

Blake Dawson



Real value in a changing world

**NISHIMURA
& ASAHI**

Japanese Real Estate

A legal guide for foreign investors



REIT
Hotel
Office
Retail
Industrial
Residential

Introduction – Blake Dawson

Welcome to *Japanese Real Estate: A legal guide for foreign investors*, one of the publications in our series of real estate guides, published in conjunction with Jones Lang LaSalle. This guide is also published in conjunction with Nishimura & Asahi, a leading Japanese law firm.

We hope this guide will give foreign investors a helpful overview and practical information, enabling them to gain a sound base of knowledge and understanding that will assist in their business development goals.

The first guide in this series, *Australian Real Estate: A legal guide for foreign investors*, provides an introduction to the legal and regulatory framework underpinning the Australian commercial real estate market. Guides on investing in Western Australia and Korea are also available on our website at www.blakedawson.com/realestateguides. In 2009 we will also publish a guide about investing in India.

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Real value in a changing world

FOREWORD – JONES LANG LASALLE

The global economic downturn has resulted in significant declines in investor confidence and transactional volumes in property markets across the Asia Pacific region. Few markets have been spared and it is largely the accepted opinion now that the worst is yet to come.

Japan's miracle economy is no exception with the country going into recession in the third quarter of 2008 as businesses cut back sharply on spending. Demand for office space has greatly diminished and in most cases has dropped to negative net absorption rates indicating a period of decline similar to what was experienced in 2004. With demand falling and vacancy rates on the rise, Japan's office market would seem to be exhibiting many of the same symptoms as other markets around the region. However, Japan still retains appeal amongst many international investors, particularly those driven by equity and opportunistic strategies.

Tokyo's property market is vast. Many international investors are still very eager to gain exposure to the market's opportunities as it still affords interested parties comfortable risk levels and a growing base on higher quality real estate assets.

Property market transparency and the intricacies of the regulatory framework surrounding the local real estate market have historically been a significant barrier for international investors to overcome. Japan has made notable improvements to market transparency. International advisory and consulting firms are now able to shed more light on the legal process, in turn making the property market more accessible to foreign investors.

I highly recommend this guide to all foreign investors who have an active interest in Japan's real estate market. It is an immensely valuable resource to assist investors in better understanding this market from a commercial perspective, as well as from a legal and regulatory perspective.

A handwritten signature in black ink, appearing to read "Stuart Crow".

STUART CROW
Head of Asia Capital Markets
Jones Lang LaSalle

NISHIMURA & ASAHI

FOREWORD – NISHIMURA & ASAHI

Since the early 1990s, various innovative real estate investment structures, sometimes introduced by legislation, have been devised and adopted by the Japanese market.

For example, the so-called GK-TK structure and the TMK structure, which we discuss in more detail in this guide, were introduced and have been frequently used for investment in real estate. Legal infrastructure for J-REITs, also discussed in this guide, was introduced with legislation that has made it possible for investors with smaller amounts of capital to invest in real estate through the purchase of listed J-REIT securities.

The development of such flexible investment structures has resulted in greater inflow of domestic and foreign capital into Japanese real estate. Response to demand from the increasing number of participants have made the Japanese real estate investment market more sophisticated and attractive, so that many investors consider the Japanese market to be an important strategic focus in a global investment strategy.

Development and innovation is continuing. The *Trust Law*, for example, which took effect in September 2007, is expected to help further innovation.

As investment structures have developed and the real estate investment market has grown increasingly more sophisticated, inviting international investment, real estate investments have become subject to various types of regulation. A recent example was the introduction of the *Financial Instruments and Exchange Law* that subjected certain real estate investment structures to securities regulations. The purpose was to provide investors with greater transparency and better protection. Although recent economic turmoil has affected, and to a certain extent slowed down, activities in the Japanese real estate investment market, it is hoped that the Japanese legal system will continue to provide a stable and a sound base for real estate investment.

This guide is intended to provide an introduction to Japanese real estate for foreign investors. Although this summary is by no means exhaustive, we hope that this guide will help foreign investors explore opportunities to invest in Japanese real estate.



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The Japanese legal system, Foreign investment in Japanese real estate, Japanese real estate law, Structures for investing in Japanese real estate, Japanese real estate investment trusts (J-REITs), Finance and banking, Tax, Environmental responsibility and land use – Nishimura & Asahi

Investing in real estate in Japan



TOKYO'S PROPERTY MARKET IS VAST. JAPAN STILL RETAINS ITS APPEAL FOR MANY INTERNATIONAL INVESTORS, PARTICULARLY THOSE DRIVEN BY EQUITY AND OPPORTUNISTIC STRATEGIES.

POLITICAL LANDSCAPE

Japan is a constitutional monarchy where power is held chiefly by the Prime Minister of Japan. For close to half a century, the Liberal Democratic Party has monopolised the political power in Japan, except for a short period during the 1990s. However, in recent years the party has lost its popularity during the terms of subsequent Prime Ministers – Shinzo Abe, Yasuo Fukuda and Taro Aso. The party's low public approval ratings suggest that the government might lose the parliamentary election in October to the Democratic Party of Japan. To regain confidence, Prime Minister Taro Aso went ahead with a record stimulus spending, which saw improvements in the economy, such as consumer confidence rising to 10-month high, sales of electronics increasing by 20% and bankruptcies falling for the first time since last April.

Japan has so far proven more resilient than Europe and the US in the face of the global financial turmoil, and its banks have bought into US lenders that were hit by bad sub-prime debt. There is concern that Japan will suffer further as the crisis spreads beyond banking and markets, given that its fiscal and monetary policies have little room to manoeuvre.

ECONOMIC CLIMATE

The Japanese Economy experienced a “miracle” growth phase after the end of the Second World War and up until the 1980s to become the second largest economy in the world after the US, and the third largest economy in the world after the US and China, measured on a purchasing power parity (PPP) basis. Japan’s economy is highly efficient, highly diversified, and very competitive. Japan has a well-educated work force, high savings and investment rates.

For three decades, overall real economic growth had been spectacular – a 10% average in the 1960s, a 5% average in the 1970s, and a 4% average in the 1980s. However, in the 1990s Japan experienced a “lost decade”, and some of its structural problems continue to hold it back. Growth slowed markedly in the 1990s, averaging just 1.7%. From 2000 to 2001, government efforts to revive economic growth proved short lived and were hampered by the slowing of the US, European, and Asian economies. From 2002 to 2007, growth improved and the lingering fears of deflation in prices and economic activity lessened, leading the central bank to raise interest rates to 0.25% in July 2006, up from the near 0% rate of the six years prior, and to 0.50% in February 2007.

However, the economic climate changed drastically in the first half of 2008 as household spending slowed under pressure from rising food and oil prices. Exports, which have been the primary driver of the economic recovery, are also peaking due to the high value of the yen and overseas economic slowdown. As Japan’s economy is gripped by recessionary conditions, its economic outlook over the next 18 months is poor.

After an unexpectedly strong performance in the first quarter of 2008 the economy contracted continually for the remainder of the year, resulting in an overall growth rate of -0.5%.

In 1Q09, Japan’s real gross domestic product shrank by 15.2%, annualised. This result represents the steepest decline in 50 years. However, Japan’s export slump eased in April, and with companies aggressively trimming inventories, factories are beginning to boost production, adding to optimism as it is regarded as a sign that the government’s stimulus measures are working. The government is trying to spark a turnaround with massive public spending. Its newest US\$156 billion stimulus package includes incentives for consumers to buy environmentally friendly appliances and cars, as well as help for the unemployed and small businesses. The economy is expected to improve in 2010 as economic growth in the US and EU will begin to improve modestly. The recovery will boost Japan’s exports and investment.

OFFICE MARKET

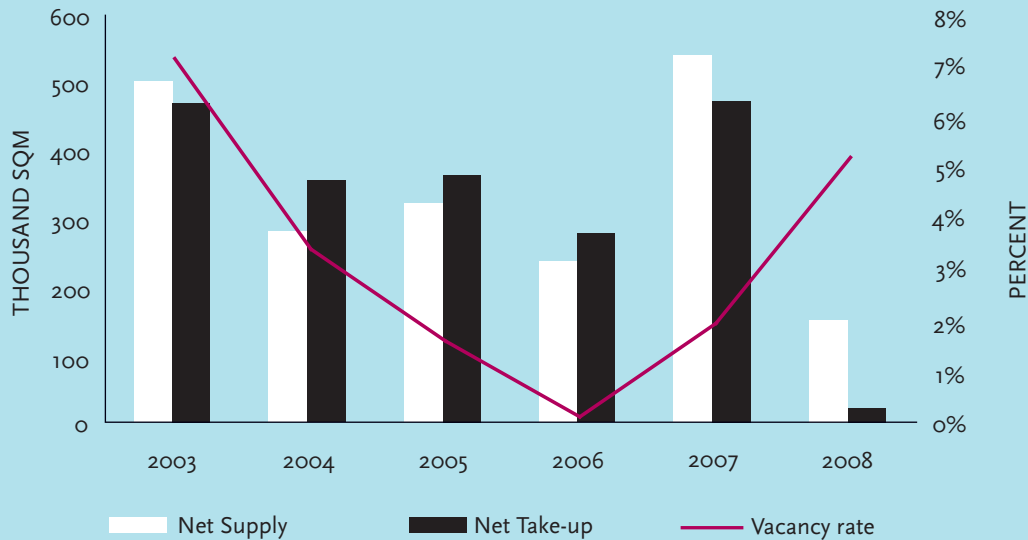
After enjoying a bullish run on the real estate market in the recent boom years, fuelled by vigorous investment by foreign financial institutions and private equity funds, Japan is currently witnessing a rapid slowdown that is exacerbated by a receding economy and the credit squeeze. Property transactions across the nation were affected severely as Western financial institutions and funds pulled out of real estate investment in Japan. In fact, the stagnant domestic scene is forcing local banks to seek M&As and ventures abroad.

The Japan government announced that real GDP grew -3.8% q-o-q or -14.2% in annualised terms in 1Q09. This is a further deterioration from the previous quarter’s -3.2% q-o-q or -12.1% annualised. According to the Bank of Japan’s survey, the business performance of large manufacturers has deteriorated sharply, although there are signs that inventories are cut. Against this backdrop, tenants are clearly leaning towards a “wait-and-see” approach on the market outlook. Furthermore, as some foreign financial institutions are forced to reconsider their business expansion plans, the heavily landlord-dominated market seems to be softening slightly.

Tenant demand was driven primarily by relocations, as well as downsizing and consolidation, as companies channeled their efforts towards the reduction of capital expenditures. This can be seen from the move of TRLis from Ebisu Prime Square Tower to New Otani Tower, the relocation of Mori Trust Sogo REIT and Mori Trust Asset Management to ATT New Tower and JS Group’s move to Tornare Nihonbashi Hamacho. As economic uncertainties loom the global economy decelerates further, the economic activity in Japan is also experiencing a rapid downturn and is expected to continue in the foreseeable future. Employment adjustment caused by rapid production contraction and the unsatisfactory long-term strength of the yen, which is expected to affect earnings of foreign firms and export-dependent manufacturers, are raising concerns for a decline in office demand.

The vacancy rate for Grade A offices in the CBD area remained mostly flat at 5.4% in 4Q08 to 5.1% in 1Q09.

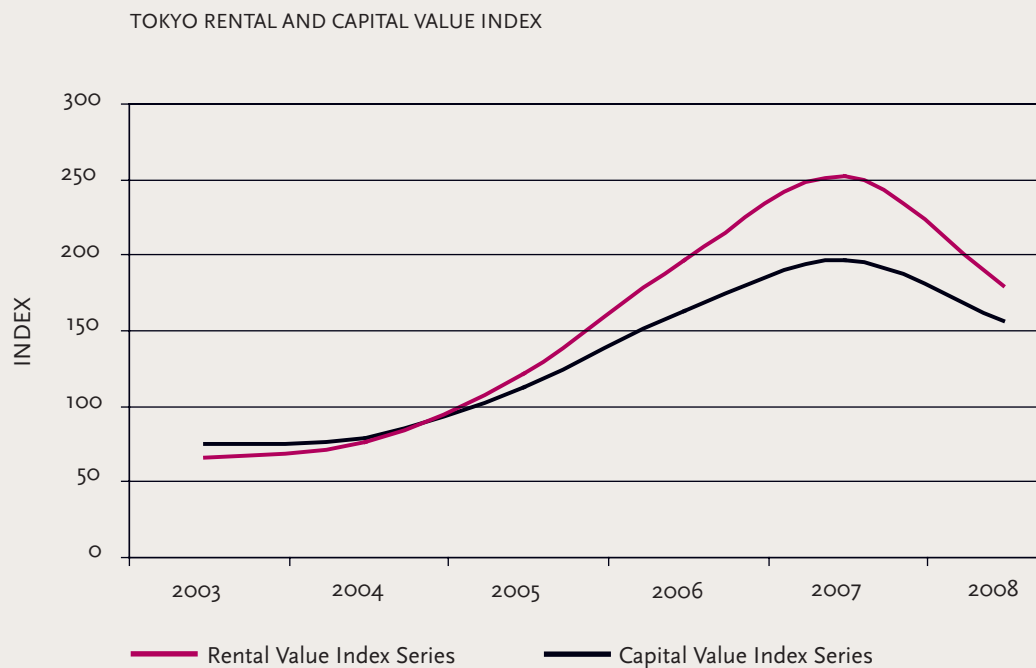
TOKYO SUPPLY AND DEMAND CHART



Source: Jones Lang LaSalle

Hailed as the first completion of the Otemachi chain of redevelopments, the Otemachi 1-chome Urban Area Redevelopment Project will be located on a 13,400 sqm site fronting the Imperial Palace and provide three office buildings (GFA: 236,000 sqm): Nihon Keizai Shimbun, JA and Keidanren Kaikan Towers. Leasehold office space is designated in the lower to middle floors of the JA Building and in the middle floors of Keidanren Kaikan, whose tenants include Sumitomo Forestry and Mitsubishi Materials. The initial completion of the Otemachi redevelopment project was scheduled in March, but was delayed until April.

