

KPMG Japan e-Tax News

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TAX UPDATE

FINANCIAL SERVICES AGENCY - TAX TREATMENT OF CARRIED INTEREST

On 22 April 2021, the Financial Services Agency (FSA) launched an English webpage '[Tax Treatment of Carried Interest](#)' and released an English translation of the [Notice](#) (PDF 465.0KB) of the tax treatment of so-called Carried Interest partnership profit distributions received by individual fund managers in relation to a partnership agreement that stipulates the distribution of partnership profits in excess of their interest holding ratio from the partnership business managed by the fund managers as its partners.

The 'Outline of the 2021 Tax Reform Proposals' (Proposal) which was agreed by the ruling coalition (the Liberal Democratic Party and Komeito) in December 2020 described that where the distribution ratio has 'economic rationality', etc. for the Carried Interest that the fund managers receive from the partnership whose business is transfer of shares, etc. in which the fund managers have an equity interest, the Carried Interest will not be subject to comprehensive taxation as consideration for the provision of services, but will be subject to separate taxation as a gain on transfer of shares, etc.

Corresponding to the Proposal, the FSA prepared the Notice, which describes the basic concept of the 'economic rationality' and the way of thinking about such concept based general cases under 36/37-19 (Attribution of profit, etc. derived from the partnership business for its partners) of 'Basic Circular on Income Tax Act'(*1), and confirmed the views of the FSA in the Notice with the National Tax Agency (NTA). The NTA replied to the FSA that there was no objection to the Notice.

(*1) This stipulates that the amount of profits, etc. for the partner derived from the partnership business (Nini Kumiai, etc.) shall be the amount of profits, etc.(*2) to be distributed according to the distribution ratio (i.e. pass-through treatment)(*3), unless the distribution ratio does not have 'economic rationality'.

(*2) The Notice describes that realized gains are subject to taxation.

(*3) The Notice describes that where the profit, etc. derived from the partnership business is based on the transfer of shares, etc., the income from the transfer of shares, etc. shall be treated as a capital gain of the shares and subject to separate taxation.

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