

THE REAL ESTATE
LAW REVIEW

ELEVENTH EDITION

Editor
John Nevin

THE LAWREVIEWS

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PREFACE

Since a mystery disease, then known as 2019-nCoV, first appeared in Wuhan back in December 2019, coronavirus (covid-19) has continued to be the dominant global issue. The covid-19 pandemic has affected the economy like nothing this generation has previously experienced. Every major jurisdiction has been forced into a series of lockdowns, with the very real possibility of more to come. Fundamentally, the pandemic has been a terrible human tragedy with, at the time of writing, more than 250 million cases globally and over 5 million deaths. Although there is still some way to go, we are starting to see light at the end of the tunnel. The covid-19 pandemic will undoubtedly affect the global economy for some time to come. It will also leave its mark on how we live, work and play, including on each and every aspect of the global real estate market.

Another global event saw the great and the good, as well as a healthy number of protestors, converge on Glasgow for COP26. Despite the absence of some key world leaders and criticism that more could have been achieved, key pledges have been made to fight the climate change emergency. The year 2021 may be remembered as the year the world finally acknowledged that something needs to be done and now. The built environment accounts for more than its fair share of carbon emissions and the property industry is beginning to wake up to the fact that significant changes are necessary. How we design, build and use buildings is an important part of the transition towards net zero carbon. Environmental, social and governance (ESG) has finally become a very real issue with all parties, from governments through landlords, tenants and funders to individual workers, having a vested interest.

A great deal has happened since the first edition of *The Real Estate Law Review* appeared in 2012, but nothing more significant than the covid-19 pandemic, a truly global crisis. This eleventh edition of *The Real Estate Law Review* will continue to prove its worth by providing readers with an invaluable overview of how key markets across the globe operate and how they react to major world events. The covid-19 pandemic and COP26 have served as reminders that it is not possible to look at domestic markets in isolation. Investors and their advisers need to understand real estate assets in the context of global events, and *The Real Estate Law Review* continues to help its readers to do just that.

This edition extends to 24 key jurisdictions around the world, and I am very grateful to all the distinguished practitioners for their insightful contributions. Each chapter has been updated to highlight key developments and their effect on the relevant domestic market. Together, the chapters offer a helpful and accessible overview of the global real estate market. Overseas investors are key influencers in most markets, and it is vital that practitioners are able to advise on a particular deal in the light of an understanding of their client's own jurisdiction.

The covid-19 pandemic is a truly global issue affecting every jurisdiction and, of course, its real estate market. Although it has been overshadowed by the covid-19 pandemic, Brexit and

the associated economic and political fallout from leaving the European Union has continued to be a concern for the UK economy and its property industry. Rising costs, a critical shortage of labour and materials as well as crippling supply chain issues have threatened to destabilise the post-pandemic recovery. On a positive note, investment volumes have bounced back and we are seeing increased interest from both overseas and domestic investors, underlining the continued importance of UK real estate as an investment asset. Although global real estate investment has picked up, the recovery has been uneven across countries, markets and sectors. The United Kingdom will be anxious to maintain its position at the top of global shopping lists. The world's growing cache of investment capital is likely to prompt a surge in investment activity once international travel and business confidence stabilises. The United Kingdom seems certain to remain attractive to overseas investors looking for a safe haven for their funds. The next few years will undoubtedly be challenging as we continue on the journey to recovery, but opportunities will arise, and real estate will remain a key part of global investment strategies.

Once again, I wish to express my deep and sincere thanks to all my fellow contributors to this eleventh edition of *The Real Estate Law Review*. I would also like to thank the members of the *Law Review* team for their sterling efforts in coordinating the contributions and compiling this edition. Finally, I wish everyone the very best of health for 2022 and beyond.

John Nevin

Slaughter and May

London

February 2022

JAPAN

Norio Maeda, Takuya Shimizu, Akihiro Shiba, Tomoaki Fujii and Masato Morizuka¹

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

The basic ways in which real estate can be held are either holding ownership title to real estate directly or holding a beneficial interest in a trust that holds title to real estate in connection with large-scale commercial investments.

Land and buildings are considered separate and independent real estate. Therefore, one person can hold the title to land while another person can hold the title to a building on the land. When different persons own a building and the parcel of land upon which the building is located, the two owners will typically enter into a contract such as a land-lease agreement where the building owner is permitted to use the land.