A couple of redevelopment plans in Otemachi/Marunouchi have been outlined. Otemachi Area B-1 District (GFA: about 241,000 sqm) is included in Phase II of the chain of redevelopments in the Otemachi area, and high-rise twin towers are scheduled to be completed in 2012. Marunouchi 1-4 Project (GFA: about 141,000 sqm; structure: 27 storeys above ground) is a joint redevelopment plan to rebuild three buildings including Togin Building. A large property providing a typical floor plate of over 3,000 sqm is expected to be completed in 2011.



Source: Jones Lang LaSalle

The average monthly rental for CBD Grade A office buildings was JPY 37,247, down 11.3% q-o-q, and down 24.6% y-o-y to JPY 135,207 per sqm per annum.

Given the continued difficulties in funding conditions and the considerable gap between asking and bidding prices, the number of large transactions decreased sharply. Meanwhile, the quarter saw a deal undertaken by NTT Urban Development. This involves the JPY 8.8-billion purchase of 6% preferred securities of a special-purpose company of Akihabara UDX (NLA: about 79,600 sqm) from Kajima Corporation. In addition, the sale of Harumi Island Triton Square was announced again in the 1Q09 after the competitive bidding failed in the previous quarter.

Tokyo constitutes the majority of the target investment area and the risk aversion spurred by deteriorating market conditions is concluding with investment capital being concentrated in Tokyo. While overseas investors continue to cash out and exit the market due to the sub-prime loan problem, activities by domestic players are increasing. This indicates the advantages gained by large domestic developers and core funds with ample investment capital resulting from the credit crunch and lesser competition in the market.

Stricter lending criteria imposed by banks, and the combined effects of the implementation of the *Financial Instruments and Exchange Law* and the amendment of the *Building Standard Law* has led to weaker performance for numerous players in the real estate market. High-leveraged players showed signs of fading presence. On the other hand, low-leveraged players focusing on long-term stable investments, such as core funds, are becoming increasingly visible.

RETAIL MARKET

Japan's retail sector has been changing in recent years as store locations have grown in size, business hours have been extended and specialty stores have increased in number. This has been driven partly by changes in shoppers' preferences and habits. New foreign competition has brought new retail formats which have captured market share. In order to compete, many of Japan's larger retailers have been restructuring through consolidation and by increasing their economies of scale. According to the Japan Ministry of Economy, Trade and Industry, employment has been decreasing at large department stores but is increasing at do-it-yourself stores, specialty supermarkets and convenience stores.

The Japan External Trade Organisation (JETRO) reports that more foreign based retailers have come to Japan in recent years and many prefer to locate at shopping malls where the costs of setting up business are less expensive than at stand alone stores. Consumers are now interested not only in pricing, but also in the variety of goods and services available in one location. Destination shopping and one stop shopping centres have increased in popularity and have provided additional choices for Japanese consumers who are particularly attracted to goods offering style, comfort and convenience.

There are two main categories in the Japanese retail real estate market: urban commercial properties and suburban shopping centres. Urban commercial properties are those located in the central metropolitan areas, represented by department stores; suburban shopping centres are large-scale commercial facilities located in the suburbs.

Urban properties are typically located near major railway stations, providing superior accessibility and good traffic flow. In regional cities, they tend to be located in the established town centre, where municipal offices and other facilities have accumulated, rather than near a railway station. They are located in busy town centres, which usually boast the highest land prices. Suburban shopping centres, which typically feature mall-type commercial properties with a core tenant and numerous specialty shops (as seen in the US), have mushroomed since 2000.

Urban department stores are mainly owned by the department stores themselves. On the other hand, ownership of suburban shopping centres by real estate investment funds, such as J-REITs, is increasing. With the recent trend of focusing management resources on core business, the shift from "ownership" to "lease" or taking real estate off the balance sheet is set to continue.

Rentals for commercial properties are derived directly from payment capability based on turnover, which varies from tenant to tenant. For urban properties, aside from the flow of customer traffic and the clustering of other shops, competition is also a factor. In supply-tight Ginza, retailers are in many instances strongly motivated by branding criteria in addition to expected sales. For suburban shopping centres, future development plans in the same catchment area, as well as existing competition, affect sales, which is a significant factor affecting rent levels. Furthermore, a variety of contracts exist – regular leases, fixed-term leases etc and as a result, an array of complicated factors determine retail rent levels, which are more difficult to assess than rent levels in the office sector.

Although domestic consumption is lacklustre, and the Japanese retail market is still non-transparent, there are still good investment opportunities. The prevalence of a low birth rate and ageing population is expected to accelerate in the near future. However, metropolitan cities such as Tokyo are expected to see an increase in population arising from the movement of people from surrounding cities, where conversely, a significant decrease in population is occurring.

Spending by tourists from Asian countries such as China, where purchasing power is growing remarkably from rapid economic expansion, is increasing. This is considered a positive factor. Second-generation baby-boomers (those born between 1971 and 1974) will be the core spenders going forward.

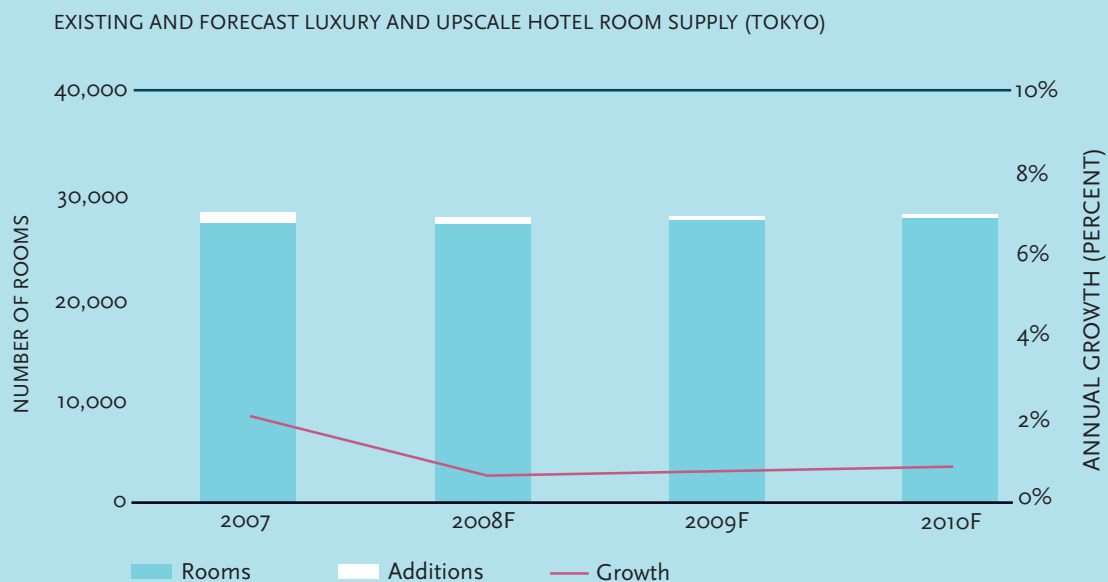
There are investment opportunities in the Japanese retail market, but it hinges on a detailed analysis of a range of factors including retail sales growth, sub-market population trends and target consumer groups.

HOTEL MARKET

A dynamic and energetic city, Tokyo is one of the world's great metropolises. As the financial centre of the world's second largest economy, the city faces some challenges as global economic growth slows and its major trading partner, the US, faces the challenges of an economic downturn. Over the past few years leisure visitors to Tokyo have increased as the city has lost its perception of being too expensive. The Tokyo Metropolitan Government has designated tourism as a primary economic growth driver and is targeting 500 million domestic and seven million international tourists by 2011. The promotion of the city as a MICE destination is also reaping benefits, with one third of all international events in Japan being held in Tokyo. Already well-developed, additional infrastructure improvements are also underway, including the construction of a fourth runway at Haneda airport.

On a year-to-year basis, RevPAR for January 2009 has increased 12.4% to JPY 15,140 and ADR increased by 25.9% to JPY 25,086.

However, the 2009 Tokyo market is estimated to stay sluggish throughout the year. The hotel market recovery depends on the financial market recovery. Some hoteliers in Tokyo expect that the recovery will take place at the end of 2009 or at the beginning of 2010.



Source: Jones Lang LaSalle



The Japanese legal system

Japan is not a federation but a single nation with a single Constitution. Under the Constitution, legislative power is granted to the Diet (*kokkai*), executive power is granted to the Cabinet (*naikaku*) and judicial power is granted to the Court (*saibansho*).

Under the same Constitution, local governments (*chihou koukyou dantai*) are granted a certain degree of local autonomy (*chihou jichi*).

LEGISLATIVE BRANCH

The Diet is the sole organisation authorised to enact national laws (*houritsu*). There is, as a general rule, no restriction on the subject matter with respect to which national laws can be enacted and there are numerous national laws addressing real estate matters.

The Diet is comprised of the House of Representatives (*shugiin*, the Lower House) and the House of Councillors (*sangiin*, the Upper House). For the Diet to pass a national law, it is a general rule that both Houses need to approve the law. In certain cases, however, the decision of the House of Representatives, not the decision of the House of Councillors, can be regarded as the decision of the Diet with respect to the approval of national law, because the composition of the House of Representatives is usually considered to be closer to the composition of the people of the nation than that of the House of Councillors.

Japan is generally said to be a Civil Law jurisdiction, not a Common Law jurisdiction. National laws enacted by the Diet play a core role in the legal system.

EXECUTIVE BRANCH

The Cabinet enforces national laws and enacts Cabinet Orders (*seirei*) for the purpose of such enforcement to the extent authorised by national laws. The Cabinet Office (*naikaku fu*) also has the power to enact Cabinet Office Ordinances (*naikaku fu rei*) to the extent authorised by national laws and/or Cabinet Orders for the purpose of the enforcement of national laws and/or Cabinet Orders.

LOCAL GOVERNMENTS

Local governments (prefectures, cities, wards and other municipalities) are granted a certain degree of local autonomy and are granted the power to enact their own local laws (*jourei*) to the extent permitted by national laws. Local laws are different from national laws in that local laws only apply to matters related to the district governed by the local government that enacted the local laws. There are numerous local laws providing local real estate regulations. Local environmental regulations can be stricter than national environmental regulations under national laws, which means that, in some cases, the fact that real estate is compliant with national regulations does not necessarily mean that it is compliant with local regulations.

JUDICIAL BRANCH

The judicial branch is comprised of the Supreme Court (*saikou saibansho*) as the highest court and other courts such as the High Courts (*koutou saibansho*), the District Courts (*chihou saibansho*), the Family Courts (*katei saibansho*) and the Summary Courts (*kan'i saibansho*).

The Constitution grants the courts the power to resolve disputes with respect to parties' specific rights and obligations by applying laws (including national laws and local laws) to the disputes. Court precedents, especially those of the Supreme Court, are in many instances persuasive in terms of the interpretation of laws, but are not legally binding. Even though Japan is generally said to be a Civil Law jurisdiction, court precedents do impact subsequent court cases in this way.

In principle, a case may be heard and ruled upon up to three times by the courts, should any litigant involved in the case so desire. Depending on the case to be heard, the court of first instance is generally the District Court, the court of second instance is the High Court and the court of last instance is the Supreme Court. For real estate related cases, the court of first instance will be the District Court in most cases. Where the value of the subject matter of such cases is JPY1,400,000 or less, or with respect to certain cases regarding land and building leases, the Summary Court will be the court of first instance, if the parties so agree.

Key points

- When you are considering an issue with respect to real estate, you should consider national laws first, and then local laws applicable to the real estate, as well as court precedents that may be relevant to the issue.

Foreign investment in Japanese real estate

THERE IS NO DIRECT LIMITATION OR RESTRICTION ON FOREIGN INVESTORS' ACQUISITIONS WHETHER DIRECT OR THROUGH A SPECIAL PURPOSE VEHICLE, OF COMMERCIAL OR RESIDENTIAL REAL ESTATE IN JAPAN.

SIMILARLY, THE ESTABLISHMENT OF A CORPORATION BY FOREIGN INVESTORS FOR PURPOSES OF INVESTMENTS IN COMMERCIAL OR RESIDENTIAL REAL ESTATE IS NOT LIMITED OR RESTRICTED.

REGULATION AND REQUIREMENTS OF FOREIGN INVESTMENT

After a foreign investor's acquisition of shares or equity of a corporation, or of real estate or a right related to real estate, a report of the transaction to the relevant authorities may be required within 15 days (in the former case) or 20 days (in the latter case) from the date of such an acquisition pursuant to the *Foreign Exchange and Foreign Trade Law (Gaikoku Kawase oyobi Gaikoku Boueki Hou)*. A post factum report of payment or receipt of payment may be required in the case of cross-border payments or payments between foreign investors and a Japanese resident in accordance with this law.

Furthermore, under this legislation, foreign investors' investments in certain types of business, such as agriculture, forestry or crude oil mining, is required to be notified in advance to the authorities, is prohibited for a certain period, and may be subject to a recommendation to be changed or discontinued.

Foreign investors' enjoyment or acquisition of rights related to land in Japan may be limited on the grounds of reciprocity or national security by a cabinet order, subject to the provisions of the *Alien Land Law (Gaikoku-jin Tochi Hou)*. However, as of the date of this publication, there is no such limitation since no such cabinet order is in effect.

