit, and shall possess and may exercise all the powers and privileges granted by the act or by any other law or by its partnership agreement, together with any powers incidental thereto. In light of this, the Court held that DRULPA, in addition to granting a Delaware LP the right and privilege to perform legal acts in its name, assumes that the effects of legal acts performed in the name of the Delaware LP are attributed to the LP itself. The Court pointed out that this was also in agreement with Article 107 of DRULPA, which indicates that a partnership interest itself is a type of property right called personal property and that a partner has no interest in specific limited partnership property. The Court also held, in light of the provisions of DRULPA, that since a Delaware LP can itself be a party to legal acts and since such legal effects can be attributed to the Delaware LP, the Delaware LP is considered to be an entity attributed rights and obligations.

III. Points to consider

Until now, it was fairly common for tax returns to be filed under the assumption that Delaware LPs were not corporations for the purposes of Japanese taxation. Naturally, with the recent ruling, tax returns should now generally be filed under the assumption that Delaware LPs constitute corporations. As a result, taxpayers investing in Delaware LPs must now consider whether it is necessary to file amended returns or request a correction for past returns. Similarly, taxpayers investing in entities established based on foreign law other than Delaware LPs, such as limited partnerships in other US states, must use the above judgment criteria to reevaluate whether such entities constitute corporations for Japanese taxation purposes.



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