



ICLG

The International Comparative Legal Guide to:
Public Investment Funds 2019

2nd Edition

A practical cross-border insight into public investment funds

Published by Global Legal Group, with contributions from:

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URL: www.glgroup.co.uk

GLG Cover Design

F&F Studio Design

GLG Cover Image Source

iStockphoto

Printed by

Ashford Colour Press Ltd
April 2019

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ISBN 978-1-912509-66-9
ISSN 2516-4821

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EDITORIAL

Welcome to the second edition of *The International Comparative Legal Guide to: Public Investment Funds*.

This guide provides corporate counsel and international practitioners with a comprehensive worldwide legal analysis of the laws and regulations of public investment funds.

It is divided into two main sections:

Four general chapters. These chapters are designed to provide readers with an overview of key issues affecting public investment funds, particularly from the perspective of a multi-jurisdictional transaction.

Country question and answer chapters. These provide a broad overview of common issues in public investment funds laws and regulations in 17 jurisdictions. All chapters are written by leading public investment funds lawyers and industry specialists and we are extremely grateful for their excellent contributions.

Special thanks are reserved for the contributing editors Gregory S. Rowland and Sarah E. Kim of Davis Polk & Wardwell LLP for their invaluable assistance.

Global Legal Group hopes that you find this guide practical and interesting.

The *International Comparative Legal Guide* series is also available online at www.iclg.com.

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PREFACE

Davis Polk & Wardwell LLP is honoured to serve as Contributing Editor for the second edition of *The International Comparative Legal Guide to: Public Investment Funds*, and it is my pleasure to have been invited to write this preface.

Publicly offered investment funds are subject to regulatory frameworks that, depending on the jurisdiction, impose comprehensive restrictions on how a fund is operated. The regulatory framework in the U.S., for example, imposes strict requirements on, among other things, a public investment fund's corporate governance, capital structure, portfolio investments, affiliated transactions, reporting and recordkeeping. The degree of regulation and the specifics of the requirements in each jurisdiction vary significantly, which is why a guide such as this is essential.

The second edition provides broad overviews of the general regulatory framework for public investment funds in 17 jurisdictions, as well as four general chapters on topics of particular interest.

As the regulations in the financial services industry continue to evolve in response to new developments and obstacles in financial systems globally, it will be important for legal professionals and industry participants to have up-to-date resources such as this guide for practical insight relating to different jurisdictions.

We hope that you find this guide useful in your practice, and we look forward to future editions of the guide going forward.

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1 Registration

1.1 Are funds that are offered to the public required to be registered under the securities laws of your jurisdiction? If so, what are the factors and criteria that determine whether a fund is required to be registered?

In Japan, domestic funds that are offered to the public are generally structured as either investment trusts or investment corporations. In addition, foreign funds that are publicly offered are categorised as foreign investment trusts or foreign investment corporations.

For a domestic investment trust, a notification that contains the basic terms and conditions of the investment trust contract must be filed with the relevant authority (the commissioner of the FSA or the director general of a local finance bureau) prior to entering into the investment trust contract, regardless of whether the units are publicly offered or privately placed.

For a domestic investment corporation, registration of the investment corporation is required prior to commencing its operations, regardless of whether the units are publicly offered or privately placed.

For a foreign investment trust or foreign investment corporation, a notification that contains an outline of the foreign investment trust or foreign investment corporation must be filed with the commissioner of the FSA prior to (a) an offering and sale of, or (b) providing intermediary, brokerage or agency services regarding, the units/shares of the fund, unless an exemption applies. Although exemptions from the notification requirement are available to foreign investment trusts and foreign investment corporations, these exemptions are quite limited and a notification will generally be required.

1.2 What does the fund registration process involve, e.g., what documents are required to be filed?

The registration and filing requirements differ depending on whether the fund is structured as an investment trust or investment corporation, and whether it is categorised as domestic or foreign.

Domestic investment trusts must file a notification including the name, the type (open-ended or closed-ended, etc.) of investment trust, and the type of assets which are to be the subject of investment, the investment policy, the planned size of the investment trust, the establishment date, and the period of the trust agreement. The notification is required to attach a draft of the basic

terms and conditions of the investment trust and a written consent of the trustee.

When registering a domestic investment corporation, the application for the registration must include the purpose, trade name, whether it is open-ended or closed-ended, the subject and policy of asset investments, the policies for distributing monies, information concerning the corporate officer(s), supervisory officers, accounting auditor(s), the asset management company, the asset custody company, and major investors. The attachments to the application include the certificate of incorporation, a certificate of registered information of the investment corporation, a resume or history of the executive managing officers, supervisory officers and organiser(s), a copy of the written entrustment contract for asset investment concluded with an asset management company, and a copy of the custody contract concluded with the asset custody company.

