



Financial Services Tax Group

News Letter

July 2004

Toushi Jigyou Yugen Sekinin Kumiai

On June 18, 2004, the National Tax Agency (“NTA”) issued a reply through its “Confirmation Prior to Transaction” system to an enquiry made by the Ministry of Economy, Trade and Industry (“METI”) involving the individual tax treatment on equity investments made through *toushi jigyou yugen sekinin kumiai* or *nin-i kumiai* (collectively, “*toushi kumiai*”). The enquiry and the reply were subsequently posted on the NTA’s homepage. In this Newsletter, we summarize the outcome of the enquiry and implications for investors.

Legal changes

Previously, *toushi jigyou yugen sekinin kumiai* were not allowed to provide or purchase loans and receivables; and the scope investments were limited only to shares in small to medium-sized corporations. The amendment of the *Law concerning Toushi Jigyou Yugen Sekinin Kumiai* (limited partnership for venture capital investment) effective from April 30, 2004 enlarged the scope of permitted investments to include shares in large and public corporations and also loans, receivables and bonds.

Individual tax treatment on equity investments through *toushi kumiai*

As you may be aware, the Circular “Tax treatment on *chusho kigyuu-tou toushi jigyou yugen sekinin kumiai*,” confirmed that income received through such *kumiai*, will be treated the same as income received through a *nin-i kumiai*. The enquiry by METI clarified the income category of individual investors and the treatment of expenses incurred in connection with the operation of the *toushi kumiai*.

Income category of the individual investors

Income received by individual investors through *toushi kumiai* include capital gains from the transfer of shares, interest income, and dividend income; which would be categorized depending on the general characteristics of such income. Whether gains from the transfer of shares will be categorized as miscellaneous income or business income, or capital gains, will be judged from the facts as to whether such a transfer of shares is conducted continuously for profit in accordance with the Special Taxation Measures Law Circular 37-10-2.

When an individual investor calculates his/her income tax in accordance with the Income Tax Law Basic Circular 36/37-20(1), any gain from the transfer of shares through *toushi kumiai* will be treated as miscellaneous income or business income, provided that all of the following conditions are met and are stated in the *toushi kumiai* agreement:

- (1) The investment in equity is the main business of the *toushi kumiai*;
- (2) Each partner knows his/her share of the income by income categories;
- (3) *toushi kumiai* is operated as a joint business by the partners;
- (4) *toushi kumiai* is organized for profit;
- (5) *toushi kumiai* will invest in more than one company; and
- (6) Investment term of the *toushi kumiai* will last for five years or more.

Tax treatment of operational expense of toushi kumiai

If a gain from the transfer of shares through a *toushi kumiai* which satisfied the above conditions is treated as miscellaneous income or business income, the individual investors can deduct expenses incurred in connection with the operation of the *toushi kumiai*.

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