Japan Property Investment Guide

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Property Tenure/Ownership

Legal concepts such as 'freehold property ownership', 'fee simple absolute', 'fee simple conditional' and 'leasehold property ownership' can be misleading when applied to the Japanese property regime. Although the classification may be overly simplistic, interests in real property under Japanese law could be classified into: ownership, lease interests, superficies and easements, and security interests.

Land and buildings are considered as separate and independent real properties. Ownership title (shoyuken) to land and the ownership title to buildings on such land can belong to different persons. If A owns the land and B owns a building on the land, B has to have a right, one way or the other, to use the land in order to enjoy its ownership title to the building without being required to demolish the building.

As a general rule, in order to perfect ownership title to real estate, the owner must have its ownership title registered in the name of the owner. However, registration does not necessarily guarantee that the registered owner validly owns the real property.

Land leases and building leases are subject to various restrictions under the Land and House Lease Act as well as Supreme Court precedents. It is also worth noting that some of these restrictions are expressly stated or construed as being mandatory restrictions that cannot be superseded by contractual arrangement between parties. This means that provisions in lease contracts would be deemed void by operation of law if they conflict with those mandatory restrictions. It should be noted that, in practice, one would almost certainly find provisions that would be voided but are nevertheless knowingly inserted in lease contracts. Investors should take such restrictions into consideration when analysing investment opportunities in real property in Japan.

For real properties of large size or for those transactions that are commercial in nature, sale and purchase transactions are frequently done in the form of the sale and purchase of a trust beneficial interest in real property rather than a straightforward sale and purchase of the real property itself.

Major Property Legislation

- Urban Planning Law
- Land Use Law
- Civil Law
- Building Standards Act
- Large Scale Retail Stores Location Law
- Land and House Lease Act
- Real Estate Registration Act
- Sectional Ownership Act
- Ordinances by Local Government

Operational Requirements for Foreign Corporations

Establishment of a Branch

Establishment of a business base such as a branch is classified as a foreign direct investment under the Foreign Exchange and Foreign Trade Law.

Within three weeks of establishment, such branch or other business base of a foreign company must be registered with the Legal Affairs Bureau before it can commence its business activities. Under the Companies Act, it is required that the foreign company appoint a 'representative in Japan' in order to do business in Japan (and for that matter, to have the branch registered as such). For taxation purposes, it also has to file notifications and applications to the competent tax bureau.

A foreign company cannot locate its head office in Japan, nor can its principal purpose of business be doing business in Japan.

Appointment of a 'Representative in Japan'

The representative need not necessarily be the practiced representative of the company. However, under Japanese law, such a person is deemed to have the authority to perform any act relating to the business of the company. There may be one or more representatives, but at least one of them must be a resident of Japan.

Foreign Investment Incentives

Certain local governments provide support programmes (such as information services, subsidies, etc.) for the acquisition of real property, equipment investment, etc. by companies, Japanese or foreign, doing certain types of business.

To promote and prompt investments by foreign persons in Japanese bonds, interest payments on, and certain profits from the redemption of, certain corporate bonds and other debt securities in book-entry form (issued on or before 31 March 2013) received by non-residents and certain others satisfying criteria set by a statute are now exempt from income tax on condition that certain procedural requirements have been satisfied.

For similar reasons, interest payments on, and certain profits from the redemption of, certain foreign-issued corporate bonds received by non-residents and certain others satisfying criteria set by a statute are exempt from income tax on condition that certain procedural requirements have been satisfied.

Restrictions on Foreign Property Ownership

There is no direct limitation or restriction on foreign investors' acquisitions, whether direct or through a special purpose vehicle, of commercial or residential real property in Japan. Similarly, the establishment of a corporation by foreign investors for purposes of investments in commercial or residential real property is not limited or restricted.

Foreign Exchange Controls

None.

Taxes on Possession and Operation of Real Estate

Fixed Asset Tax

Fixed asset tax is levied on land, buildings and other depreciable assets used for business purposes (hereinafter termed 'fixed assets'). Fixed asset tax is levied on the registered owner of fixed assets as of 1 January every year by the municipality where the fixed assets are located. The annual tax rate is decided by each municipality and is usually 1.4%, applied to the tax value of the fixed assets.