A foreign investment trust must file a notification including an outline of the settlor, trustee, beneficiary, the beneficiary certificates, the management and investment of the trust, calculation of the trust and the distribution of profits and the offering/placement. A foreign investment corporation must file a notification including the purpose, trade name, and address of the investment corporation, outline of its organisation and officers, the management and investment of its assets, the accounting for and distribution of profits, the rights represented by the units, and the refund and repurchase of the units. The attachments to the notifications of a foreign investment trust and foreign investment corporation include: a certificate of incorporation (only foreign investment corporation); a copy of the written approval, written authorisation, written permission, notification or documents equivalent thereto in cases where an approval, authorisation, permission, notification or the equivalent thereto has been made with regard to the establishment of the relevant fund based on laws and regulations of the state in which the fund was established; a legal opinion by legal experts stating that the establishment of the relevant fund is legal as well as copies of the relevant provisions of the relevant laws and regulations set forth in the legal opinion; and a document describing the contents of the entrustment in cases where a person who has the authority for the investment of the relevant fund has entrusted the authority to another person.

1.3 What are the consequences for failing to register a fund that is required to be registered in your jurisdiction?

Regarding domestic investment trusts, a person who has failed to make a notification or has made a false notification of the basic

terms and conditions of the investment trust shall be punished by imprisonment with labour for not more than six months, a fine of not more than JPY 500,000, or both.

Domestic investment corporations, organiser(s) of an investment corporation, corporate officer(s) or supervisory officer(s), etc., who have conducted a sale or purchase of securities and certain other transactions without obtaining registration shall be punished by imprisonment with labour for not more than one year, a fine of not more than JPY 1 million, or both.

Regarding foreign investment trusts or foreign investment corporations, a person who has failed to make a notification or has made a false notification of certain matters shall be punished by imprisonment with labour for not more than six months, a fine of not more than JPY 500,000, or both.

1.4 Are there local residency or other local qualification requirements that a fund must meet in order to register in your jurisdiction? Or are foreign funds permitted to register in your jurisdiction?

For a domestic investment trust, the settlor of the trust, which manages the assets of the investment trust, must be a financial instruments business operator (a “FIBO”) who conducts investment management business, and is required to have an office in Japan.

A domestic investment corporation needs to be established under the Investment Trust and Investment Corporation Act of Japan, and be headquartered in Japan.

For a foreign investment trust or foreign investment corporation that makes a notification concerning (a) an offering and sale of, or (b) intermediary, brokerage or agency services regarding, its units or shares, the issuer must appoint a person who has an address in Japan and who has the authority to represent the issuer for any acts concerning the notification. In addition, the Japan Securities Dealers Association (“JSDA”) allows its members to market units of a foreign investment trust to the public in Japan only where the management company of the foreign investment trust has appointed a person with an address in Japan and with the authority to represent the issuer for any acts in Japan and a representative firm from members of the JSDA. For an investment corporation, the JSDA allows its members to market shares of a foreign investment corporation to the public in Japan only where the foreign investment corporation has appointed a person who has an address in Japan with the authority to represent the issuer for any acts in Japan and a representative firm from members of the JSDA.

2 Regulatory Framework

2.1 What are the main regulatory restrictions and requirements that a public fund must comply with in the following areas, if any? Are there other main areas of regulation that are imposed on public funds?

i. Governance

For a domestic investment trust, a settlor of the trust and a trustee are required. A domestic investment trust is generally managed by a settlor, which must be a FIBO who conducts investment management business, though written resolution by beneficiaries is required for a material change to the basic terms and conditions of an investment trust or consolidation of investment trusts. A trustee of a domestic investment trust must be either a bank that is allowed to engage in trust business, or a trust company licensed or registered under the Trust Business Act.

A domestic investment corporation must have one or more corporate officers, supervisory officers numbering at least one more than the number of corporate officers, a board of officers which is composed of all the corporate officers and supervisory officers, and an accounting auditor. A domestic investment corporation is generally managed by the corporate officer(s) and/or board of officers, though resolution by an investors’ meeting is required in order to, among others, entrust its business pertaining to asset investment to an asset management company and change its certificate of incorporation or appoint its corporate officer(s) and supervisory officers. In addition, a domestic investment corporation must entrust its business pertaining to asset investment to an asset management company, which must be a FIBO that is registered under the FIEA to conduct investment management business. Further, a domestic investment corporation must entrust its business pertaining to custody of assets to an asset custody company, and entrust business affairs related to the solicitation of persons to subscribe for, or the issue of, its equity interests or bonds, business affairs related to the operations of the administrative instruments, or business affairs related to accounts to specified persons.