It is also noted that it is difficult for foreign investors to acquire agricultural land, because the requirement for acquisition of such land is settled in favour of individuals who are farmers and qualified entities such as "agricultural production corporations" (nougyou seisan houjin) whose shareholders or members are limited to individuals who are full-time farmers and certain qualified individuals including those who rent or have sold the agricultural land to such corporations for their agricultural operations, corporations such as agricultural cooperatives, or local governments.

Key points

- There are no limitations on foreign investment in commercial or residential real estate.
- Reports on investments to the relevant authorities may be required.



Japanese real estate law

THE CIVIL CODE (*MINPOU*) IS THE MAIN PIECE OF LEGISLATION THAT GOVERNS REAL ESTATE TRANSACTIONS.

Real estate property rights are subject to the law of property rights contained in Book 2 of the Civil Code, which regulates ownership, joint ownership, assignment and other relevant matters. Real estate related agreements are subject to the law of contracts contained in Book 3 of the Civil Code, which regulates the formation of agreements, the rights and obligations of the parties and other relevant matters.

REGISTRATION OF REAL ESTATE PROPERTY INTEREST

In principle, real estate transactions, such as the sale and purchase of real estate and the creation of mortgages, take effect upon the mutual agreement of the parties and no formalities are required. However, a holder of a real estate property right, as a general rule, cannot assert its right against a third party if such a right is not registered. To perfect a property right, the general rule requires the holder to have a property right as a result of a valid agreement between the parties, and that such a right be registered in the name of the holder.

While registration does not necessarily mean that the registered holder has the registered property right, registration can be one of the proofs to support the fact that the property right in question belongs to the registered holder. Title insurance is not available for real estate located in Japan.

In Japan, there are 50 local Legal Affairs Bureaus, each of which has its own real estate registry with respect to real estate located within its region. Some of the local Legal Affairs Bureaus participate in an online application system for the registration of real estate property rights.

Under the real estate registration system, almost all land is already registered except for government land. Buildings are required to be registered under the *Real Estate Registration Law (Fudousan Touki Hou)*, but, in practice, some buildings remain unregistered until it becomes necessary for the owners to perfect their title to the buildings against a third party (eg at the time of sale).

Registration and license tax (*touroku-menkyo-zei*) is discussed in the chapter “Tax” (see page 40).

HOLDING TITLE TO REAL ESTATE

Land and buildings are considered to be separate and independent real estate. Ownership title (*shoyuken*) to land and the ownership title to buildings on such land can belong to different persons. If A owns land and B owns a building on the land, B has to have a right to use the land in order to secure its ownership title to the building.

Ownership title to real estate can be held jointly by multiple persons. Such a way of holding an ownership title is called joint ownership (*kyouyu*) and is subject to the Civil Code. Ownership title to a condominium as part of a building is called condominium ownership title (*kubun shoyuken*). Condominium ownership title is subject to the *Condominium Law (Tatemono no Kubun Shoyu tou ni kansuru Houritsu)* and the Civil Code.

To perfect a property right, the general rule requires the holder to have a property right as a result of a valid agreement between the parties, and that such right be registered in the name of the holder.

LEASES

LEASES WITH OR WITHOUT RENT

Leases that do not include the requirement to pay rent (*shiyoutaishaku*) are principally governed by the law of contracts contained in Book 3 of the Civil Code. Such leases are not granted the protection available under the *Land Lease and Building Lease Law (Shakuchi Shakuya Hou)*.

On the other hand, leases subject to the payment of rent (*chintaishaku*) with respect to real estate (hereinafter referred to as simply “leases”) are governed by either or both the law of contracts contained in Book 3 of the Civil Code and the *Land Lease and Building Lease Law*. The general rule is that the *Land Lease and Building Lease Law* is applicable to land leases having the purpose of a lessee owning a building on the land, and to building leases, and takes precedence over the Civil Code to the extent the Civil Code has provisions on the same subject matter, except that only the Civil Code is applicable to land leases or building leases which deal with the temporary use of the subject real estate.

Under the *Land Lease and Building Lease Law*, both:

- a lessee under a land lease having the purpose of owning a building on land who owns a registered building on the land can assert its perfected right against a new owner of the land
- a lessee under a building lease who has possession of the building can assert its perfected right against a new owner of the building.

Therefore, in practice, leases subject to the *Land Lease and Building Lease Law* are not purely contractual. Rather, such leases have the nature of a property right to some extent.

VARIOUS LEASES UNDER LAND LEASE AND BUILDING LEASE LAW

The *Land Lease and Building Lease Law* provides for various leases, including the following:

LAND LEASE HAVING THE PURPOSE OF LESSEE OWNING BUILDINGS ON THE LAND

- **Ordinary land lease**

Under the *Land Lease and Building Lease Law*, a land lease having the purpose of a lessee owning a building on the land (other than the fixed-term land lease as discussed below) has a 30 year term, unless the parties agree to a longer term. Such a land lease is automatically renewed for a term of 10 years (20 years for the first renewal) unless otherwise agreed by the parties, and the lessor cannot object to such renewal without a justifiable reason. Generally, justifiable reasons are not easy to establish, and the lessor's refusal to renew the lease is strictly regulated. An example of what the court will usually consider in finding a justifiable reason for not agreeing to the renewal of the lease is an offer by the landlord of compensation for the non-renewal (however, such compensation alone would not always suffice).

- **Fixed-term land lease**

A fixed-term land lease having the purpose of lessee owning a building on land is not renewable under the *Land Lease and Building Lease Law*, provided that the parties are not prohibited from entering into a new lease agreement at the time of expiration of the lease term. The fixed-term land lease was introduced to address a land owner's concern that the strict regulations over a land owner's refusal to renew a lease could inhibit the land owner's effective use of its real estate. There are three types of fixed-term land leases:

- a general fixed-term land lease available for either residential purposes or business purposes (the fixed term is 50 years or more)
- a land lease with a special agreement by which the lessee assigns the building on the land to the lessor (the lease agreement can provide for the lessor's right to obtain the building on the land from the lessee at a reasonable price to terminate the lease after 30 or more years following the commencement of the lease)
- a fixed-term land lease for business purposes (the fixed term is 10 years or more but required to be less than 50 years).

BUILDING LEASES

- **Ordinary building lease**

A building lease usually has an agreed term. Under the *Land Lease and Building Lease Law*, a building lease with an agreed term (other than the fixed-term building lease discussed below) is automatically renewed and the lessor cannot object to the renewal of the building lease without a justifiable reason. Generally such a justifiable reason is not easy to establish and the lessor's refusal to renew the lease is strictly regulated. An example of what the court will consider in finding a justifiable reason is an offer by the lessor of compensation for the non-renewal (however, such compensation alone would not always suffice).

- **Fixed-term building lease**

A fixed-term building lease is not renewable under the *Land Lease and Building Lease Law*, provided that the parties are not prohibited from entering into a new lease agreement at the time of expiration of the lease term. The parties can agree on the fixed term of the fixed-term building lease without restriction on the length of the term.

RENT INCREASE OR DECREASE

Under the *Land Lease and Building Lease Law*, if the level of rent payable becomes inappropriate (for example if it differs significantly from market rent), the lessor or the lessee may request an increase or decrease in the amount of rent. This applies both to land leases having the purpose of owning buildings on the land and to building leases. However, the parties to the lease agreement can remove the right to request an increase in rent by agreeing not to increase the amount of rent for a certain period of time. It should be noted that the right to request a decrease cannot be removed, except in the case of fixed-term building leases.

TERMINATION

Under the Civil Code, in the event that one party breaches an agreement, the other party can terminate the agreement, provided that the other party has requested the breaching party to cure the breach within a reasonable period if the breach is curable. However, under the Supreme Court precedents, a lessor cannot terminate a lease agreement with respect to real estate, if the lessee can establish the existence of a special circumstance where there still remains a relationship of mutual trust between the lessor and the lessee even after the breach. It should be noted that under the Supreme Court precedents, non-payment of rent may entitle the lessor to terminate the lease, because such non-payment may be regarded as destroying the relationship of mutual trust between the lessor and the lessee.

ASSIGNMENT OF LEASE OR SUB-LEASE

The lease agreement usually prohibits the lessee from assigning the lease or subletting without the consent of the lessor.

OTHER RIGHTS OVER REAL ESTATE

Other rights over real estate include the following rights.

MORTGAGES (*TEITOUKEN*)

A mortgage is a real estate property right, being a security interest over real estate created by an agreement to secure payment of a claim. In general, once the mortgage is registered, the mortgagee has priority over other creditors except tax claims due prior to the mortgage registration, prior existing and registered mortgages and certain other perfected security interests. The mortgagor's right to use the subject real estate continues after creation of the mortgage. The mortgage can be created on real estate owned by a debtor of the secured claim, as well as on real estate owned by other persons.

SUPERFICIES (*CHIJOUKEN*)

Superficies is a property right to use another person's land for the purpose of owning buildings and other structures on the land. Superficies can be created by an agreement in consideration for payment of instalments to the land owner. Superficies can be created underground or above the land.

SERVITUDES (*CHIEKIKEN*)

A servitude is defined as a property right to use another person's land for the benefit of one's own land (eg a right of way).

REAL ESTATE SALE AND PURCHASE TRANSACTIONS

In a real estate sale and purchase transaction, ownership title to the subject real estate transfers to the purchaser in accordance with the sale and purchase agreement between the parties. A sale and purchase agreement usually provides that ownership title transfers to the purchaser in exchange for payment in full of the purchase price. After the transfer of the ownership, the parties register the transfer of the ownership title in the real estate registry and perfect the ownership title of the purchaser.

As discussed in more detail in the chapter, “Structures of investing in Japanese real estate” (see page 20), real estate investment vehicles frequently hold a trust beneficial interest in real estate. In the case where a real estate investment vehicle would like to purchase real estate from its owner in the form of a trust beneficial interest, the sale and purchase agreement provides that:

- the seller, the owner of the real estate first entrusts the real estate to the trustee and in exchange obtains from the trustee a trust beneficial interest in the real estate
- the seller then registers the entrustment to the trustee in the real estate registry
- the seller transfers the trust beneficial interest to the real estate investment vehicle in exchange for the vehicle’s payment of the purchase price.

As it is the purchaser who would usually request the sale and purchase transaction to take the form of a trust beneficial interest arrangement, the purchaser is usually granted under the sale and purchase agreement the right to approve the trustee and the trust agreement between the seller and the trustee. The purchaser usually has to pay for the costs incurred by the seller in connection with the creation of the trust beneficial interest, including the costs associated with the registration of the entrustment of the real estate by the seller to the trustee.

Sometimes, a real estate broker is involved in the sale and purchase transaction of real estate. If the broker acts as an intermediary between the seller and the purchaser or an agent of the seller or the purchaser, the broker needs to be licensed as a real estate transaction broker (*takuchitatemono torihiki gyousha*) under the *Real Estate Transactions Business Law (Takuchitatemono Torihiki Gyou Hou)*. A licensed broker acting as an intermediary between the seller and the purchaser needs to disclose important information about the subject real estate to both the seller and the purchaser. When a licensed broker is acting as an agent of the seller or the purchaser, the broker needs to disclose important information to the party who retains the broker as the agent.

In the case that the sale and purchase transaction is made in the form of a trust beneficial interest in real estate, and not as a sale of the real estate itself, if the broker acts as an intermediary between the seller and the purchaser or an agent of the seller or the purchaser, the broker must be registered as a person conducting type II financial instruments business (*dai ni shu kin’yu shouhin torihiki gyou*) under the *Financial Instruments and Exchange Law (Kin’yu Shouhin Torihiki Hou)* (the “FIEL”) and is subject to the regulations under the FIEL.

Involvement of lawyers is usually limited to transactions which are complicated or sizable in amount. On the other hand, judicial scriveners (*shihoushoshi*) who are licensed to handle real estate registration matters are involved in almost all real estate transactions.

Key points

- As a general rule, in order to perfect an ownership title to real estate, the owner has to have obtained ownership title as a result of a valid agreement with the seller, and the ownership title has to be registered in the name of the owner. Registration does not necessarily mean that the registered owner has the registered ownership title.
- Land leases and building leases are subject to various restrictions under the *Land Lease and Building Lease Law* and the Supreme Court precedents, which may not be superseded by an agreement of the parties. Investors should take such restrictions into consideration when analysing land leases and building leases.
- Sale and purchase transactions are frequently made in the form of sale and purchase of a trust beneficial interest in real estate, not of the real estate itself.

Structures for investing in Japanese real estate



The most common choices of vehicles used for real estate investments are:

- GK (*goudou kaisha*) or KK (*kabushiki kaisha*) used in combination with a TK (*tokumei kumiai*) investment arrangement (GK-TK or KK-TK structure)
- TMK (*tokutei mokuteki kaisha*)
- J-REIT.

Real estate investment vehicles frequently hold trust beneficial interests in real estate rather than holding the real estate itself.

The choice of a certain vehicle leads to a certain investment structure. Choosing the vehicle and the structure involves a consideration of legal, accounting and tax implications as these factors can be the driving factors in determining the investment vehicle.

J-REITs are discussed in more detail in the chapter “Japanese Real Estate Investment Trusts (J-REITs)” (see page 25).

TRUST BENEFICIAL INTEREST

A frequently seen structural feature of real estate investment is the vehicle's holding of a trust beneficial interest in real estate, not the real estate itself.

A trust beneficial interest in real estate is created upon entrustment to the trustee of real estate by its owner. Upon entrustment, the entrusting owner becomes a trust beneficial interest holder, and the trustee becomes the title holder of the real estate. The trustee administers and manages the real estate for the benefit of the trust beneficial interest holder in consideration of the trustee fee. The trust beneficial interest holder receives from the trustee periodical trust distributions of revenue minus costs associated with the real estate.

