

Are “Tokumei Kumiai” and “Partnership” Distant Relatives?

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Among the various real estate investment structures in Japan, I believe that most famous one is the “Tokumei Kumiai Contract” (Undisclosed Association Contract) of the commercial law. The major benefits of TK structure is the (1) avoidance of double taxation, and (2) that investors can remain anonymous.

Even though the TK is a sophisticated investment structure, it still has some bad image from past tax evasion cases and from its anonymousness. However, the TK or undisclosed association system has been in used in Japan for a very long time.

The origin of the TK contract is from the Commenda contract of the Mediterranean trading in 10th century Italy. Commenda was a contract between the capitalist (commendator) and the transporter (tractator) to sell the capitalist’s products overseas and for the transporter to bring back the profit. This contract developed into consortium called “collegantia”, and later separated into first partnership firm called “accomandita” and the first TK called “participatio”, where the transporter developed into entrepreneur and capitalist to investor. This became an initial form of TK structure.

This “participatio” was adopted in England via France and became the partnership structure of English and American law.

In the continental Europe, the partnership firm developed in France (société en commandite) and the TK developed in Germany (Stille Gestlshaft). Since Japanese commercial law is based on German commercial law, “Tokumei Kumiai Contract” was adopted in the Japanese system.

The TK contract first appeared in Japan in the “Draft of Commercial Law” published in Meiji 23, and the current system is based on this draft. However, this TK contract was not used for a long time until post war period of the 1950’s, and was known to the public by the unpopular “Hozen Keizai-kai case”. In the post war period, the Japanese government policy was to transfer individual savings to key industries through financial institutions. This left the individuals and small-medium corporations with little money and created a financial back market such as Hozen

Keizai-kai. The Hozen Keizai-kai promised high return and gathered money from regional farmers which they invested in stocks. However, Hozen Keizai-kai did not have any investment know-how and ended up being bankrupt in the stock market crash in 1953 (Showa 28) creating a huge social dispute.

Through this “law concerning the investment, deposit, and interest rate (Investment Deposit and Interest Rate Law)” was enforced in order to protect the consumers. Income tax law concerning the deducting tax from income at source was also enacted at a same time.

Even though the TK system has had a rough experience in Japan, it has been widely used in Europe for a long time as a direct finance to collect risk money. Japanese TK structure itself had no problem, however, issue concerning the disclosure of risk factors has been discussed then. And as a result, a risk product will not violate the Investment Deposit and Interest Rate Law when clearly indicated.

Since post war Japan did not have a healthy environment to develop risk money may be the reason which caused these types of fraud using TK system. I would like to define this as a by-product of Japanese government’s effort to create indirect finance system and a pipeline to revive the Japanese economy in the post war period.