For a foreign investment trust, there are no governance requirements except that the JSDA allows its members to market units of a foreign investment trust to the public in Japan only when a change in the officers of the management company shall require the approval, etc. of the relevant authorities, investors or trustees.

There are no governance requirements on a foreign investment corporation, except that the JSDA allows its members to market shares of a foreign investment corporation to the public in Japan only when a change in the officers of the foreign investment corporation shall require the approval, etc. of the relevant authorities, investors or trustees.

ii. Selection of investment adviser, and review and approval of investment advisory agreement

For a domestic investment trust, a settlor of a trust generally gives instructions on the investment. A settlor may entrust another person with the authority to do so, if the person is registered to conduct the investment management business under the FIEA or a foreign judicial person conducts the investment management business in a foreign state. The registration may be required for the foreign judicial person unless an exemption applies.

A domestic investment corporation must entrust its business pertaining to asset investment to an asset management company, which must be a FIBO that is registered under the FIEA to conduct investment management business. The registration may be required in order for the investment advisor to work for the asset management company unless an exemption applies.

For a foreign investment trust or foreign investment corporation, there are no restrictions.

iii. Capital structure

For a domestic investment trust, a settlor of a trust must have both capital of JPY 50 million and net assets amounting to JPY 50 million and trustees must also have a certain amount of capital and net assets depending on the type of licence/registration.

A domestic investment corporation must have at least JPY 50 million both for its capital amount and its net asset amount.

For a foreign investment trust, the JSDA allows its members to market units of a foreign investment trust to the public in Japan only when the net assets of the management company are at least JPY 50 million and net assets of the foreign investment trust are at least JPY 100 million.

For a foreign investment corporation, the JSDA allows its members to market shares of a foreign investment corporation to the public in

Japan only when the net assets of the foreign investment corporation are at least JPY 100 million and net assets of the asset management company are at least JPY 50 million.

iv. Limits on portfolio investments

A domestic investment trust and domestic investment corporation may invest only in “specified assets” which include securities, derivatives, real estate, loans and commodities. Restrictions relating to management of credit risk and other restrictions also apply.

For a foreign investment trust or foreign investment corporation, the JSDA allows its members to market units of a foreign investment trust or shares of a foreign investment corporation to the public in Japan only when investments by the fund comply with the JSDA’s rules.

v. Conflicts of interest

A settlor of a domestic investment trust and a management company of a domestic investment corporation must not make an investment that involves a transaction being conducted with itself or its directors or executive officers, or make an investment that involves a transaction being conducted between or among funds it manages.

For a foreign investment trust, the JSDA allows its members to market units of a foreign investment trust to the public in Japan only when there is a prohibition against improper transactions, under which, among others, the management company is forbidden to conduct transactions for the purpose of its own benefit or for the benefit of third parties other than beneficiaries, and other transactions that go against the protection of a beneficiary or that hamper the appropriate management of the investment trust.

For a foreign investment corporation, the JSDA allows its members to market shares of a foreign investment corporation to the public in Japan only when there is a prohibition against improper transactions, under which, among others, the asset management company is forbidden to conduct transactions for the purpose of its own benefit or for the benefit of third parties other than investors, and other transactions contrary to the protection of the investors or that hamper the appropriate management of the investment corporation.

vi. Reporting and recordkeeping

For a domestic investment trust, a settlor must prepare an investment report for the investment trust that it manages, on the last day of the accounting period for the fund, and deliver it to known beneficiaries of the investment trust, unless an exemption applies. In addition, the settlor of the trust, as a registered FIBO, must prepare and archive its business books and documents, and must file annual business reports with the relevant authority in accordance with the FIEA.

A domestic investment corporation is required to prepare financial statements, asset investment reports, and statements on the distribution of monies for each business period. In addition, an asset management company, as a registered FIBO, must prepare an investment report for the investment corporation and deliver it to the investment corporation, unless an exemption applies, prepare and archive its business books and documents, and must file an annual business report with the relevant authority in accordance with the FIEA.

For foreign investment trusts and foreign investment corporations, the JSDA allows its members to market units of a foreign investment trust or shares of a foreign investment corporation to the public in Japan only when information concerning the fund is disclosed to investors and the relevant authority, unless an exemption applies.

vii. Other

There are no other main regulatory restrictions and requirements to be aware of.