City Planning Tax

City planning tax is levied on land and buildings located in certain urban areas as a surcharge to fixed asset tax by the municipality where the land or the buildings are located. The annual tax rate is 0.3% or less, applied to the asset value for fixed asset tax purposes.

Business Office Tax

Business office tax is levied on enterprises (whether individuals or corporations) by certain urban municipalities.

The business office tax consists of an asset levy and an employee levy, of which the tax rate and tax exemption limit are, in principle:

Tax Rate	Tax Exemption Limit
Asset levy: JPY 600 per sqm of floor space	1,000 sqm
Employee levy: the total employee's salary amount x 0.25%	100 employees

Land Value Tax

Land value tax is levied on an individual or a corporation that holds land (including lease interests) in Japan at the start of 1 January every year by the national government. However, as a temporary measure, land value tax has been ceased for the time being.

Taxes on Acquisition and Transfer of Real Estate

Stamp Tax

Stamp tax is paid when affixing a revenue stamp on taxable documents, which are listed in the Stamp Tax Act. Agreements for the transfer of ownership title of real property are taxed at progressive amounts ranging from JPY 200 to JPY 540,000 based on the amount stipulated in the agreement.

Registration and License Tax

Registration and license tax is levied upon the registration regarding real property (land or buildings), companies, etc. with Registry Offices. Typical rates for the registration of real property are:

Registration Items		Tax Basis	Tax Rate
Preservation of ownership	–	Assessed value	0.4%
Transfer of ownership	In principle	Assessed value	1.0%
–	Inheritance or merger of corporations	Assessed value	0.2%
Granting or transfer of lease interests	In principle	Assessed value	1.0%
–	Inheritance or merger of corporations	Assessed value	0.2%

A tax reduction is applicable in cases that satisfy certain criteria, including the following:

- Preservation of ownership of certain qualified residential buildings built or acquired by individuals and then resided in by themselves: 0.15% or 0.1%
- Transfer of ownership of certain qualified residential buildings acquired (through sale or auction) by individuals and then resided in by themselves: 0.3% or 0.1%

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Real Property Acquisition Tax

Real property acquisition tax is levied on the acquisition of land or buildings at the tax rate of 3% (for land and residential buildings) or 4% (for non-residential buildings). The tax base is, in principle, the value of acquired land or building for the fixed asset tax purposes or, for building land, half of such value. Acquisition of land or buildings by merger or inheritance is non-taxable, and acquisition of land or buildings for certain use has certain advantages of reduced tax.

Capital Gains Tax

For corporations, capital gains from the transfer of real property are counted in their income for the purpose of the normal corporate tax. For individuals, capital gains from the transfer of land are levied according to the following table (in principle):

Holding Period of Land	Tax Rate
5 years or less	39.0%
Over 5 years	20.0%

Value Added Tax/Goods and Services Tax

Consumption tax, a kind of value added tax, is applied to almost every domestic transaction and every import transaction except for financial transactions, capital transactions, medical services, welfare services and education services. The aggregate consumption tax rate (national tax and local tax) is 5%. Non-taxable transactions include the sale or lease of land and lease of residential buildings.

Tax Depreciation

The straight-line method and the decline-balance method are available as depreciation methods. The useful life and depreciation rate of an item are specified mainly in the 'Ministry Ordinance Concerning the Useful Life, etc. of Depreciable Assets'.