The trust beneficial interest holder can transfer the interest to a purchaser, usually with the consent of the trustee. There are tax benefits in using a trust structure. While real estate acquisition tax (*fudousan-shutoku-zei*) and registration and license tax (*touroku-menkyo-zei*), calculated on the basis of certain percentages of the value of real estate, are imposed on a purchaser of the real estate itself, such taxes are not imposed on a purchaser of a trust beneficial interest in real estate.

If however, the trust beneficial interest to be transferred is created by the transferring holder itself, entrustment of the underlying real estate by the holder attracts registration and license tax for registration of the entrustment. Although this registration and license tax is lower than the registration and license tax that would have been imposed on the purchaser if the real estate itself were transferred to the purchaser, it is common that such registration and license tax is borne by the purchaser pursuant to the sale and purchase agreement. The advantageous tax treatment with respect to a trust beneficial interest, which can be offset by the contractual allocation of registration and license tax for registration of entrustment, is generally cited as one of the reasons for the vehicle's frequent acquisition of a trust beneficial interest in real estate, not real estate itself. Tax implications on a trust beneficial interest in real estate are further discussed in the chapter "Tax" (see page 38).

Another reason for this structure's popularity is that the trustee is usually a licensed trust bank that customarily conducts a thorough due diligence investigation of the real estate before accepting the entrustment, which can benefit the investor in the real estate because of the expertise of the licensed trust bank.

KK (*KABUSHIKI KAISHA*)

A KK incorporated under the *Companies Law* (*Kaisha Hou*) is the most common type of corporation for business purposes, but not as a real estate investment vehicle. Shareholders of a KK hold shares in the KK and are not personally liable for liabilities of the KK. The business of the KK is usually managed by its director(s) and, if applicable, its board of directors. Stricter corporate governance requirements are imposed on a KK under the *Companies Law*, which is generally cited as one of the reasons for the less frequent use of a KK than a GK as a real estate investment vehicle.

GK (*GOUDOU KAISHA*)

A GK incorporated under the *Companies Law* is more commonly used than a KK as a real estate investment vehicle. This vehicle was modelled on the Limited Liability Company (LLC) of the United States. The members of a GK as a real estate investment vehicle are usually structured as limited liability members and are not personally liable for liabilities of the GK. Members of a GK hold equity units of the GK and generally manage its business. The corporate governance requirements are not as strict as those with respect to a KK.

A lender has a reason to prefer a GK to a KK in light of the applicability of certain statutory insolvency proceedings. Corporate reorganisation proceedings (*kaisha kousei tetsuzuki*) under the *Corporate Reorganisation Law* (*Kaisha Kousei Hou*) cannot be commenced with respect to a GK, while the proceedings can be commenced against a KK. Because a lender's security interest in the assets of a corporate reorganisation debtor is subject to the corporate reorganisation proceedings pursuant to the Law, which can be a risk to the lender, a lender generally prefers a GK, which cannot be subject to corporate reorganisation proceedings.

GK-TK (KK-TK)

When a GK (or KK) is used as an investment vehicle for foreign investors, typically the investors own a TK interest, not equity units (or shares) in the GK (or KK). Such units (or shares) are typically held by an orphaned entity in accordance with the request of a lender to the GK (or KK), as part of the efforts to make the GK (or KK) a so-called “bankruptcy remote entity”. In Japan, the combination of the GK (or KK) and the TK is usually called a “GK-TK” (or “KK-TK”) structure.

The TK relationship is a bilateral, not multilateral, contractual partnership relationship created for the purpose of investment by the TK interest holder, called the TK investor. The other party to the bilateral contract is called the TK operator. The TK operator manages the funds contributed by the TK investor to the TK operator, and such management is called a TK operation. In the case of a GK-TK (or KK-TK) structure used by a foreign investor, the TK operator is the GK (or KK) and the TK investor is the foreign investor.

When an investor would like to use a TK arrangement for joint investment with another investor, the investors would enter into two separate TK agreements, each of which will be bilateral agreements. Each TK agreement would be entered into by each TK investor and the TK operator. Each TK agreement would typically have identical provisions, except for the provisions to ensure that the profit from the TK operation would be distributed to the TK investors on a pro rata basis in accordance with the amount of TK contribution made by each TK investor.

An issue arises as to whether an intercreditor agreement between the TK investors should be entered into, because such an agreement may jeopardize the bilateral, not multilateral, nature of a TK relationship and may risk the relationship between each TK investor and the TK operator being regarded as something other than a TK relationship.

In the TK relationship, the TK investor is contractually entitled to a distribution of profit (profit after payment of the debts and other costs of the TK operator) generated by the TK operation. The TK investor is not liable for any liabilities of the TK operator.

A major advantage of the GK-TK (or KK-TK) structure is that under the TK relationship, the distribution of profit by the TK operator to the TK investor can be treated as a deductible expense in the calculation of tax payable by the TK operator, which prevents double taxation on the profit from the TK operation. By using the TK arrangement, a GK (or KK) can achieve this tax benefit, similar to an LLC in the United States. A GK cannot enjoy such a tax benefit without using the TK arrangement under the Japanese taxation system.

To ensure that the TK relationship enjoys this tax benefit, the TK relationship needs to be a passive investment arrangement for the TK investor. The TK relationship is, therefore, in many cases structured so as to ensure the TK investor does not have the right to be involved in, to approve of, or to veto the TK operation.

TK investment in real estate is regulated under Japanese law. The TK operator must be licensed to manage real estate using the funds contributed by the TK investor. In order to avoid this regulation, the GK (or KK) in the GK-TK (or KK-TK) structure frequently holds a trust beneficial interest in real estate, instead of the real estate itself.

A major advantage of the GK-TK (or KK-TK) structure is that under the TK relationship, the distribution of profit by the TK operator to the TK investor can be treated as a deductible expense.

This combination of the GK-TK (or KK-TK) structure and a trust beneficial interest is also regulated because a trust beneficial interest is treated as a security under the recently effectuated FIEL and the TK operation, which invests in such a security, is subject to the requirement of registering the TK operator as a discretionary investment manager under the FIEL. The exemptions from this requirement will have to be reviewed if using the GK-TK (or KK-TK) structure.

Another regulatory implication with regard to the combination of the GK-TK (or KK-TK) structure and a trust beneficial interest is that, if the TK operator (the GK or KK) is not capable of making substantial investment decisions for the reason that its decision making organs such as its members, shareholders and directors are orphaned entities or independent persons, the passive investor concept described above, where the TK investor may not be allowed to make substantial investment decisions for the TK operator, may necessitate the TK operator (the GK or KK) to delegate its investment decisions with respect to the trust beneficial interest to a third party. The third party may have to be registered as a discretionary investment manager under the FIEL in order to make investment decisions with respect to the trust beneficial interest of the TK operator which is defined as a security under the FIEL.

TMK (TOKUTEI MOKUTEKI KAISHA)

A TMK incorporated under the *Asset Liquidation Law (Shisan no Ryudouka ni kansuru Houritsu)* is another entity commonly used as a real estate investment vehicle. The *Asset Liquidation Law* provides for the TMK to be a vehicle for asset liquidation. An asset is acquired by a TMK and the TMK issues asset backed securities including bonds (*tokutei shasai*) and preferred shares that are underpinned by the asset. Shareholders of a TMK are not personally liable for liabilities of the TMK.

Common shareholders and preferred shareholders of a TMK hold common shares and preferred shares in the TMK respectively. The TMK's business is generally managed by its director(s).

The *Asset Liquidation Law* requires a TMK to comply with various regulations including the requirement to file an asset liquidation plan (*shisan ryudouka keikaku*) with the relevant authority. The asset liquidation plan must be filed prior to acquiring real estate or a trust beneficial interest in real estate, issuing bonds or preferred shares, or borrowing under loans. The business of the TMK must be conducted in compliance with the asset liquidation plan.

As in the case of a GK, corporate reorganisation proceedings cannot be commenced with respect to a TMK, which means that a security interest on the assets of a TMK will not be subject to corporate reorganisation proceedings.

Investment in real estate by a foreign investor is typically made through its direct or indirect holding of the preferred shares (and sometimes common shares) in a TMK which owns the subject real estate or trust beneficial interest in real estate. A TMK is funded not only by its preferred shares and common shares, but also by its bonds and loans.

When an investor would like to utilise a TMK structure for joint investment with another investor, the investors will typically directly or indirectly hold the preferred shares (and sometimes the common shares) in the TMK. The joint investors will typically enter into a joint investment agreement to clarify the rights and obligations with respect to the joint investment.

A major advantage of the TMK structure is that a TMK can treat dividends on its shares as deductible expenses in the calculation of tax payable by it, if certain conditions are satisfied. For more details, see the chapter on “Tax” on page 38. A TMK can also enjoy other tax benefits when acquiring real estate itself (not a trust beneficial interest in real estate), such as reduced rates of real estate acquisition tax and registration and license tax.

In light of the regulations under the FIEL, even if a TMK acquires a trust beneficial interest in real estate, the investment by the TMK of the proceeds of its shares into a trust beneficial interest will not subject the TMK to the requirement of registering as a discretionary investment manager under the FIEL. The investment of the share proceeds into a trust beneficial interest is not a regulated investment activity under the FIEL.

USING A FOREIGN COMPANY

A foreign company can be a real estate investment vehicle for foreign investors, so long as the foreign company complies with the relevant regulations relating to foreign companies doing business in Japan. Such regulations include requirements such as:

- a foreign company cannot locate its head office in Japan, nor can its principal purpose of business be doing business in Japan, if the foreign company intends to do business in Japan on a continuing basis
- a foreign company must register as a foreign company prior to starting business in Japan on a continuing basis. The foreign company so registered must give public notice of its balance sheet
- a foreign company which intends to do business in Japan on a continuing basis must appoint its representative in Japan, of which at least one shall be a resident in Japan.

The chapter “Foreign investment in Japanese real estate” (see page 14) describes more examples of regulations applicable to foreign companies’ investments in Japanese real estate.

INDIVIDUALS

While direct investment in real estate by foreign individuals is possible, it is more common to invest indirectly by utilising the commonly used vehicles described above.

Key points

- The GK-TK structure and the TMK structure are commonly used in real estate investments in Japan.
- An investor needs to carefully consider the tax, accounting and legal implications of each available vehicle and structure, in order to choose and set up an investment platform which will best serve the needs of the investor.



Japanese Real Estate Investment Trusts (J-REITs)

The so-called “J-REIT” (Japanese real estate investment trust) generally refers to a financial product using a vehicle formed or incorporated pursuant to the *Law Concerning Investment Trusts and Investment Companies (Toushi Shintaku oyobi Toushi Houjin ni kansuru Houritsu)* (the “Investment Trust Law”) with certain preferential treatments in respect of taxation granted to the investors.

More specifically, J-REITs are one type of investment funds formed under 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 (eg real property trust beneficial interests). Investment earnings, primarily consisting of rental incomes in respect of the invested real properties, are paid out to investors as profit distributions.

Under the Investment Trust Law, three types of vehicles are made available for use for purposes of J-REITs:

1. an “investment company” (*toushi houjin*) as a corporate-type investment fund
2. an “investment trust managed by a “trust settlor” (*itakusha sashizu gata toushi shintaku*) as a contract-type investment fund
3. an “investment trust not managed by a trust settlor” (*itakusha hi-sashizu gata toushi shintaku*) also operating as a contract-type investment fund.

However, in practice, all J-REITs are formed as investment companies.

An investment company is merely an investment vehicle and all investment decisions are designed to be made by its asset management company.

LEGAL AND REGULATORY FRAMEWORK

1. Investment company

An investment company is an entity created under the *Investment Trust Law* for purposes of investing its funds mainly in certain asset classes defined as “specified assets” (securities, real property, and other classes of assets designated by a government order as being easily accessible for investments).

2. Investment trust managed by a trust settlor

An investment trust managed by the trust settlor is a trust for the purpose of investing the trust funds mainly in specified assets pursuant to instructions of the trust settlor (which is required to be a licensed entity as described in more detail below). Such a trust is created pursuant to the *Investment Trust Law* for purposes of dividing the beneficial interests therein and causing the divided interests to be acquired by more than one interest holder.

3. Investment trust not managed by a trust settlor

An investment trust not managed by the trust settlor is created based on the *Investment Trust Law*. It is a trust that makes investments pursuant to investment decisions of the trustee (to be made, as a matter of course, in accordance with the terms and conditions of the relevant trust deed (*shintaku-yakkan*)) as opposed to those of the trust settlor’s instructions. Similar to the two preceding types of investment funds, trust funds gathered into the trust with investors’ money are required to be invested mainly in specified assets.

MANAGEMENT OF REITS

1. Investment company

An investment company may be established only by entities satisfying certain criteria, such as the requirement that it be a Financial Instruments Operator (*kin’yuu shouhin torihiki gyōsha*) registered under the FIEL. A newly-established investment company raises funds by issuing equity securities called “investment units” (*toushi-guchi*) to investors (unit-holders (*toushi-nushi*)).

Investment companies may also issue debt securities called “investment company bonds” (*toushi-houjin-sai*) as well as obtaining extensions of credit in the forms of loans and commercial papers. Investment companies then invest the funds so raised for the benefit of the unit-holders, who are entitled to investment earnings in proportion to their respective interests in the investment units. Correspondingly, the terms “investment unit”, “unit-holder”, “investment company bond”, and “investment company bondholder” (*toushi-houjin-saiken-sha*) of an investment company, relate respectively to “share”, “shareholder”, “bond”, and “bondholder” of a KK.