2.2 Are investment advisers that advise public funds required to be registered and/or regulated in your jurisdiction? If so, what does the registration process involve?

A domestic investment trust is generally managed by the settlor of the trust. A domestic investment corporation is generally managed by an asset management company. An investment advisor to a settlor or asset management company must be registered as a FIBO that engages in investment management business if it has the discretionary power to invest in and dispose of assets. If an investment advisor does not have that discretionary power, it must be registered as a FIBO that engages in investment advisory and agency business.

An investment advisor to a foreign investment trust or foreign investment trust is not subject to Japanese law as long as no advisory-related activity is conducted in Japan.

2.3 In addition to the requirements above, are there additional regulatory restrictions and requirements imposed on investment advisers that advise public funds?

An investment advisor to a settlor of a domestic investment trust or asset management company of an investment corporation that is registered as a FIBO is subject to obligations under the FIEA, which include reporting and bookkeeping obligations.

2.4 Are there any requirements or restrictions in your jurisdiction for public funds investing in digital currencies?

As mentioned above in question 2.1 iv. “Limits on portfolio investments”, a domestic investment trust and domestic investment corporation may invest only in “specified assets”, which does not include digital currencies. Therefore, public funds investing only in digital currencies do not fall under the definition of a domestic investment trust or domestic investment corporation under the Act on Investment Trusts and Investment Corporations (the “AITIC”).

If a domestic public fund, as a fund of funds, invests in equity of a fund which invests only in digital currencies, the fund of funds can be a domestic investment trust or domestic investment corporation under the AITIC.

Whether a fund falls under the definition of a foreign public funds depends on the similarity between the foreign public fund and a domestic investment trust or domestic investment corporation. Therefore, foreign public funds which invest only in digital currencies are not likely to fall under the definition of a foreign investment trust or foreign investment corporation under the AITIC.

3 Marketing of Public Funds

3.1 What regulatory frameworks apply to the marketing of public funds?

Basically, the regulatory framework is divided into: requirements regarding disclosure; and requirements regarding the conduct of business.

As for the disclosure requirements, in the event of an offering of interests in funds to the public in Japan (i.e., where no private placement exemption is available), the issuer must file a securities registration statement (an “SRS”) with a local finance bureau with respect to the proposed offering in Japan, unless an exemption applies. The SRS becomes effective, at the earliest, 16 days after it is filed, and the offeror cannot execute a sale and purchase agreement with the offerees until the SRS has become effective. The offeror must also deliver a prospectus to each offeree with respect to the proposed offering in Japan. In addition, an issuer who has filed an SRS becomes subject to the continuous disclosure requirements under the FIEA, which include the requirement to file a securities report for each calculation period.

One possible exemption from the abovementioned disclosure requirements is the “secondary distribution of foreign securities” exemption that is applicable to foreign investment trusts and foreign investment corporations. When secondary distributions of foreign securities meeting prescribed requirements are conducted by a FIBO or a bank, or certain other financial institutions registered as engaging in financial instruments business (a “FIBO, etc.”), an SRS need not be filed with respect to the offering of such secondary distribution, provided that prescribed “foreign securities information” must, in general, be provided or publicised simultaneously with, or in advance of, the distribution.

As for the requirements regarding the conduct of business, please see question 3.2 below.

3.2 Is licensure with a regulatory authority required of persons (whether entities or natural persons) engaged in marketing activities? If so: (i) are there commonly available exceptions that may be relied on?; and (ii) describe the level of substantive regulation applied to licensed persons.

A distributor, in principle, must be registered as a FIBO, etc. that conducts “type I financial instruments business”, provided that a foreign securities firm that engages in securities transactions in its home jurisdiction having a proper licence or being properly exempted may engage in marketing to a qualified financial institution from outside of Japan.

There are various requirements to be registered as a FIBO, etc. that conducts “type I financial instruments business”. For example, the applicant must be a company incorporated in Japan having a board of directors as its governance organisation, or a non-Japanese company having a branch in Japan with sufficient human resources and prospects of financial soundness to carry on regulated financial instruments business.

If marketing activities are conducted by a settlor of an investment trust, the settlor must be registered as a FIBO, etc. that conducts “type II financial instruments business”. There are various requirements to be registered as a FIBO, etc. that conducts “type II financial instruments business”, though the requirements are less strict to some extent than those for “type I financial instruments business”.

If marketing activities are conducted by a foreign investment corporation, the investment corporation does not have to be registered as a FIBO, etc. A domestic investment corporation must entrust business affairs related to the solicitation of persons to subscribe for, or the issue of, its equity interests or bonds and is not allowed to conduct marketing activities by itself.