The depreciation rate and useful life of steel frame reinforced concrete buildings are:

Type Of Use	Useful Life	Depreciation Rate (Straight-line Method)	Depreciation Rate (Declining-balance Method)
Office	50 years	2.0%	5.0%
Dwellings	47 years	2.2%	5.3%
Shops	39 years	2.6%	6.4%
Hotels and Inns	31 or 39 years	3.3 or 2.6%	8.1 or 6.4%

Corporate Taxation

Corporate Tax

Corporate tax is levied by the national government on the income of Japanese companies and foreign companies with permanent establishment in Japan. The tax rates are as follows:

Paid-in Capital	Taxable Income	Tax Rate
JPY 100 million or less	Portions of JPY 8 million or less	22%
	Portions over JPY 8 million	30%
Over JPY 100 million	All income	30%

Corporate Inhabitant Tax

Corporate Inhabitant Tax is levied by prefectures and municipalities on income of Japanese companies and foreign companies with a permanent establishment in Japan. Corporate Inhabitant Tax includes a per capita levy which varies according to the amount of capital and number of employees, and a corporate tax levy which is computed as 17.3% (standard rate) of the amount of corporate tax payable.

Corporate Enterprise Tax

Corporate Enterprise Tax is levied by prefectures and municipalities on Japanese companies and foreign companies with a permanent establishment in Japan and which conduct business activities continuously in Japan. The taxable income for Corporate Enterprise Tax purposes is calculated in the same manner as Corporate Tax.

Corporate Enterprise Tax standard rates are:

Taxable Income	Tax Rate
Up to JPY 4 million	5.0%
Over JPY 4 million, up to JPY 8 million	7.3%
Over JPY 8 million	9.6%

Personal Taxation

Resident Status of Foreigners

A resident is an individual who has his/her domicile in Japan or an individual who has his/her residence in Japan for one year or longer. An individual who does not qualify as a resident is classified as a non-resident. 'Domicile' means the centre of living. 'Residence' means the place where an individual stays continuously for a certain period but which cannot be said to be the centre of living.

A resident taxpayer who has no intention of residing permanently in Japan, does not have Japanese nationality and has his/her domicile or residence consistently in Japan for less than five years in the last ten years is a non-permanent resident.

The scope of taxable income for individuals is classified as follows:

- Permanent resident – Worldwide income, i.e. total of Japanese-sourced income and foreign-sourced income
- Non-permanent resident – Japanese-sourced income and foreign-sourced income paid in or remitted into Japan
- Non-resident – Japanese-sourced income

A resident taxpayer, including a non-permanent resident, is subject to income tax assessment. Withholding income tax levied on certain types of income is creditable against assessment of income tax. A non-resident's tax liability is usually settled by the withholding income tax, except on rent incomes from real property or capital gains from land transfer, etc.

Income Tax

The Japanese Income Tax Law provides that the tax amount is calculated on the total of the taxpayer's incomes, while providing certain special measures; (i) a withholding tax system applicable to salaries and wages, dividends and other payments to residents (ii) special measures for separate taxation on interest on bank deposits, dividend income and capital gains; and (iii) for deductions following house acquisition.

The simplified formula for the income tax rate (except for forestry income) is shown below:

Total Taxable	Income Tax Rate
Up to JPY 1.95 million	5%
Over JPY 1.95 million, up to JPY 3.3 million	10%
Over JPY 3.3 million, up to JPY 6.95 million	20%
Over JPY 6.95 million, up to JPY 9 million	23%
Over JPY 9 million, up to JPY 18 million	33%
Over JPY 18 million	40%

In addition to national income tax, an individual inhabitant tax is imposed by prefectures (about 4% of taxable income) and municipalities (about 6% of taxable income) on income during the previous year. If the individual is operating a business, a local enterprise tax is also imposed on the individual.

Filing of income returns is not required of salary income earners of up to JPY 20 million.

Tax Treaties: Avoidance of Double Taxation

A non-resident or a foreign company is subject to a withholding tax of 20% on the payment of various Japanese-sourced incomes. However, if a tax treaty for the avoidance of double taxation exists, specifying the definition of income, a reduced tax rate (5% to 15%) or no tax, the tax treaty has priority over the domestic law.

