

The tax treatment under Japanese law of items of income derived through a U.S. Limited Partnership by Japanese resident partners

The National Tax Agency (NTA) is aware that taxpayers seek clarity regarding the tax treatment under Japanese law of items of income derived through a U.S. Limited Partnership (U.S. LP) by Japanese resident partners, such as Japanese pension funds. Taxpayers seek clarity because a July 17, 2015 decision by the Japanese Supreme Court has led some taxpayers to raise the concern that, as a general matter, U.S. LPs should be treated as opaque entities and not as fiscally transparent entities.

In light of 2005 tax reform (newly introduced loss limitation rules for foreign partnerships), the NTA will no longer pursue any challenge to the fiscally transparent entity (FTE) treatment of an item of income derived through a U.S. LP. The NTA treats an item of income paid to and through a U.S. LP of which Japanese residents are partners as derived by the Japanese resident partners and subject to tax on a current basis in the hands of the partners, irrespective of distributions from the U.S. LP, and the character and source of the item of income in the hands of the Japanese partners are determined as if such items were realized directly from the source from which realized by the U.S. LP, provided that the U.S. LP has not made an election to be classified as an association taxable as a corporation for U.S. federal income tax purposes.

Accordingly, for purposes of applying the U.S.-Japan income tax convention (the "Treaty"), a Japanese resident that derives the item of income through a U.S. LP, and that meets all other requirements under the Treaty would be eligible to claim treaty benefits.