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## KPMG Japan tax newsletter

### US (Delaware) LPS – Japanese Supreme Court Decision



On 17 July 2015, the Japanese Supreme Court rendered a decision declaring that a limited partnership formed under the laws of the state of Delaware (Delaware LPS) should be treated as a corporation for Japanese tax purposes.

This Supreme Court decision had been much awaited for more than 2 years, as previous District Court and High Court decisions in Tokyo, Osaka and Nagoya have been split over the issue, as summarized below:

	District Court decisions	High Court decisions
Tokyo	Not a corporation (19 July 2011)	Corporation (13 March 2013)
Osaka	Corporation (17 December 2010)	Corporation (25 April 2013)
Nagoya	Not a corporation (14 December 2011)	Not a corporation (24 January 2013)

The Japanese government petitioned to appeal the decision reached by the Nagoya High Court that a Delaware LPS is not a corporation for Japanese tax purposes, pursuant to which the Supreme Court reversed the Nagoya High Court decision and ruled in favor of the government.

Although the taxpayers who lost in the Tokyo High Court and the Osaka High Court trials also appealed to the Supreme Court, the appeal applications were rejected.

## 1. Criteria for Determining Whether a Foreign Entity should be Treated as a Corporation

The Supreme Court determined in its ruling that the following steps should be used in determining whether a foreign entity should be treated as a corporation for Japanese tax purposes:

### [Step 1]

Determine whether it is clear beyond doubt, that legal status equivalent to that of a Japanese corporation is granted to the foreign entity under the laws of the country in which it was established, considering the provisions of such laws and the legal framework.

In cases where Step 1 cannot be demonstrated beyond doubt, the Step 2 may be used to reach a decision:

### [Step 2]

Determine whether the foreign entity is an entity that assumes rights and obligations on its own account (i.e. whether the foreign entity itself can be a party to legal actions and whether the legal effects of the actions are attributable to such foreign entity).

## 2. Judgment of a Delaware LPS based on the Above Criteria

The Supreme Court concluded that a Delaware LPS should be treated as a corporation for Japanese tax purposes based on the above criteria as follows:

### [Step 1]

- The Delaware Revised Uniform Limited Partnership Act (Delaware LPS Act) only provides that a limited partnership established under the Delaware LPS Act shall be a 'separate legal entity,' and hence it is not clear beyond doubt on the basis of the Delaware LPS Act that it has legal status equivalent to that of a Japanese corporation.
- Further, even upon detailed review of the Delaware LPS Act and other related laws, it is not clear beyond doubt that legal status equivalent to that of a Japanese corporation is granted to a Delaware LPS.

As the relevant legislation was determined not adequate to claim definitive proof for this Step, the Supreme Court thus proceeded to Step 2.

### [Step 2]

- The Delaware LPS Act provides that a limited partnership may carry on any lawful business, purpose or activity, whether or not for profit, with certain exceptions, and a limited partnership 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.
- Considering the above provisions of the Delaware LPS Act, it is construed that the Act is based on the premise that a limited partnership is granted rights and powers to conduct legal actions under its own name and the effect of such actions is attributable to the limited partnership. This is consistent with a provision of the Act which provides that a partnership interest itself is personal property, a type of property right, and that a partner has no interest in specific underlying limited partnership property.

- In the light of the above provisions of the Delaware LPS Act, it is possible to say that a Delaware LPS itself can be a party to legal actions and the legal effects of the actions are attributable to the Delaware LPS. Thus, a Delaware LPS can be considered an entity that has the ability to assume rights and obligations on its own account.

### 3. Issues to Be Considered Going Forward

In light of the above ruling, our first recommendation is that existing or contemplated structures involving investment via Delaware LPSs should be re-examined at the earliest opportunity.

Additionally, this decision is the first Supreme Court decision that has indicated criteria to determine whether a foreign entity should be treated as a corporation for Japanese tax purposes; thus, for investments where the assumed tax treatment is derived based on assumptions on the Japanese tax treatment of certain offshore entities, it may be necessary to reassess whether such assumptions are still valid based on the criteria established by the ruling.

Moreover, whether the Japanese tax authorities will release any practical guidance as a result of this decision should also be monitored going forward.

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