Treaties for the avoidance of double taxation in existence and in effect:

Armenia
Australia
Austria
Azerbaijan
Bermuda Islands
Bangladesh
Belarus
Belgium
Bermuda
Brazil
Brunei Darussalam
Bulgaria
Canada
China
Czech Republic
Denmark
Egypt
Fiji Islands
Finland
France
Georgia
Germany
Hungary
India
Indonesia
Ireland
Israel
Italy
Kazakhstan
Kuwait (not yet in effect)
Kyrgyzstan
Luxembourg
Malaysia
Mexico
Moldova
Netherlands
New Zealand
Norway
Pakistan
Philippines
Poland
Romania
Russia
Singapore
Slovakia
South Africa
South Korea
Spain
Sri Lanka
Sweden
Switzerland
Tajikistan
Thailand
Turkey
Turkmenistan
Ukraine
United Kingdom
United States of America
Uzbekistan
Vietnam
Zambia

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Real Estate Investment Trusts

Introduction

In Japan, Real Estate Investment Trusts (REITs) are a type of investment fund formed under the Law Concerning Investment Trusts and Investment Companies (Toushi Shintaku oyobi Toushi Houjin ni kansuru Houritsu) (the 'Investment Trust Law') that invests funds gathered from investors, particularly in assets related to real properties, such as ownership rights, land use rights, lease rights, or assets whose underlying assets are such rights (e.g. property trust beneficial interests). The practical norm has been that REITs are formed as corporations as opposed to trusts. Income is generated by rents collected from those properties and proceeds from the sale of properties. This income is then distributed to investors in the form of dividends. Investors receive equity securities called 'investment units' (toushi-guchi) (equivalent to shares), which can be listed and traded on the stock exchange REIT market just like stocks.

The statute allows the formation of REITs according to two entity types: corporate and contract types. Japanese REITs or J-REITs, as a practical matter, have all been formed as a corporate type. The basic principle for this type of REIT is that a special corporation, established for the purpose of investing in and managing real estate assets, uses investors' money to buy real estate, in return for which investors receive 'investment units'. Although the corporation has legal personality and is technically responsible for owning and managing the real estate properties, in reality, all investment decisions are designed to be made by its asset management company that is registered as a Financial Instruments Operator under the Financial Instruments and Exchange Act ('FIEA').

Restrictions

1. Business Scope
   - Under the Investment Trust Law, the business scope of a REIT is limited to businesses such as (a) acquiring or transferring securities, (b) lending and borrowing securities, (c) acquiring or transferring real property, (d) leasing real property, (e) entrustment of the management of real property, and (f) other transactions specified by cabinet order.
2. Asset Restrictions
   - At least 50% of the total assets shall be invested in certain categories defined as 'specified assets' (securities, real estate and other asset-classes designated by government order). In order to have 'investment units' listed on the Tokyo Stock Exchange, there are additional requirements such as (a) real estate (inclusive of certain limited number of real estate-related asset-classes) must make up at least 70% of the total assets under management, and (b) real estate (inclusive of certain limited number of real estate-related asset-classes), real estate-related assets (the scope of which is obviously broader than those that are included in the definition of 'real estate') and current assets must make up at least 95% of the total assets under management.
3. Fund Restrictions
   - Under the Investment Trust Law, net assets of a J-REIT must be at least JPY 50 million. In order to have 'investment units' listed on the Tokyo Stock Exchange, there are additional requirements such as (a) the total net assets equalling JPY 10 billion or more, (b) total assets being worth at least JPY 5 billion, and (c) net assets per 'investment units' being at least JPY 50,000.
4. Distribution and Unit-holders' Restrictions
   - The amount of dividend distributions is prohibited from exceeding the amount obtained by deducting the 'amount of the net assets threshold' (as defined under the Investment Trust Law) from the amount of net assets stated on the balance sheet. In order to have 'investment units' listed on the Tokyo Stock Exchange, there are additional requirements such as (a) at least 4,000 units are listed, (b) major unit-holders may hold no more than 75% of listed units, (c) there are at least 1,000 unit-holders, and (d) no redemption of 'investment units' may be made other than due to dissolution or liquidation of the investment fund.
   - A unit-holder, together with its direct and certain indirect affiliates and other related entities/persons, cannot hold more than 50% of the total investment units in a REIT without jeopardising pass through status for tax purposes (described in more detail below).
   - As stated below, more than 90% of the net income of the REIT must be distributed for each fiscal period to investors as dividends in order for a REIT to be treated as a pass-through entity for tax purposes.