Unlike an investment trust (ie contract-type investment fund), an investment company has legal personality and holds the raised funds under its own name. An investment company is merely an investment vehicle and all investment decisions are designed to be made by its asset management company (described in more detail below). In order to avoid unforeseen risks being incurred by the unit-holders, an investment company may not and shall not cause its asset management company to, as part of its business, conduct any transaction other than investments in mainly specified assets and other activities related to such investment activities.

An investment company's functions are limited to providing a form of organisation for expressing the will of the asset management company (as defined below), for expressing the will of the unit-holders and creditors, and for acting as a holder of assets. The investment company is not expected by itself to make investment decisions or take custody of assets. For this reason, the *Investment Trust Law* does not permit an investment company to hire employees or maintain any office other than its head office.

An investment company must commission others to engage on its behalf in certain services. For example:

- investment decision-making duties and capabilities must be delegated to an asset management company pursuant to the *Investment Trust Law* (the “asset management company”) that is registered under the FIEL as a Financial Instruments Operator
- services related to asset custody must be commissioned to a qualified asset custodian, such as a trust bank or securities company
- other services, such as placement of investment units and investment company bonds, organisation management, and accounting, must be commissioned to appropriate service providers.

However, whether the asset management company is entitled to make any decision as to indebtedness (such as decisions as to the borrowing of funds from a lender) remains unclear under the *Investment Trust Law*.

2. Investment trust managed by a trust settlor

An investment trust management company under the Investment Trust Law registered as a Financial Instruments Operator under the FIEL acts as a trust settlor, and enters into a trust agreement with a trust company or trust bank acting as a trustee. The trust settlor handles all investment decision-making regarding asset managements; the trustee merely follows the trust settlor's instructions concerning, for example, purchase of and/or sale of specified assets.

Investors acquire beneficial interests in the trust by making contributions through a distributor or the investment trust management company, and are thereby entitled to the investment earnings of the trust assets in proportion to their respective interests. In cases where these investment trusts are managed by their trust settlors, the capacity to borrow and to incur other types of debts is limited, and therefore, practically, there is no capacity to obtain leveraged financing for acquisitions of assets or investments in assets.

3. Investment trust not managed by a trust settlor

Each investor is both a trust settlor and a beneficiary, and separately enters into a trust agreement (that is based on a single set of terms and conditions set out in a trust deed) with a qualified trustee such as a trust bank. In contrast to an investment trust managed by a trust settlor, the trustee makes investment decisions and conducts sales, purchases and other investment activities, with all of the funds invested by the investors gathered as commingled funds. The investors, as the beneficiaries, are entitled to all earnings from the commingled trust assets. All investors are subject to the single trust deed, pursuant to which the trustee manages the commingled trust assets.

As all J-REITs take the entity form of an investment company, our discussions below focus on investment companies.

TAX TREATMENT

The tax treatments of J-REITs is discussed in the chapter “Tax” (see page 38).

LICENSING REQUIREMENTS (IF APPLICABLE)

An investment company is a highly regulated entity and must be registered with the Financial Services Agency of Japan (FSA) prior to the commencement of its investment management business. An investment company must retain an asset management company registered under the FIEL and have the asset management company carry out the investment management activities on behalf of and for the benefit of, the investment company.

In addition, in order for an investment fund that is formed or incorporated pursuant to the *Investment Trust Law* (whether an investment trust or an investment company) to list its securities on a stock exchange as a J-REIT, the investment funds and its portfolio managers (such as asset management companies and investment trust management companies) must meet certain criteria set under the rules of the listing stock exchange, and once listed, the listed investment company and its asset management company will also be regulated by the stock exchange as well.

COMPLIANCE

Both investment companies and asset management companies are regulated under the *Investment Trust Law* (and in the case of asset management companies, the FIEL as well) and are supervised by the FSA pursuant to the *Investment Trust Law* (and the FIEL, in the case of asset management companies). If securities of an investment company are listed on a stock exchange in Japan, then the investment company is also subject to regulations under the rules of the relevant stock exchange and subject to the strict scrutiny of the stock exchange. For the purposes of compliance, investment companies (J-REITs) and their asset management companies need to follow and comply with the *Investment Trust Law*, the FIEL and the rules of the relevant stock exchange.

Investment units and investment company bonds (collectively, “investment company securities”) are not subject to the insider trading regulations under the FIEL other than with respect to information related to tender offers and the like. Thus, for example, no penalty under the FIEL applies to a person affiliated with an investment company who trades in investment company securities based on material internal information not yet publicly disclosed (again, other than information related to tender offers, etc). This could lead to unfairness in specific instances and, generally, damage confidence in the fairness of the market for investment company securities. In this regard, each stock exchange has adopted its own regulations imposing a duty of timely disclosure of certain material matters regarding investment companies issuing listed investment units; and asset management companies handling the investment of their assets. While this helps reduce the possibility of insider trading, it is not considered a sufficient counter-measure.

Both the investment company and the asset management company are under the strict supervision and scrutiny of the FSA.

Conflicts of interest may also occur between an investment company and a service provider, such as an asset management company or an asset custodian. Frequently, business entities (often referred to as “sponsors” of J-REITs) with substantial real estate related asset portfolios are major shareholders of asset management companies, which can raise suspicions that investments may be made in a way that benefits the sponsors rather than the investment companies and the stakeholders behind the investment companies.

To prevent this and other undesirable behaviour from occurring, among other things, the *Investment Trust Law* provides for:

- a fiduciary duty and a duty of prudent care of asset management companies and other service providers towards the investment company
- where, in connection with the asset management company’s services involving investment management of the investment company’s assets, the asset management company deals with parties with which it has certain capital or other relationships; a prohibition on transactions that might harm the investment company (and its stakeholders) and which contribute to the protection of interests of customers of such a related party, instead of benefiting the investment company (and its stakeholders)
- a requirement for investigation of asset transfer prices by a real estate appraiser, auditing firm, or other third-party professional at the time the asset management company acquires or disposes of specified assets for and on behalf of an investment company
- for certain transactions where a conflict of interest is suspected, a duty on the asset management company to report to the investment company and other constituencies.

DISCLOSURE REQUIREMENTS

Investment company securities fall within the FIEL’s definition of “securities” (*yuka-shouken*). Under the FIEL, solicitations to acquire newly issued securities are categorised into private placements and public offerings, with a different scope of information disclosure required for each.

“Public offering” means a solicitation to acquire newly-issued securities that do not fall under the definition of “private placement”. Private placements can be categorised into:

- “small number” private placements, for which the number of solicited and/or offered (prospective) investors is 49 or less
- “qualified institutional investors” private placements, where only “qualified institutional investors” as defined under the FIEL are the subject of solicitations and offers
- “specified investors” private placements, where only “specified investors” as defined under the FIEL are the subject of the solicitations and offers.

DUTY OF DISCLOSURE IN PUBLIC OFFERING UNDER THE FIEL

When making a public offering, the investment company is under a duty to file a securities registration statement (SRS) and provide a prospectus to prospective investors.

Land, buildings, etc, always have particular characteristics on which their profitability depends. For prospective purchasers of investment company securities, an important factor is the composition of the real property underlying the investment company's assets. However, there exist few means for retail investors to independently obtain information regarding the profitability of real property. For this reason, the SRS and the prospectus must disclose not only the investment company's policies and standards for investment, but also:

- the name, location, usage, area, structure, description of ownership or other rights, price and investment ratio, and (where lease agreements have been executed) the total number of tenants, total amount of rent income, total leased area, total leasable area, changes in the occupancy rate for the past five years, etc, for each real property
- concerning each major tenant of key real properties, the tenant's name and business, and specific details of the lease agreements such as annual rent, leased area, lease expiry date, manner of renewal, and amounts of key money and security deposit (to the fullest extent possible).

Another practical characteristic of the SRS and the prospectus for investment company securities is worth noting. J-REITs are an emerging financial product and not yet widely recognised among retail investors. For this reason, risk factors are described in more detail than for other financial products. For example, not only the risks inherent in the particular investment company's securities, but also the risks associated with investment company's securities in general are normally stated as a product category.

While, in principle, the SRS and the prospectus contain substantially the same information, in the case of investment company securities (as with investment trusts on securities), it is permissible to use easy-to-understand wording in the prospectus and alter the order of entries. In practice, however, J-REIT prospectuses (unlike those of investment trusts on securities) tend to duplicate the content of the SRS.

DUTY OF DISCLOSURE IN PRIVATE PLACEMENT UNDER THE FIEL

Under the FIEL, as long as an offering or placement of securities qualifies as a private placement (under any of the available categories noted above), no disclosure requirements are imposed on "issuers", nor is a delivery of a prospectus to investors required.

However, certain "disclosure" requirements apply to broker-dealer/underwriters of the offered securities and there are certain requirements as parts of the private placement criteria (such as the requirement that the issuer, broker-dealer and underwriters explicitly disclose and clarify to potential investors that the securities are being offered or otherwise sold as a private placement and therefore that no securities registration statement is available).

Exceptions are offerings and solicitations that fall under the category of a "small number" private placement (see above) satisfying certain criteria, which include, among others, that the total issue amount of the securities so offered is more than JPY10 million and less than JPY100 million. Where the exception applies, only a securities notification statement (*yuuka-shouken tsuuchisho*) needs to be filed.

In the case of a "qualified institutional investors" private placement and a "specified investors" private placement, a securities notification statement need not be filed. Having noted the above exception, however, the scope of information required to be included in the securities notification statements includes only securities-related information, such as the issue volume, issue price, and manner of application, and not detailed information regarding real estate related assets. Also, in practice, after an investment company has listed its securities on a stock exchange, an offering or solicitation of the listed investment company's securities rarely falls under such a category.

RESTRICTIONS ON LISTING UNDER THE LISTING RULES OF A STOCK EXCHANGE

In order to list investment units on a stock exchange as a listable J-REIT, the particular exchange's listing rules must be observed. All exchanges have requirements concerning:

- the substance of the assets held by the investment company (types of assets, total asset value, and ratio of real estate related assets to total assets)
- the investment company's organisation (systems of executive management, regulatory compliance, and timely disclosure of material information)
- the condition of allocation of investment units (total number of outstanding investment units, total number of unit-holders, and lockup on investment units issued by way of third-party allotment before the listing)
- that no redemption of investment units may be made other than due to dissolution or liquidation of the investment fund.

DUTY OF DISCLOSURE OF OTHER MATTERS

Under the *Investment Trust Law* and other relevant laws and regulations, certain important matters regarding an investment company must be registered in the corporate register maintained by the relevant Legal Affairs Bureau and in the investment company register maintained by the relevant Regional Financial Bureau. Also, an "operating member" (*shikkou-yakuin*) of an investment company, which is a member of the board of members, is required to send accounting documents annually (eg an asset investment report) and an auditing report to its unit-holders, and investment companies are required to make such documents and reports available for inspection at their head-offices.

With respect to investment company securities listed on a stock exchange, or those for which a public offering has been made, the FIEL requires the filing of a security report for each accounting period. In addition to this, the FIEL requires the filing of:

- a semi-annual report for each six-month period (however, since virtually all existing listed J-REITs, other than one listed J-REIT, to our knowledge, have their respective fiscal year (or, "accounting period") set at six months (rather than a full year), it is extremely rare, if at all, that a listed J-REIT files a semi-annual report separately from its security report corresponding to its fiscal year)
- an extraordinary report upon occurrence of any of a number of events specified under the FIEL and regulations promulgated thereunder as events requiring extraordinary reports, such as a termination of the asset management company's appointment.

In addition, disclosure of various matters is required pursuant to:

- the *Financial Product Sales Law* (*Kin'yuu Shouhin no Hanbai tou ni kansuru Houritsu*)
- the *Real Estate Transactions Business Law*
- self-regulatory rules of the Investment Trusts Association of Japan (*Nihon Toushi Shintaku Kyou-kai*) and those of the Japan Securities Dealers Association (*Shou-ken Gyou Kyou-kai*)
- in the case of a listed J-REIT, the listing rules of each relevant stock exchange.

MERGERS AND TAKEOVER ACTIVITY (IF APPLICABLE)

Although interests of market participants for mergers and takeover activities relating to J-REITs are dramatically increasing under the current market conditions where J-REITs' share prices have plummeted, there have been a limited number of transactions that could be characterised as M&A activities involving J-REITs. This is primarily due to the fact that:

- there are no provisions in relevant statutes allowing an investment company to conduct a “company split” (*kaisha bunkatsu*; a type of demerger), share exchange (*kabushiki kou-kan*) or share transfer (*kabushiki iten*)
- an investment company is allowed to merge only with another investment company
- an investment company is allowed to issue only a single class of equity security (in other words, no equity securities other than investment units, which correspond to common shares, can be issued)
- an investment company will lose its pass-through entity status for tax purposes if a single investor or a single group of investors hold more than 50% of the investment units at the end of the fiscal year of the investment company.

The purposes for acquiring control over an investment company can be classified as:

- a way of entry into the J-REIT business
- a way to expand the portfolio of another investment company.

However, because of the limitations noted above, available structures for the acquisition of control over an investment company are limited to:

- the purchase of investment units of the targeted investment company, most likely via tender offers (in compliance with tender offer rules stipulated by the FIEL)
- the issuance of new shares (investment units) to the acquiring party by the targeted investment company (note that the *Investment Trust Law* provides that an investment company must issue its investment units only at a “fair price,” there is little room for issuance of new investment units at below-market price)
- the merger of the targeted investment company with another investment company already controlled by the acquiring party
- a transfer of the assets of the targeted investment company to the acquiring party (or another investment company or other entities already controlled by the acquiring party). In the case of new entry into the J-REIT business, the acquiring party most likely would need to purchase or otherwise acquire controlling shares in the asset management company of the targeted investment company concurrently with, or prior to, the acquisition of the controlling stake in the targeted investment company, which in itself would require compliance with certain requirements under the FIEL.