Joint title to real estate, which is governed by the rules under the Civil Code, is one form of title that can be held by multiple persons. Condominium title to a condominium that is part of a building, which is governed by both the rules under the Condominium Law and by the Civil Code, is another form of title that can be held by a single person separately from other condominium owners of the building.

Trust beneficial interests in real estate are typically issued when a real estate owner places the real estate in a trust. The trustee holds title to the real estate placed in the trust. The owner, however, holds a trust beneficial interest that represents a contractual relationship with the trustee under a trust agreement. Under this, the beneficiary may instruct the trustee to administer and manage the real estate in the trust and to distribute profits earned from the real estate (after deducting costs and expenses for administration and management of the real estate). Trust beneficial interests are used for various reasons, including delegating administrative duties from the beneficiary to the trustee and deferring taxes related to real estate transfers by transferring the trust beneficial interests instead.

ii System of registration

Ownership title and other property rights with respect to real estate are typically registered in the real estate registry maintained by local registration offices. Trustees are typically the registered owners of real estate that is placed in trust. The general rule is that transactions, including the sale and purchase of real estate and creation of a mortgage on real estate, take effect upon execution of agreements between the parties, and that no formalities are required; however, the holder of ownership title or other property rights with respect to real estate must

¹ Norio Maeda, Takuya Shimizu and Akihiro Shiba are partners, and Tomoaki Fujii and Masato Morizuka are associates at Nishimura & Asahi.

have its interest registered in the appropriate real estate registry to assert its rights against a third party. This means that generally, to perfect a right over real property, there must be a valid agreement between the parties and the right must be registered in the name of the holder. The registration is governed by the Real Property Registration Act.

While registration of a real property right in the name of a certain person does not necessarily mean that the person actually holds the registered right, registration is usually considered strong evidence. Neither the local registration office nor the government guarantees the accuracy of the real estate registry. A registration in the real estate registry only reflects and records the transactional activities that private persons described in their applications for registration.

iii Choice of law

In the context of a cross-border transaction, choice of law rules are provided in the Act on General Rules for Application of Laws. Under the Act, if the subject matter is a property right or other registrable right in real estate, the law of the jurisdiction in which the real estate is located shall be the governing law; however, under the Act, the governing law of a contract can be chosen by the parties thereto. Despite the Act permitting the parties to choose the governing law of the contract, parties usually choose Japanese law as the governing law of a sale and purchase agreement with respect to real estate located in Japan because property right in real estate is governed by Japanese law.

II OVERVIEW OF REAL ESTATE ACTIVITY

Japan has developed various innovative real estate investment structures during the past few decades.

The GK-TK structure (see Section IV) and the specified-purpose company (TMK) structure are frequently used in real estate investment transactions. Japanese real estate investment trusts (J-REITs) have made it possible for investors with smaller amounts of capital to invest in real estate through the purchase of listed J-REIT securities. The listed J-REITs have become major players in the Japanese real estate investment market through the use of the accumulated capital of investors, and the flow of capital through listed J-REITs into the real estate investment market has contributed to the overall growth of the real estate industry.

The increase in flexibility offered by such investment structures has resulted in a greater influx of domestic and foreign capital into Japanese real estate. The response to demands from an increasing number of participants has made the real estate investment market more sophisticated and attractive, and many investors consider the Japanese real estate market to be an important focus in their global investment strategy.

After the governmental pension fund's adoption of the Principles of Responsible Investment in 2015, and announcement to commence investments using ESG (environmental, social and governance) index as a benchmark in 2017, there has recently been a growing emphasis on the ESG factors in the Japanese market, including the real estate market. Growing number of investors into Japanese real estate market have started to realise that the value of real estate that considers ESG factors is increasing and will increase, and even listed J-REITs have started to publish their policy regarding ESG and obtain ratings from evaluating organisations.

III FOREIGN INVESTMENT

There are no direct restrictions on acquisitions of commercial or residential real estate in Japan by foreign investors, either directly or through a vehicle. Similarly, establishment of a corporation by foreign investors to invest in commercial or residential real estate is not restricted.