Taxation

- Unlike ordinary corporations, which are liable for corporate taxation on profits, REITs are exempt from taxation if certain criteria are met, which include, among others, (a) the REIT not being engaged in any business other than those permitted to REITs, (b) the REIT not being an entity that would be classified as a 'family corporation' at the end of its fiscal period, and (c) the REIT distributes over 90% of its profits to unit-holders as dividends for each fiscal period.

Special Purpose Entity Available Only to Certain Property Investments: TMK

Introduction

A tokutei mokuteki kaisha (TMK), or a specified purpose company is a corporate-type entity that could be used as an SPC that will acquire and hold assets as part of securitisation transactions and non-recourse finance transactions, subject to certain statutory regulations (for example, copies of certain documents such as a TMK's charter documents, the 'asset liquidation plan' and certain agreements, etc. are required to be submitted to a governmental authority). TMKs are very often used in real property investment transactions because of their tax benefits and for certain regulatory reasons. In real property transactions using a TMK, acquisition of underlying real property is funded by loans extended to the TMK, and/or bonds, commercial papers or preferred equity interests issued by the TMK.

'Pay-through' Entity

Though conditioned upon certain criteria being satisfied, distribution of profits by a TMK to its equity interest holders is counted into the TMK's expenses for corporate-tax purposes. Such criteria include:

- all the bonds issued by the TMK being expected to be held by certain qualified institutional investors, or all the preferred equity interests being subscribed by certain qualified institutional investors, or other alternative requirements being satisfied; and
- over 50% of preferred equity interests (and certain common equity interests) on an issued amount basis having been offered (allotted or offered, for common equity interests) in Japan.

Reduction of Taxes on Acquisition of Real Estate

Regarding a TMK's acquisition of a real property, the TMK could enjoy, conditioned upon satisfaction of certain criteria, a reduction of, among others:

- applicable registration and licence tax levied on the registration of the transfer of ownership title of the real property; and
- applicable real property acquisition tax levied on the acquisition.

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Unit of Measurement	
Unit of Measurement	Tsubo (1 tsubo = 3.3 sqm = 35.58 sq ft)
Rental Payments	
Rents	¥/sqm/month ¥/tsubo/month may also be stated in the lease
Typical lease term	Standard leases: 2-3 years with like renewals. Fixed term leases: 3-5 years, but can be longer
Frequency of rent payable (in advance)	Monthly
Typical rent deposit (expressed as x months rent)	12 months
Security of Tenure	Only for the duration of the tenancy, no guarantee beyond the original lease term (typically has automatic renewal provision in standard leases)
Does tenant have statutory rights to renewal	Standard lease term: Yes Fixed lease term: No
Basis of rent increases or rent review	An negotiated amount based on an open market rental value
Frequency of rent increases or rent review	Typically at lease renewal, but with traditional leases can be any time during term if market rent has substantially increased or decreased. Rents may not be varied for a fixed term unless otherwise agreed
Service Charges, Operating Costs, Repairs & Insurance	
Responsibility for utilities	Electricity, water consumption and after core hour HVAC charges are separately metered and payable by each tenant; telecommunication is separately payable typically to vendor
Car parking	Where parking is available, it is held under a separate monthly lease for an additional rent and deposit
Responsibility for internal repairs	Tenant
Responsibility for repairs of common parts (reception, lifts, stairs, etc)	Landlord
Responsibility for external/structural repairs	Landlord
Responsibility for building insurance	Usually landlord
Disposal of Leases	
Tenant subleasing & assignment rights	Subletting or premises sharing is generally permitted to tenant related companies. Rights to sublease to an unrelated or third party tenant are rare
Tenant early termination rights	Normally allowed with 6 months written notice or immediately by paynig 6 months gross rent in advance Termination within initial lease term usually requires repayment of any rent-free period Typically not allowed under fixed-term lease
Tenant's building reinstatement responsibilities at lease end	Original condition

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