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Title	*Japan Govt To End Cap Gain Taxes On Foreign Invests In Funds*

The Japanese government's plan to scrap hefty capital gains taxes on foreign investment in funds will be submitted to parliament in the coming weeks, a move that could potentially boost much-needed investment in the world's second-largest economy.

Officials said Wednesday that barring any objections, the tax will be revoked on April 1 for buyout and venture capital funds. Investors in these funds, such as sovereign wealth funds, rich individuals and university endowment funds are currently subject to a capital gains tax of up to 40%, a higher tariff than in many other jurisdictions.

(This story and related background material will be available on The Wall Street Journal Web site, WSJ.com)

The high taxes have resulted in crimped investment. Only 4% of the funds managed by private equity and venture capital firms active in Japan comes from abroad, well below 75% in the U.K., 60% in the European Union and 20% in the U.S.

The 200 active limited partnerships, a structure used by private equity and venture capital funds, only manage about Y2 trillion, according to the Ministry of Economy Trade and Industry, which is promoting the reform.

The officials say they hope private equity firms will prompt sprawling Japanese conglomerates to hive off non-core businesses and spread western management techniques.

The case for attracting foreign investment, particularly from the Middle East, has become increasingly urgent since Japan entered a recession last year. Banks are less willing to put their capital at risk by making loans to small and medium-sized companies.

The present tax regime was ushered in during 2005 after private equity investors in Japan's Shinsei Bank, Ltd. (SKLKY) walked away with over $1 billion in profits tax free because of a loophole. This created a public outcry because government money was used to rescue Shinsei from bankruptcy only a few years earlier.

Tax lawyers say the reforms will repeal much of 2005's draconian measures, which only have a parallel in French law. But they note a clause saying exceptions will be made for types of insolvent financial institutions, showing the Shinsei experience will not be repeated.

Tax lawyers and lobbyists say the reforms are positive but don't go far enough. Many Middle Eastern investors, for example, have to pay withholding tax on dividends from Japanese companies. The proposal is also riddled with exceptions. To be eligible, investments in the limited partnership set up must be over a year old and they can't own 25% or more of the limited partnership of the fund. But for most investors, who generally stay in funds for several years and don't own a huge percentage, the reform is a boon.

Tokyo stocks ended higher partly because of the tax reform plans. Japan's leading share benchmark, the Nikkei, ended the day up 1.7% at 9239.24.

“It's a good first step,” said Hans-Peter Musahl, head of the tax committee of the European Business Council in Japan