To date, no merger of investment companies has been concluded nor has there been a case where a listed J-REIT sold or otherwise transferred all of its assets to a third party.

Key points

- Under the *Investment Trust Law*, three types of vehicles are available for use for the purpose of J-REITs. All J-REITs however take the entity form of an investment company.
- An investment company must be registered with the FSA and is subject to various restrictions under the *Investment Trust Law*, the rules of the FSA and, in the case of a listed J-REIT, the rules of the stock exchange. In addition, an investment company must retain an asset management company registered under the FIEL, to which the investment company delegates all of its investment decision-making functions.
- Various kinds of disclosure requirements concerning the investment company and the investment company securities apply, including those of the *Investment Trust Law*, the FIEL, the rules of the stock exchange (in the case of a listed J-REIT) and other laws.



Finance and banking

JAPAN HAS AN EXTENSIVE, COMPETITIVE AND WELL-DEVELOPED FINANCE AND BANKING SYSTEM, AS WELL AS FINANCIAL MARKETS, COMPRISING BOTH BANK AND NON-BANK SECTORS.

THE BANKING SECTOR

The banking sector consists of:

- the Bank of Japan (BOJ) – Japan’s central bank
- a number of commercial banks licensed to carry on banking business under the *Banking Law (Ginkou Hou)* (including foreign banks’ branches in Japan), as well as cooperative financial institutions and other savings and thrifts licensed under relevant statutes
- special government-chartered banks (such as the Development Bank of Japan Inc.) incorporated according to special laws.

The non-banking sector consists of numerous types of financial institutions, including:

- insurance companies
- securities companies (some of which conduct investment banking activities)
- leasing companies
- other general moneylenders registered under the *Money Lending Business Law (Kashikin-gyou Hou)*.

REGULATORY FRAMEWORK

The banking and finance system in Japan is regulated, supervised and overseen by the Financial Services Agency (FSA). Banks, insurance companies, securities companies, cooperative financial institutions and other non-bank financial companies are, in most cases (if not all), supervised and inspected by the FSA (and with respect to some categories, jointly with other regulatory or supervisory government bodies). These financial institutions are required to comply with laws and regulations, as well as guidelines for supervision and inspection manuals published by the FSA.

The Bank of Japan retains and solely reserves its central banking functions, including responsibility for central payment and settlement systems.

The vast majority of financial institutions, whether from the banking sector or non-banking sector, are required by statute to be licensed by or registered with the relevant government agency or agencies. For example, banks are required to be licensed under the *Banking Law*, insurance companies under the *Insurance Business Law (Hoken-gyou Hou)* and general moneylenders are required to be registered under the *Money Lending Business Law*. The relevant statutes provide for regulation of financial institutions, including regulation of capital requirements (which in the case of banks, savings and thrifts are based on the Basel Accord), limitations on the scope of business, and regulations on the holding of subsidiaries or of voting shares in other corporations/institutions, etc.

The *Money Lending Business Act* regulates moneylenders, other than financial institutions licensed or incorporated under certain other statutes such as banks and insurance companies, as well as cooperative financial institutions and other savings and thrifts. While there are no capital requirements applicable to moneylenders under the *Money Lending Business Law*, regulations under the legislation restrict or limit the manner in which moneylenders deal with their customers.

Many kinds of business that relate to securities, such as underwriting activities, activities relating to public offerings, private placements or brokerage of securities, and advising on or managing the investment in securities require the entity intending to engage in such business to register with the FSA and to be regulated by the FSA pursuant to and under the FIEL. However, some investor protection regulations are not applied to those entities or activities that deal only with certain qualified professional investors.

CREDIT FACILITIES AND FINANCIAL MARKETS

Borrowers in Japan can raise debt finance either from banks and other credit providers or from domestic and/or offshore capital markets. As an indirect result of usury regulations in Japan, credit facilities in the form of commitment lines or other lines of credit consisting of a covenant to extend a loan or loans, irrespective of the provider of the facility, are allowed only if the borrower qualifies as an eligible borrower under the *Commitment Line Law* (*Tokutei Yuushi-waku Keiyaku ni kansuru Houritsu*). Also, anti-money laundering regulations under the *Gatekeeper Law* (*Hanzai ni yoru Shuueki no Iten Boushi ni kansuru Houritsu*) apply to all types of financial institutions.

REQUIREMENTS FOR REAL ESTATE FINANCE

There are certain requirements to be aware of in regard to real estate finance such as loans, bonds, TK contributions and trust beneficial interests.

LOANS

Under the *Money Lending Business Law*, as described above, a moneylender which is not otherwise licensed or permitted to extend loans is required to register with the relevant governmental authority in order to lawfully engage in the business of money lending, which includes lending of money to finance real estate investments. However, there are no specific regulations concerning the lending of money aimed at the financing of real estate investments separately from general regulations applicable to registered moneylenders.

TYPICAL SECURITY PACKAGE

The primary method by which a real estate lender seeks to protect itself from credit risks in respect of a borrower is a mortgage (*teitouken*) on the real estate created pursuant to and under the Civil Code. An umbrella mortgage (*neteitou*) is also a popular method of security. Umbrella mortgages allow the lender to include certain unspecified obligations (including future obligations) of the borrower as part of the secured obligations. However, the maximum amount to be secured under the umbrella mortgage needs to be stated (and registered in the relevant property registration system) as a specified amount (*kyokudo-gaku*) within the relevant umbrella mortgage agreement and the scope or types of obligations to be secured also need to be specified (and registered in the relevant property registration system).

When investors lend money to an SPC holding a trust beneficial interest in real estate, the most typical method of providing the collateral is to create a pledge on the trust beneficial interest (as opposed to creating a mortgage or umbrella mortgage directly over the underlying real estate).

FORMALITIES

There are no formalities required for real estate lending; however, in practice, usually all real estate lending transactions are in writing.

PERFECTION OF SECURITY

A real estate lender is protected by the registration of the mortgage from claims against the borrower or the real estate asset by other creditors. The lender can assert its mortgage interest in the real estate against third parties, including other creditors' interests over such real estate, if the mortgage is registered save for certain exceptions such as tax claims. It should be noted that the priority of the various mortgages on the real estate is based on the order of registration. In the process of a borrower's bankruptcy proceedings (*hasan tetsuzuki*) or civil rehabilitation proceedings (*minji-saisei tetsuzuki*), a lender may, save for limited exceptions, assert its mortgage against the trustee and other creditors outside of those proceedings.

However, in the process of a borrower's corporate reorganisation proceedings under the *Corporate Reorganisation Law*, a lender's credit secured by a mortgage or pledge (or other forms of security interests, for that matter) would be stayed (and therefore a lender would not be allowed to assert or exercise any right outside of the proceedings) and furthermore the loan could be reduced, delayed or otherwise modified in accordance with the adopted reorganisation plan.

BONDS

Most types of corporations are allowed to issue bonds. Ordinarily, bonds are not secured by mortgages or other security interests with certain exceptions such as a general security interest granted to holders of TMK bonds (*tokutei shasai*) by law. For a general explanation in respect of TMK, see the chapter "Structures for investing in Japanese real estate" (page 20). It is practically almost impossible to issue secured bonds secured by collateral, including real estate, because of the legal requirements set out in the *Secured Bond Trust Law* (*Tanpo-tsuki Shasai Shintaku Hou*).

There are basically no requirements regarding the acquisition or holding of bonds. However, in practice, due to tax implications, TMK bonds are available only to certain qualified institutional investors.

If an issuer (including but not limited to a TMK) wants to avoid disclosure required by the FIEL for the bonds issued, the private placement requirements provided for in the FIEL would need to be satisfied.

TK CONTRIBUTIONS

For a general explanation of TK contributions, see the chapter "Structures for investing in Japanese real estate" (page 20).

TK contributions for real estate investment are regulated under the FIEL as interest on a collective investment scheme.

TRUST BENEFICIAL INTEREST

Anyone can invest in commercial or residential real estate through a trust structure in which case the investor would be holding a trust beneficial interest in the property trust. Trust beneficial interests are now classified as "securities" (*yuka-shouken*) under the FIEL.

Key points

- Financial institutions are in most cases, if not all, regulated by the FSA.
- Many kinds of business that relate to direct or indirect investments in securities are regulated under the FIEL.
- Investors in real estate may face certain limitations, restrictions and regulatory requirements in extending credit to their customers/borrowers. For example, a credit provider's ability to extend credit through a secured bond is practically restricted under Japanese law and there could be certain registration requirements under the FIEL for financial instruments formed or issued as a way to finance real estate investments.



Tax

JAPAN HAS TWO LEVELS OF GOVERNMENT (THE NATIONAL GOVERNMENT AND THE LOCAL GOVERNMENTS) AND EACH SEPARATELY IMPOSES TAX ON REAL ESTATE TRANSACTIONS AND INVESTMENTS.

However, the local governments' tax impositions are possible only to the extent national laws allow or enable them to do so. For the advancement of cross-border investments, the national government of Japan has entered into tax treaties with certain countries that aim to prevent international double taxation and these tax treaties, in principle, take priority over Japanese domestic tax law in their application to the taxpayer.

Gains from sales and other transfers of real estate are taxed as capital gains, which is a taxable income in Japan.

The following is an outline of Japanese taxation in terms of real estate transactions and investments. For general guidance on TMKs, J-REITs and other structures and vehicles for real estate transactions, see the chapter "Structures for investing in Japanese real estate" (page 20) and the chapter "Japanese Real Estate Investment Trusts (J-REITs)" (page 25).

INCOME TAX

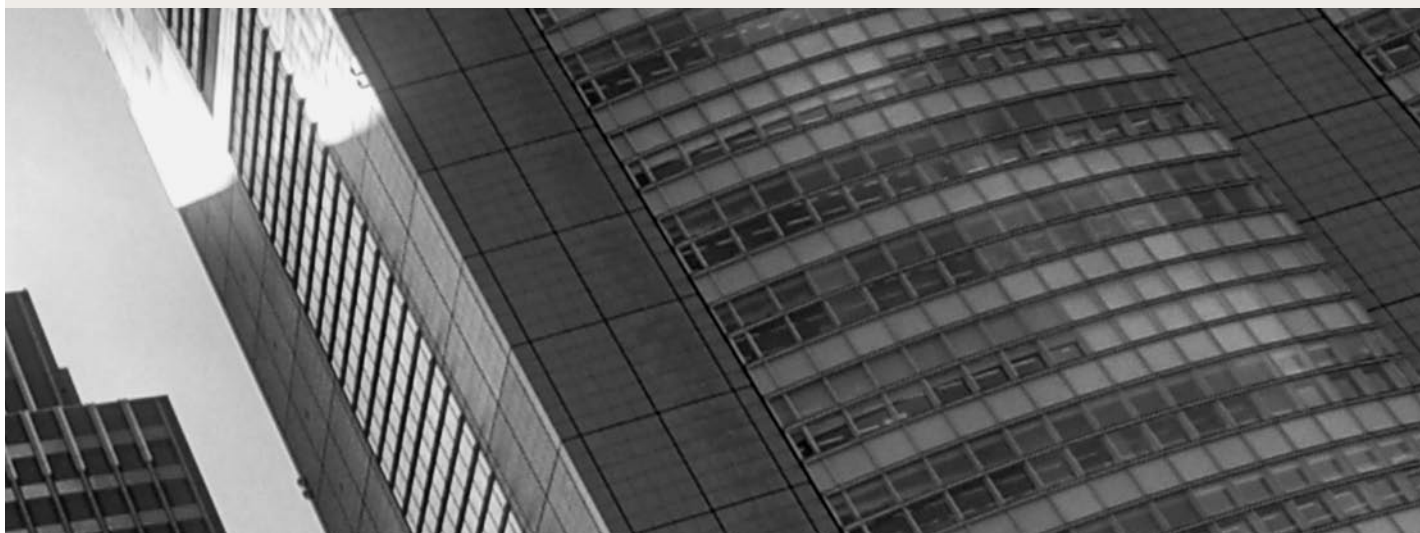
Individuals, corporations and all other entities (save for limited categories qualifying for exemptions) are levied income tax (*shotoku-zei*) by the national government.

An individual is levied, in addition to income tax, individual inhabitant tax (*juumin-zei*) by the local government, while a corporation is levied corporation tax (*houjin-zei*) by the national government, as well as corporation inhabitant tax (*houjin-juumin-zei*) and enterprise tax (*jigyou-zei*) by the local government.

The assessable income of an individual is calculated for each calendar year. For a corporation, the business year for tax purposes usually means the accounting period established by the articles of incorporation.

TAXATION OF REAL ESTATE TRANSACTIONS

If an individual transfers land, a building, a trust beneficiary interest in a real estate trust or any other real estate related asset, income tax will be imposed on the net income from the real estate transfer. The rates of income tax imposed on individuals and corporations are noted below.



INCOME TAX RATES – INDIVIDUALS

If the seller of real estate is an individual, income tax and individual inhabitant tax is levied on the seller. Whether the tax base for the income tax is long-term capital gain or short-term capital gain is determined based on the length of time the real estate has been owned. Long-term capital gain is derived from real estate owned for more than five years and short-term capital gain is any capital gain other than long-term capital gain. In the case of long-term capital gain, the tax rate is 20% (15% income tax and 5% individual inhabitant tax). In the case of short-term capital gain, the tax rate is 39% (30% income tax and 9% individual inhabitant tax).

INCOME TAX – NON-RESIDENT INDIVIDUALS

DOMESTIC SOURCE INCOME

Japanese tax is imposed on non-resident individuals only if they have any “domestic source income” as defined in the *Income Tax Law*. Any income generated by or arising from a sale (or other transfer) of transferred land, buildings, or stocks of a real estate related corporation (a corporation in which real estate makes up more than 50% of the corporation’s assets) is taxed as a domestic source income pursuant to the *Income Tax Law*.