For marketing activities, a FIBO, etc. must comply with the requirements regarding the conduct of business, which include restrictions on advertising, requirement of delivering a document

stating prescribed particulars to the customer in advance, prohibition of engaging in fraudulent, misleading and other prescribed acts, and principle of suitability.

3.3 What are the main regulatory restrictions and requirements in the following areas, if any, that must be complied with by entities that are involved in marketing public funds?

i. Distribution fees or other charges

This is not applicable in our jurisdiction.

ii. Advertising

A FIBO, etc. must, when advertising the contents of its financial instruments business or conducting any similar acts, indicate its trade name, registration number, the amount of fees, risks and other prescribed matters clearly and accurately.

iii. Investor suitability

A FIBO, etc. must not conduct solicitations with regard to a financial instruments transaction in a manner that is inappropriate in light of the customer’s knowledge, experience, the status of property or the purpose of concluding a contract for a financial instruments transaction, which results in or is likely to result in insufficient protection for investors.

iv. Custody of investor funds or securities

For a domestic investment trust, a trustee must comply with the requirements under the Trust Act, Trust Business Act and Act on Engagement in Trust Business Activities by Financial Institutions.

A domestic investment corporation must entrust its business pertaining to custody of assets to an asset custody company, which must comply with the requirements under the Trust Act, Trust Business Act and Act on Engagement in Trust Business Activities by Financial Institutions or the FIEA.

For a foreign investment trust or foreign investment corporation, no restrictions apply.

3.4 Are there restrictions on to whom public funds may be marketed or sold?

No, there are no restrictions.

3.5 Are there other main areas of regulation that are imposed with respect to the marketing of public funds?

If the aggregate subscription amount is JPY 1 billion or more, the foreign issuer is required to submit a report to the Minister of Finance within 20 days following the issuance of the shares. In addition, an annual report regarding the status of redemption, etc. of securities would be required.

In relation to subscription by Japanese investors of interests in a fund, identity confirmation is generally required pursuant to the Act on Prevention of Transfer of Criminal Proceeds. In addition, in the event assets received are suspected of being criminal proceeds, or in the event the counterparty is suspected of engaging in actions which correspond to the concealment of criminal proceeds or other crimes, the facts related to the suspicious transactions must be reported promptly to the Commissioner of the Financial Services Agency.

The preparation of certain legends may be required under the Act on Sales, etc. of Financial Instruments.

4 Tax Treatment

4.1 What are the types of entities that can be public funds in your jurisdiction?

In Japan, domestic funds that are offered to the public are generally structured as either investment trusts or investment corporations. Foreign funds that are publicly offered are categorised as foreign investment trusts or foreign investment corporations.

4.2 What is the tax treatment of each such entity (both entity-level tax and taxation of investors in respect of allocations of income or distributions, as the case may be)?

A domestic investment trust would generally not be treated as a taxpayer for Japanese corporate income tax purposes.

A domestic investment corporation is able to deduct the amount of distributions to its shareholders from its taxable income if certain requirements are satisfied, which include:

- (i) it is registered under the Investment Trust and Investment Corporation Law;
- (ii) either of: (a) when established, it makes a public offering of its shares, the aggregate sale price of which exceeds JPY 100 million; or (b) at the end of the fiscal year, shares are held by 50 or more persons, or held by specified institutional investors only;

- (iii) the majority of its shares were offered in Japan;
- (iv) its fiscal year is one year or shorter;
- (v) it is not a “family company” (a company is a family company if the majority of the shares are held only by one person and his/her/its affiliated person(s));
- (vi) it distributes more than 90% of its distributable amount;
- (vii) it does not hold 50% or more of the shares of another company; and
- (viii) it does not borrow money from any person other than specified institutional investors.

A foreign investment trust or foreign investment corporation is not subject to Japanese taxation unless it has income from sources within Japan.

As for the taxation of individual investors, although tax treatment differs depending on type of the fund, individual investors, in general, may choose separate taxation at the rate of 20.315% for income from distributions. If an investor chooses comprehensive taxation, the maximum income tax rate for individuals is roughly 56%. Capital gains qualify for separate taxation at the rate of 20.315%. Withholding tax may apply.

4.3 If a public fund, or a type of entity that may be a public fund, qualifies for a special tax regime, what are the requirements necessary to permit the entity to qualify for this special tax regime?

For details of the special tax regime applying to a domestic investment corporation, please see question 4.2 above.

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