# Japan Tax Bulletin

## Taxation of partnerships in Japan

**July 2020**

A partnership is a vehicle not used frequently for business activities but rather used for investment activities in aircraft leasing, ship leasing etc. A partnership is formed under the Civil Code and called a Kumiai or Nini Kumiai (NK).

1. *Nini Kumiai (NK)*

*Formation*

An NK is formed by the conclusion of a kumiai contract among Kumiai-in (members or partners). There are no formal articles of incorporation and an NK is not registered with the Legal Affairs Bureau. A member may contribute cash, property or services to the NK. All member contributions to an NK and all NK assets are owned jointly by all the members. A member is not allowed to dispose of interests in an NK without consensus from other members. Creditors of a member of an NK are not allowed to seize the member's interests in the NK. Creditors of an NK are allowed to claim on members' own assets. As such, members in an NK bear unlimited liabilities of the NK.

An operating management member is usually appointed among the NK's members. The operating management member conducts the NK's ordinary business.

2. *Limited liability partnership (Toshi Jigyo Yugen Sekinin Kumiai)*

A limited liability partnership for investment ("LLPI") can be formed under the Limited Liability Partnership Act for Investment. An LLPI's members consists of unlimited liability members and limited liability members and its business activities are restricted to certain investment activities as stipulated in the law.

3. *Limited liability partnership (Yugen Sekinin Jikyo Kumiai)*

A limited liability partnership can be formed under the Limited Liability Partnership Act. All members' liabilities are limited to the members' investment. An LLP is used for setting up joint-ventures, corporate alliances etc.

4. *Taxation of NKs, LLPIs and LLPs*

NKs, LLPIs and LLPs (collectively "partnership") are transparent for tax purposes. Profits or losses of a partnership are attributed directly to members. Members must recognize profits or losses of a partnership for each business year even if they have not received distributions.

Where a partnership closes accounts for a period of 1 year or shorter, attributable profits or losses can be calculated based on the partnership's calculation period and members can recognize the profits or losses in the business year during which the end of the partnership's calculation period falls.

Members can recognize the partnership's profits or losses in the one of following manners:

(1) A member records revenue, costs, expenses, assets and liabilities of the partnership based on an allocation ratio.
(2) A member records revenue, costs, expenses of the partnership based on an allocation ratio. A member cannot set up tax-deductible reserves using this method although it can claim intercompany dividend exemptions or tax credit for withholding taxes.
(3) A member records bottom-line profits or losses of the partnership. Under this method, a member cannot claim tax-deductible reserves, intercompany dividend exemptions or tax credits for withholding taxes.

5. *Foreign members*

Where a foreign company or a non-resident is a member of a partnership, the place of business of the partnership is treated as a place of business of the foreign company or the non-resident. Therefore, the foreign company or the non-resident is deemed to have Permanent Establishment ("PE") in Japan.

If a foreign company or a non-resident is a member of an LLPI or LLP above, or a foreign limited partnership equivalent to an LLPI or LLP, and the member has income attributable to the PE in connection with the partnership, the foreign members are exempt from Japan income tax if the following conditions are satisfied.

(1) The foreign member is a limited liability member,
(2) The foreign member is not involved in the management and operation of the partnership's business,
(3) The foreign member's interest in the partnership is less than 25%,
(4) The foreign partner does not have a special relationship with the unlimited liability member,
(5) The foreign member would not have PE attributable income if it were not a member of the partnership.

In order for a foreign member to claim this treatment, it is necessary to file "APPLICATION FORM TO APPLY FOR SPECIAL PROVISION FOR FOREIGN MEMBER OF INVESTMENT LIMITED PARTNERSHIP" with the tax office.