As well as the domestic source income requirement, tax on a non-resident individual is dependent upon whether the non-resident individual has one or more “permanent establishments” (“PE”). There are three types of PE: a branch of an entity, a construction site, and an agent.

A purchaser of real estate from a non-resident or a foreign corporation must withhold a certain amount from the purchase price of the real estate as withholding tax (see “Foreign investors” below on page 39).

TAX RATES

For non-resident individuals and foreign corporations, the rate of withholding tax applied to the transfer of real estate is 10%.

TAX TREATIES

Some concessions are granted under tax treaties against Japanese domestic tax law. Such concessions are usually granted to a resident individual or a resident corporation of a foreign country which has entered into a tax treaty with Japan, when they are not at the same time either a Japanese resident individual or a Japanese domestic corporation.

To avoid international double taxation, an individual who, or a corporation which, pays foreign taxes that are similar to income tax to a national or local government abroad may choose to have the amount of those foreign taxes credited against the payable Japanese income tax.

TAXATION OF A CORPORATION

TAX RATES

Corporation taxes, corporation inhabitant taxes and enterprise taxes are levied on the net income a corporation derives from a transfer of real estate. The total rate of these taxes is approximately 40%.

TRUSTS

If a beneficiary has trust beneficial interests, the income from the trust property based on the profits and expenses is taxed as if the income were received by the beneficiary, and in that case income tax is not levied on the trustee, the trust settlor or the trust itself. In other words, trusts are granted a pass-through entity status for tax purposes, save for certain exceptional categories of trusts.

There are some exceptions to the principle that trusts are deemed pass-through entities for tax purposes (ie, beneficiaries of trusts are taxed as opposed to trustees, trust settlor or trusts themselves). If the trust is, for example, a “collective investment trust” (*shuudan toushi shintaku*), a “pension fund trust” (*taishoku nenkin tou shintaku*) or a “specified public interest trust,” (*tokutei koueki shintaku*) in accordance with the principle, the beneficiary is taxed on the income obtained from the trust when the income earned by the trust is distributed to the beneficiary.

On the other hand, if the trust falls under the definition of a “corporate taxation trust” (*houjin kazei shintaku*) which includes business trusts and trusts having no beneficiaries, etc, such a trust would not be granted a pass-through status and corporation tax will be levied on the income of the trust, as if the trust were a corporation.

TMKs

Although TMKs are a type of corporation in Japan, they are permitted to deduct, as an expense, the dividends distributed by TMKs to their respective equity holders on the condition that the following requirements, among others, are met:

- the TMK is not conducting any business other than the business of securitisation or off-balance liquidation transactions in respect of certain asset classes
- the TMK is not classified as a “family corporation” as defined under tax statutes at the end of its fiscal year
- more than 90% of the net income is distributed to the investors as dividends.

A 15% withholding tax is imposed on interest payments on bonds (including TMK bonds) received by corporations or individuals. However, financial institutions such as banks or securities corporations, including foreign ones licensed or registered in Japan, are exempted from this withholding tax.

For general information on TMKs, see the chapter “Structures for investing in Japanese real estate” (page 23).

REITs

J-REITs are, in practice, all formed as an investment corporation, which is one of the types of corporations under Japanese law. To avoid double taxation in the advancement of the investment, it is granted that if the following requirements are met, the dividends paid by J-REITs

may be treated as a deductible expense, similar to TMK taxation as described above. The requirements are, among others, that:

- the J-REIT is not conducting any business other than those permitted to J-REITs
- the J-REIT is not classified as a “family corporation” at the end of its fiscal year
- more than 90% of the net income is distributed to investors as dividends.

A withholding tax is levied on individual investors based on the amount of dividends received from the J-REIT as “dividend income” and on the amount of capital gain from a transfer of the investment units (equity shares in J-REITs) as “capital gain income.” There is, in effect, no imposition of corporation tax on J-REITs because the amount distributed as dividends by a J-REIT is permitted to be deducted as an expense on the books of the J-REIT if the requirements described above are satisfied. Therefore, a deduction of the amounts received as dividends from the tax amount (which is available to dividends received from general corporations) is not available to the investors to the J-REIT. A withholding tax is levied on corporate investors based on the amount of dividends received from the J-REIT, and corporation tax is levied on the capital gains from a transfer of the investment units as gross income.

For general information on J-REITs, see the chapter “Japanese Real Estate Investment Trusts (J-REITs)” (page 25).

FOREIGN INVESTORS

A purchaser, whether a domestic investor or a foreign investor purchasing real estate from a non-resident or a foreign corporation is required to withhold an amount equal to 10% of the consideration to be paid for the real estate.

There are some exemptions to this withholding rule. First, if the purchase price of the real estate is 100 million yen or less, the principle above is not applicable. Second, if the seller of the real estate is a non-resident individual or a foreign corporation which has a PE in Japan, the seller can avoid being levied the withholding tax on the condition that the seller as a taxpayer for Japanese tax purposes obtains from the taxation office of Japan and presents to the purchaser a certificate which evidences that the income arising from such sale and purchase of the real estate, combined with the seller's business income, is taxable.

In order to avoid international double taxation, when an individual or a corporation has paid foreign taxes similar to income tax to a foreign government, the seller as a taxpayer for Japanese tax purposes may credit the amount of the foreign taxes against the amount of payable Japanese income tax.

TRANSFER PRICING

If a corporation executes a real estate transaction with a foreign related person – an affiliate, for example – having a special relationship with the corporation, at a price different from an arm's length price, the corporation is taxed as if it had made the transaction at an arm's length price, and the difference between the taxes levied on the different prices is not allowed to be counted as an expense. If a foreign corporation has some "domestic source income," the corporation is taxed according to the transfer pricing rules.

FOREIGN EXCHANGE

If a real estate transaction is executed in a foreign currency, for tax purposes, the relevant amount should be converted to Japanese yen according to the exchange rate at the time of the transaction.

GOODS AND SERVICES TAX – CONSUMPTION TAX

The Japanese government imposes "consumption tax (*shouhi-zei*)", which can be categorised as a goods and services tax, on almost every domestic transaction and every transaction involving imports of foreign goods. Consumption tax is also applied to the transfer of real estate (but only with respect to buildings as noted below). The consumption tax rate is 5% (4% national consumption tax and 1% local consumption tax). The taxpayer is the enterprise that transfers taxable assets; however, the tax amount is normally added to the price of the assets and is ultimately borne by purchasers or transferees. However, no consumption tax is imposed upon a transfer of land, nor upon a lease of residential buildings or land.

STAMP DUTY

A stamp tax (*inshi-zei*) is levied by the national government on the parties to various contracts, for example, contracts of sale. For a contract for transfer of real estate, this tax can be up to 600,000 yen depending on the value of the contract.

Key points

- Japan has two levels of government (the national government and the local governments) and each separately imposes tax on real estate transactions and investments.
- To prevent international double taxation, Japan has entered into tax treaties with certain countries.
- Purchasers of real estate from non-residents or a foreign corporation are required to withhold an amount equal to 10% of the consideration for the transfer of the real estate.

LAND TAX – FIXED PROPERTY TAX

Fixed property tax (*koteishisan-zei*) is levied by the local governments on the value of land, buildings or any other kind of depreciable property by the registered owner as of the first day of January of each year. The registered owner is the person registered as the holder of the title of the real estate in the property registration records. The rate of fixed property tax varies in a range up to 2.1%.

OTHER TAXES

REGISTRATION AND LICENCE TAX

A registration and licence tax (*touroku-menkyo-zei*) is levied by the national government on applicants for registrations, including property registrations. This tax rate is 2% of the tax base of the value as recorded in the tax rolls (approximately 70% of the market value if the property is land). It should be noted that a tax rate of 1% applies to an applicant for registration in relation to the transfer of land which occurs between 1 April 2006 and 31 March 2011.

REAL ESTATE ACQUISITION TAX

A real estate acquisition tax (*fudousan-shutoku-zei*) is levied by the local governments on the person acquiring the subject real estate. The real estate acquisition tax rate is 4% of the tax base of the value as recorded in the tax rolls. It should be noted that a tax rate of 3% applies to persons acquiring land and/or buildings between 1 April 2006 and 31 March 2012.

SPECIAL LAND HOLDING TAX

Special land holding tax (*tokubetsu-tochi-hoyuu-zei*), which is a local government tax, used to be levied on holders or acquirers against the holding and acquisition of land. Taxable land was able to be limited depending on the size and location of the land; land which was 2,000 square meters or less was exempt from the tax in ward districts of designated cities. The tax rate was at 1.4% on holding of land and at 3% on acquisition of land. However, in response to the recent economic circumstances, imposition of this special land holding tax has been temporarily ceased and the tax has not been levied since 1 January 2003.

Environmental responsibility and land use



INVESTMENT IN JAPANESE REAL ESTATE INVOLVES CONSIDERATION OF ENVIRONMENTAL AND PLANNING ISSUES, AS WOULD BE THE CASE IN OTHER COUNTRIES. DEPENDING ON THE REAL ESTATE TRANSACTION, THESE ISSUES CAN BECOME SIGNIFICANT AND THE MAJOR ONES ARE OUTLINED BELOW.

ENVIRONMENTAL ISSUES

SOIL CONTAMINATION

SOIL CONTAMINATION COUNTERMEASURES LAW

The *Soil Contamination Countermeasures Law (Dojo Osen Taisaku Hou)* is the main national law addressing the issue of soil contamination.

Under the *Soil Contamination Countermeasures Law*, the owner, manager, or occupant of land (“landholder”) must investigate the land to determine whether there is any soil contamination, when a factory using certain harmful materials ceases its operation on the land, or when a governor of the relevant prefecture orders the landholder to conduct such investigation suspecting that the land contains a certain level of soil contamination that may harm people’s health.

If the investigation reveals that there is a certain level of contamination in the land, the governor must register the land as designated contaminated land in the contaminated land ledger administered by the governor. If a governor finds that there is a threat of contamination in the designated land causing harm to people's health, the governor can order the relevant landholder to clean up the contamination or to take other necessary measures to the extent necessary in order to prevent such damage. If appropriate, the governor can issue such an order to a polluter who is not a landholder, provided that no landholder has any objection. If the landholder who receives the order is not the polluter, the landholder can seek reimbursement of its costs from the polluter, if such a person can be identified.

An amendment to the *Soil Contamination Countermeasures Law* to strengthen the soil contamination regulations has been approved and passed by the Diet and will take effect on a date to be designated by Cabinet Order, but no later than April 1, 2010. Under the amendment:

- the landholder's obligation to investigate land will be broadened to include cases where the character of the land of a certain size is to be changed
- a governor may designate two types of contaminated land, and the designation depends on the level of threat that the contamination in the designated land may cause harm to people's health
- regulations will be newly imposed on moving contaminated soil from certain designated contaminated land.

LOCAL LAWS

Local laws regarding soil contamination should also be considered as they sometimes include regulations that are stricter than the *Soil Contamination Countermeasures Law*. For example, local laws sometimes require land developers of certain large lots (eg 3,000 square meters or more in the case of the local law of the Tokyo Metropolitan Government) to investigate the lots, and to clean up soil contamination before commencing development if the contamination exceeds a certain level.

PRACTICE IN SALE AND PURCHASE TRANSACTIONS

In practice, parties to a potential sale and purchase transaction of land frequently conduct a thorough soil investigation voluntarily, regardless of the existing regulations with respect to soil contamination. If contamination is found in the soil and such contamination is curable, the parties usually come to an agreement as to how to deal with the contamination and at whose cost.

If the purchaser is not aware of soil contamination, the seller can be liable for the hidden soil contamination under a statutory defect warranty (*kashi tanpo sekinin*) applicable to the seller under the Civil Law.

In practice, parties to a potential sale and purchase transaction of land frequently conduct a thorough soil investigation voluntarily.

POLYCHLORINATED BIPHENYL WASTE

Polychlorinated biphenyl waste (PCB) (eg old transformers) is sometimes kept in buildings. Under the *Act on Special Measures Concerning Advancement of Proper Treatment of Polychlorinated Biphenyl Waste (Pori Enka Bifeniru Haikibutsu no tekisei na Shori no Suisin ni kansuru Tokubetsu Sochi Hou)*, a business enterprise possessing PCB must:

- report to the governor of the relevant prefecture the condition of the PCB
- dispose of the PCB, or use a third party contractor to dispose of the PCB within a certain period of time. Assignment of PCB is, in principle, prohibited.

At the time of sale and purchase of a building, the seller needs to remove PCB from the building at its own cost before the sale in order to avoid violating the prohibition described above.

ASBESTOS

Currently asbestos cannot be used in buildings. An owner of a building that contains asbestos, which was used in the period during which its use was allowed, can keep the building as it is, but needs to take necessary steps to prevent asbestos from being dispersed.

Under the *Asbestos Damage Prevention Ordinance (Ishiwata Shougai Kisoku)* established in connection with the *Industrial Safety and Health Act (Roudou Anzen Eisei Hou)*, when an owner of a building retains a contractor for demolition, repair or renovation of the building, the contractor must check whether the building contains asbestos. If the building contains asbestos, the contractor must prepare a work plan to prevent the asbestos from causing damage to the health of labourers and must comply with the plan. The contractor must also submit the construction plan to the relevant authority in advance of the demolition, repair or renovation work.

The *Air Pollution Control Law (Taiki Osen Boushi Hou)* also includes regulations with respect to demolition, repair, and renovation work of a building that contains asbestos. The person who is to conduct such work must notify the governor of the relevant prefecture of such work in advance. In conducting the work, that person must take certain measures to prevent the asbestos contained in the building from being dispersed.