Under the Agricultural Land Act, an authorisation by the relevant authority is required to acquire certain agricultural land. This authorisation can only be granted if the purchaser is qualified as a farmer or a qualified corporation for owning agricultural land. It would not be easy for foreign investors to be granted such an authorisation.

After a foreign investor's acquisition of real estate, a post-transaction report to the government authority may be required pursuant to the Foreign Exchange and Foreign Trade Act (FEFTA). A post-transaction report of payment or receipt of payment may be required in the case of cross-border payments or payments between a foreign investor and a Japanese resident in accordance with the FEFTA.

As described in Section VII.ii below, a prior notice will be required for acquisition of certain real estate under the new regulation to come into effect in 2022.

IV STRUCTURING THE INVESTMENT

When choosing an investment structure, the legal, accounting and tax implications must be considered because each can be a driving factor for the choice. The most popular structures and investment vehicles used for real estate investments in Japan are the GK-TK structure, the TMK structure and the J-REIT.

i GK-TK structure

A limited liability company (GK) is one type of corporate entity under the Companies Act. In some respects, it is similar to an LLC in the United States; however, it is not itself a pass-through entity for tax purposes. When a GK is used as an asset investment vehicle, typically an investor leverages its investment by third-party loans and makes its own investment in the GK through a contractual anonymous partnership (TK) arrangement. The TK arrangement is a bilateral (not multilateral) contractual partnership relationship created for the investment purposes by the TK interest holder, called the TK investor. The other party to the contract is called the TK operator. Under the GK-TK structure, the TK operator is the GK. A TK arrangement qualifies for favourable tax treatment if the TK investor is a passive investor with minimal control over the management of the GK and the contributed funds under the arrangement. If the TK arrangement qualifies, the GK is permitted to deduct distributions to the TK investor from its taxable profits in addition to deducting debt payments. This tax-efficient combination of a GK and a TK arrangement is called a GK-TK structure.

Typically, a GK-TK structure has been used to make investments in trust beneficial interests in real estate, and loans backed by real estate. If a GK holds real estate directly, by raising funds from TK investors, it will generally be subject to a licensing requirement under the Act on Specified Joint Real Estate Ventures (ASJREV). Therefore, the GK-TK structure has usually been structured to invest in trust beneficial interests in real estate, not in real estate itself. An exemption from the licensing requirement under the ASJREV allows the GK-TK structure to invest in real estate itself if certain requirements are met.

A GK-TK structure that is used to invest in a trust beneficial interest in real estate will subject the GK to the strict registration requirement under the Financial Instruments and Exchange Act (FIEA), unless an exception applies. One of the exceptions available under the FIEA is the QII exemption, which essentially requires that:

- a* there is at least one qualified institutional investor (QII) under the FIEA among the TK investors;
- b* the number of non-QII TK investors (if any) is 49 or fewer (non-QIIs are limited to certain categories, which includes a foreign corporation);
- c* none of the TK investors is a disqualified investor as described in the FIEA; and
- d* the GK, as the operator of the TK arrangement, files with the relevant governmental authority a notification regarding the QII exemption.

Another exception newly introduced in November 2021, and now available under the FIEA, is the foreign investors exemption, as discussed in Section VII.i, below.

Yet another exception available under the FIEA is the exemption by outsourcing to a registered discretionary investment manager. Under this exemption, the GK retains a registered discretionary investment manager (a 'registered financial instruments operator' under the FIEA) as its asset manager to manage its trust beneficial interest in real estate on a discretionary basis. This exemption requires, among other things, that:

- a* the GK enters into a discretionary asset management agreement with the registered discretionary investment manager that authorises the manager to make a discretionary investment decision on behalf of the GK on its trust beneficial interest in real estate;
- b* the TK agreement provide that under the asset management agreement described above, the GK authorises the manager to make a discretionary investment decision on its behalf on its trust beneficial interest in real estate;
- c* the TK agreement provide an outline of the asset management agreement described above, including the fees (or the fee arrangement) to be paid to the asset manager from the assets managed under the GK-TK structure;
- d* both the TK agreement and the asset management agreement described above provide certain duties of the asset manager, such as the asset manager's duty of loyalty and duty of care of a prudent manager, both owed to the TK investor in carrying out the investment management of the trust beneficial interest in real estate held by the GK;
- e* the GK manages its assets of the GK-TK separately from its own assets (and its other investment assets managed for other investors, if any) and the asset manager supervises such separate management; and
- f* the asset manager file with the relevant authority a notification of the outsourcing by the GK prior to the GK entering into the TK agreement.

ii ASJREV structure

GK-TK structures may, provided certain requirements are met, directly invest into real estate without the GK (the TK operator) having to obtain a licence or registration.

