

Financial Services Tax News

Financial Services Tax Group

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The Limited Liability Partnership Act (Yugen Sekinin Jigyo Kumiai)

The Limited Liability Partnership Act (“LLP Act”) was enacted on May 6, 2005. A *Yugen Sekinin Jigyo Kumiai* (“LLP”) is a partnership formed under the LLP Act. An LLP is expected to be adopted as a new investment vehicle for use in Japan, and is different in nature from the current investment vehicles, namely, *Tokutei Mokuteki Kaisha*, *Tokumei Kumiai* and *Nin-i Kumiai*. In this Newsletter, we provide an outline of the LLP Act.

1. Definition and Requirements of the LLP

In the LLP Act, LLP means a partnership that is formed by individual or corporate partners to carry on their business jointly and the partner’s liabilities are limited to the amount of their contribution to the LLP. The LLP agreement will become effective after contributions by all partners are executed.

At least one partner has to be an individual resident who has his domicile in Japan or has had his residence in Japan for at least one year; or a domestic corporation whose head or main office is located in Japan.

The LLP Agreement shall stipulate the matters listed below and be signed by or have printed the name and be sealed by each of the partners.

- (i) Business of the LLP
- (ii) Name of the LLP
- (iii) Location of the office of the LLP
- (iv) Names and addresses of all partners
- (v) Date on which the LLP Agreement becomes effective
- (vi) Duration of the existence of the LLP
- (vii) Assets to be contributed and the value of such assets
Fiscal period of the LLP

2. Business of LLP

An LLP is not permitted to conduct the following business:

- (i) Business determined by Cabinet Order that is not appropriate to limit the partner's liability within the amount of their contribution; or
- (ii) Activities determined by Cabinet Order that is likely to be detrimental to the creditor of the LLP in an unfair manner.

Unanimous agreement amongst the partners is required when determining the operation of an LLP. However, an LLP agreement may prescribe majority agreement in determining operations other than the disposition or acceptance of any important asset or borrowing of a significant amount.

Each partner shall execute the operation of the LLP as determined by agreement amongst the partners and may delegate part of the execution of the LLP operation to others. Each partner may execute day-to-day operations of the LLP.

3. Investment

Partners of the LLP may only contribute cash or other assets. Contributions of personal services to the LLP is not permitted.

4. Liability of the Partner of LLP

A partner shall be liable for the LLP's obligations only to the extent of its capital investment. Where a partner has contributed a claim, if the obligor of such claim has failed to make repayment on the due date, such partner shall be liable for the repayment.

Where a partner has caused damage to a third party in relation to the operation of the LLP, the partner shall be liable to compensate for damage with the assets of the LLP. However, where a partner has performed their duties in bad faith or with gross negligence, the partner shall be liable for the damages to the third party with no limitation.

5. Fiscal Period and Accounting

The fiscal period of the LLP as provided in the LLP agreement shall be a period of one year or less.

Partners are required to prepare the balance sheet of the LLP as of the date of commencement of the LLP. The balance sheet, income statement and specifications annexed thereto are required to be prepared within two months after the fiscal period end.

6. Profit Allocation and Distribution

The ratio of allocation of the LLP's profit and loss amongst the partners is, in principle, determined based on the value of the contribution by each partners as recorded in the accounting books of the LLP. However, a different rule for allocation may be adopted if the rule is determined by the unanimous agreement amongst the partners.

Distributions can be made in accordance with a formula determined by Ministerial Ordinance as of the

date of distribution. The formula is not yet published.

7. Application Mutatis Mutandis of Provisions for Nin-i Kumiai in the Civil Code

The provisions with respect to Kumiai contract in the Civil Code apply mutatis mutandis to the LLP.

8. Date of Introduction

The LLP Act will become effective on the date determined by the Cabinet Order within six months from the date of announcement (May 6, 2005).

Taxation

With regard to the Japanese tax treatment on the LLP, in principle, pass through taxation would be adopted where an LLP is exempt from entity-level income tax but each partner is directly subject to income tax. Please note that new articles are incorporated in the Special Tax Measures Law at the 2005 Tax Reform (Article 27-2 for individual partners and Article 67-13 for corporate partners) where losses incurred in an LLP and allocated to the partners are subject to certain limitation in treating the losses as necessary expenses for individual income tax purposes or as a loss for corporation tax purposes.

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