Under the Civil Law's tort rule, if a building is used by third parties, such as hotel guests, the occupant or owner of the building can be liable for the damage incurred by those third parties due to any defect of the building. Because such a defect can include asbestos being dispersed in the building, the occupant or owner of the building will need to ensure that the asbestos will not be dispersed.

ENERGY SAVING

Under the *Energy Saving Law (Enerugii no Shiyou no Gourika ni kansuru Houritsu)*, owners of certain large-scale buildings must submit a report to the relevant government authority with respect to the measures to be taken for energy saving in the building. If the proposed measures are insufficient, the government authority can instruct the owner to take more effective measures for the purpose of energy saving.

CO₂ REDUCTION

In 2008, as part of the local government efforts to reduce CO₂, the Tokyo Metropolitan Government established new local regulations which obligate certain large-scale offices to reduce their emissions of CO₂, and allow such offices to achieve reductions by emissions trading. Such regulations are to take effect on 1 April 2010.

PLANNING ISSUES

DEVELOPMENT AND ZONING

The *City Planning Law (Toshi Keikaku Hou)* is the main national law which governs real estate development and zoning.

Under the *City Planning Law*, in urbanisation control areas (*shigaika chousei kuiki*), the development of land is subject to strict control. In areas designated for urbanisation (*shigaika kuiki*), developers are required to obtain permission for development from the relevant authority. Such permission is given, if the proposed development satisfies certain requirements under the *City Planning Law*.

There are various local laws established under the framework of the *City Planning Law*. Relevant local authorities are granted the power to control land use in accordance with the *City Planning Law* and such local laws.

BUILDING STANDARDS

The *Building Standard Law (Kenchiku Kijun Hou)* provides regulations with respect to various standards for a building, including, among other things, regulations with respect to:

- the use (*youto*) of a building
- the ratio of the total floor area of a building to the site area of the building (*yoseki ritsu*)
- the ratio of the building area of a building to the site area of the building (*kenpei ritsu*).

Under the *Building Standard Law*, building construction work needs approval by the relevant authority in advance of the work, and a completion inspection of the building by the relevant authority is required upon completion of the work.

Key points

- When considering an investment in Japanese real estate, it is important for foreign investors to consider the environmental and planning issues with respect to the targeted real estate.
- If there are environmental and/or planning issues identified by due diligence, the investor will have to carefully examine the related environmental and/or planning regulations and consider the allocation of risk between the parties.

The City Planning Law (Toshi Keikaku Hou) is the main national law which governs real estate development and zoning.

Useful websites

JONES LANG LASALLE

www.joneslanglasalle.com

This website includes information for real estate owners, occupiers and investors, as well as details about Jones Lang LaSalle's advisory services.

NISHIMURA & ASAHI

www.jurists.co.jp/en

The Nishimura & Asahi website includes general firm information, practice areas and attorney profiles, as well as firm updates including recent publications and seminars presented by attorneys.

BLAKE DAWSON

www.blakedawson.com

The Blake Dawson website includes information about the firm, updates on recent legal developments, partner profiles and contact details

LEGAL AFFAIRS BUREAU

houmukyoku.moj.go.jp

The Legal Affairs Bureau is a government agency which administers property right registrations. The website is available in Japanese only.

MINISTRY OF LAND, INFRASTRUCTURE, TRANSPORT AND TOURISM

www.mlit.go.jp/index_e.html

This government ministry administers policies in relation to real estate. The website includes reports, statistics and policy information.

FINANCIAL SERVICES AGENCY

www.fsa.go.jp/en

Summaries of various regulations, policies and publications concerning finance, banking and capital markets are available on this website.

STOCK EXCHANGES

www.tse.or.jp/english

Tokyo Stock Exchange Group, Inc

www.ose.or.jp/e

Osaka Securities Exchange Co., Ltd.

These are the two major Japanese stock exchanges.

TAXATION

www.nta.go.jp/foreign_language

The website of the Japanese National Tax Agency provides information about the Japanese taxation system, including an income tax guide for foreigners.

ENVIRONMENT

www.env.go.jp/en

The website of the Ministry of the Environment includes information about policies, laws and resources for businesses related to environment.

STATISTICS BUREAU

www.stat.go.jp/english

This website provides various statistics and information about Japan.

TRANSLATIONS OF LAWS AND REGULATIONS

www.japaneselawtranslation.go.jp

This website provides English translations of various Japanese laws and regulations.

JAPAN NATIONAL TOURISM ORGANISATION

www.jnto.go.jp/eng

This website provides information on travelling in Japan.

NISHIMURA & ASAHI

About Nishimura & Asahi

Nishimura & Asahi prides itself in being Japan's best and foremost full-service law firm, advising in all aspects of domestic and international business and corporate activity. We currently have over 400 Japanese and foreign lawyers, as well as talented support staff including tax advisors and one of the largest paralegal teams.

The firm has experienced, multilingual lawyers with specialised training, including advanced international law degrees from law schools in the U.S. or the U.K. Many of our lawyers have been on secondments to firms in jurisdictions such as the U.S., U.K. and Australia.

We offer an exceptional level of client service in highly-specialised and complex structured financing transactions, mergers and acquisitions, and all areas of commercial law. As well as advising on a wide range of domestic legal matters, the firm engages in all aspects of international corporate and commercial business activity. We advise both Japanese and foreign clients to a competitive international standard. We have a great deal of experience in representing our international clients in establishing their business ventures, both in Japan and worldwide.

Nishimura & Asahi understands its clients' ever-growing needs for the best legal advice and service. The firm's fully-integrated team of lawyers and professional staff are proud to share the same fundamental philosophy: an uncompromising commitment to quality.

OUR REAL ESTATE PRACTICE

The firm advises on a broad range of real estate matters such as real estate sales and purchases, investment, construction and development, leases, management, and financing in various phases of real estate transactions, as well as securitisation and other real estate related structured finance transactions, in Japan and abroad.

We have considerable experience with complex and large-scale transactions working with both Japanese and foreign clients in respect of all types of real estate. We are also experts on environmental law, providing advice on many types of business transactions and developments.

Our deep understanding of the real estate law and the Japanese real estate culture is the solid basis of our expertise, enabling us to provide the best tailored solutions, whether innovative or conventional, to our clients.

According to *Chambers Global 2008*, which lists us as a leading firm for real estate, our team is "reliable, knowledgeable and deeply experienced".

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Real value in a changing world

About Jones Lang LaSalle

Jones Lang LaSalle (NYSE:JLL) is a professional services firm specialising in real estate. The firm offers integrated services delivered by expert teams worldwide to clients seeking increased value by owning, occupying or investing in real estate. With 2008 global revenue of USD 2.7 billion, Jones Lang LaSalle serves clients in 60 countries from 750 locations worldwide, including 180 corporate offices. The firm is an industry leader in property and corporate facility management services, with a portfolio of approximately 1.4 billion square feet worldwide. LaSalle Investment Management, the company's investment management business, is one of the world's largest and most diverse in real estate with more than USD41 billion of assets under management.

For further information, please visit our website, www.joneslanglasalle.com.

Jones Lang LaSalle has over 50 years of experience in Asia Pacific, with over 17,400 employees operating in 79 offices in 13 countries across the region.

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About Blake Dawson

REAL ESTATE PRACTICE

The past decade has seen an increasing number of innovative real estate projects and transactions in Australia and throughout Asia. Despite the most challenging conditions in a generation, the medium to long-term outlook for real estate in the region remains strong and will continue to create demand for clear advice in domestic and cross border transactions, regulation, structuring and taxation of real estate.

Our team has extensive experience advising on real estate projects and transactions in the residential, retail, commercial, hotels and industrial sectors. This experience extends to corporate disposals and acquisitions, complex leasing, portfolio and capital management and real estate development in mainstream and specialist sectors such as infrastructure, aged care, and tourism and leisure.

Our investment real estate practice combines legal expertise in funds management, REITs, commercial property, direct and indirect tax, capital raising, debt financing, M&A, planning and environment, construction and dispute resolution with specialist industry experience and wide ranging regional knowledge.

We have an established track record of assisting our local and international clients in domestic and cross-border transactions, developments, joint ventures, investments, real estate based mergers and acquisitions and capital raisings. We act as a bridge between legal cultures and advise on highly complex projects both domestically and across multiple jurisdictions.

We are engaged by major domestic and international corporations, pension funds, financial institutions, sovereign funds, government, owners, developers, investors, users, managers, occupiers and promoters of real estate and real estate investments.

Our active engagement in the Asian Public Real Estate Association (APREA) and the Association for Real Estate Securitisation (ARES) ensure that our people maintain a thorough understanding of our clients' business environments domestically and internationally, including the commercial issues and risks they face.

We have a strong client culture across our firm and employ over 800 lawyers in nine offices throughout Australia and Asia. Some of our clients have been with us since we began advising more than 160 years ago. We're immensely proud of this. We have advised clients in many regions of the world including Australia, China, Indonesia, India, Japan, Jordan, Korea, Kuwait, the Philippines, Singapore, Taiwan, Thailand, the United Arab Emirates and Vietnam. We are privileged to work with many of the organisations who are shaping tomorrow's industries.

JAPAN CLIENT SERVICES

Blake Dawson has the largest and most experienced Japanese client practice operating in Australia. Our Japan Client Services team has more than 25 years experience assisting Japanese corporations with their investments in Australia and the Asia-Pacific region.

We advise Japanese clients across all aspects of M&A, joint ventures, energy and resources projects, listed property trusts, PPP and infrastructure projects and project finance.

Major Japanese trading corporations, banks, security houses, manufacturers and construction companies choose to work with us on their complex and strategic projects.

OUR PERSPECTIVE

Because of our deep understanding of doing business between Australia and Japan our lawyers act as a cultural and business bridge between Australia and Japan.

Our lawyers are committed to understanding your commercial objectives and providing the most practical, innovative and relevant solutions to your legal and investment issues. You have access to Australian qualified lawyers who are Japanese nationals or are fluent in Japanese. Many of our team have had experience working in Japan (both in Bengoshi Jimusho and legal departments of Japanese companies).

Members of our team have lived and worked in Japan and regularly visit Japan maintaining close personal ties with many Japanese corporations and lawyers. We are also closely involved with the Australia-Japan Business Cooperation Committee, the Australia and New Zealand Chamber of Commerce in Tokyo and the various state branches of the Japan Chamber of Commerce and Industry and the Australia Japan Society.

We value our relationships with our clients and look forward to working with you. For further information please contact:

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Investing in Japanese real estate – An overview

- There is strong interest in the Japanese real estate market and its unique opportunities. Understanding the political landscape, the economic climate and the real estate market, as well as the legal and regulatory framework is essential. (Investing in real estate in Japan by Jones Lang LaSalle page 6)
- Japan is a single nation with a single Constitution. Under the Constitution, legislative power is granted to the Diet (*kokkai*), executive power is granted to the Cabinet (*naikaku*) and judicial power is granted to the Court (*saibansho*). When you are considering an issue with respect to real estate, you should consider national laws first, and then local laws applicable to the real estate, as well as court precedents that may be relevant to the issue. (The Japanese legal system page 12)
- There are no limitations on foreign investment in commercial or residential real estate. Reports on investments to the relevant authorities may be required. (Foreign investment in Japanese real estate page 14)
- As a general rule, in order to perfect an ownership title to real estate, the owner has to have obtained ownership title as a result of a valid agreement with the seller, and the ownership title has to be registered in the name of the owner. Registration does not necessarily mean that the registered owner has the ownership. Sale and purchase transactions are frequently made in the form of sale and purchase of a trust beneficial interest in real estate, not of the real estate itself. Investors should take legal restrictions imposed on leases into consideration when analysing land leases and building leases. (Japanese real estate law page 15)
- The GK-TK structure and the TMK structure are commonly used in real estate investments in Japan. An investor needs to carefully consider the tax, accounting and legal implications of each available vehicle and structure, in order to choose and set up an investment platform which will best serve the needs of the investor. (Structures for investing in Japanese real estate page 20)
- Under the Investment Trust Law, three types of vehicles are available for use for the purpose of J-REITs. All J-REITs however take the entity form of an investment company. An investment company must be registered with the FSA and is subject to various restrictions under the Investment Trust Law, the rules of the FSA and, in the case of a listed J-REIT, the rules of the stock exchange. In addition, an investment company must retain an asset management company registered under the FIEL, to which the investment company delegates all of its investment decision-making functions. Various kinds of disclosure requirements concerning the investment company and the investment company securities apply, including those of the Investment Trust Law, the FIEL, the rules of the stock exchange (in the case of a listed J-REIT) and other laws. (Japanese Real Estate Investment Trusts (J-REITs) page 25)
- Investors in real estate may face certain limitations, restrictions and regulatory requirements in extending credit to their customers/borrowers. For example, a credit provider's ability to extend credit through a secured bond is practically restricted under Japanese law and there could be certain registration requirements under the FIEL for financial instruments formed or issued as a way to finance real estate investments. (Finance and banking page 33)
- Japan's two levels of government, national and local, each separately impose tax on real estate transactions and investments. To prevent international double taxation, Japan has entered into tax treaties with certain countries. Purchasers of real estate from non-residents or a foreign corporation are required to withhold an amount equal to 10% of the consideration for the transfer of the real estate. (Tax page 36)
- When considering an investment in Japanese real estate, it is important for foreign investors to consider the environmental and planning issues with respect to the targeted real estate. If there are environmental and/or planning issues identified by due diligence, the investor will have to carefully examine the related environmental and/or planning regulations and consider the allocation of risk between the parties. (Environmental responsibility and land use page 41)

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