The 'special venture' GK-TK structure available under the ASJREV essentially requires that:

- a* the GK must be established for the sole purpose of distributing proceeds and profits from transactions related to the subject real estate;

- b* the GK as the TK operator must delegate the management of transactions related to the subject real estate to a licensed operator of ‘specified joint real estate venture’ or registered operator of ‘small-scale specified joint real estate venture’ to conduct the management activities pursuant to the ASJREV;
- c* the GK as the TK operator must delegate the solicitation of TK investments into the TK operator by the potential TK investors to a licensed operator of ‘specified joint real estate venture’ to conduct such solicitation activities pursuant to the ASJREV. The licensed or registered operator must also be a registered operator of ‘type II financial instruments business’ under the FIEA to conduct such solicitation of the TK investments, which are regulated as securities under the FIEA;
- d* the TK investors must be limited to ‘special investors’ (or professional investors), which includes licensed operators of ‘specified joint real estate venture’ under the ASJREV, real estate brokers approved to conduct transactions for the clients on a discretionary basis under the Real Estate Brokerage Business Act, real estate investment advisers registered under the Real Estate Investment Advisor Registration Regulations, professional investors under the FIEA, and stock companies with stated capital of ¥500 million or more, if the GK as the TK operator is to conduct development of land as a site for buildings, construction of a building, or repair or renovation of a building, the cost of which exceeds (1) 10 per cent of the value of the subject real estate, in the case that the asset manager retained by the GK is a licensed operator of ‘specified joint real estate venture’ or (2) ¥100 million, in the case that the asset manager is a registered operator of ‘small-scale specified joint real estate venture’;
- e* the agreement between the GK and the licensed operator of ‘specified joint real estate venture’ or registered operator of ‘small-scale specified joint real estate venture’ as described in (b) above must stipulate certain items specified under the ASJREV; and
- f* the GK must submit a notification to the relevant authority as the operator of a ‘special venture’ before commencing its business under the TK arrangement.

Another GK-TK structure available under the ASJREV (the ‘venture only for qualified special investors’) is a structure where the TK investors are limited to ‘qualified special investors’ (or ‘super professional investors’), which includes licensed operators of ‘specified joint real estate venture’ under the ASJREV, real estate brokers approved to conduct transactions for clients on a discretionary basis under the Real Estate Brokerage Business Act, discretionary real estate investment advisers registered under the Real Estate Investment Advisor Registration Regulations and certain types of ‘qualified institutional investors’ under the FIEA. To use this structure, the GK as the TK operator is required to submit a notification to the relevant authority as the operator of a ‘venture only for qualified special investors’ before commencing its business under the TK arrangement, but it is not required for the GK to retain a licensed operator of ‘specified joint real estate venture’ or registered operator of ‘small-scale specified joint real estate venture’ as its asset manager or distributor.

The foregoing GK-TK structures under the ASJREV can enjoy certain preferential tax treatment such as reduction of registration and licence tax, and real estate acquisition tax.

iii TMK structure

A TMK incorporated under the Act on the Securitization of Assets (ASA) is another type of corporate entity often used as a real estate investment vehicle. This entity may only be used to liquidate or securitise certain assets. This investment platform is used to make investments

in real estate, trust beneficial interests in real estate, and loans and TMK bonds that are backed by real estate. A TMK is typically funded by issuing TMK bonds and preferred shares that meet certain tax qualifications required for the preferential tax treatment of the TMK. If a TMK, its bonds and its preferred shares are properly structured, and the TMK meets certain other requirements under the Tax Code, it is permitted to deduct distributions to the preferred shareholders from its taxable profits in addition to deducting debt payments.

One of the requirements for the preferential tax treatment is that its TMK bonds be purchased by an institutional investor or other similar person or entity (a Tax II or equivalent investor) as defined in the Tax Code. Certain QIIs under the FIEA and certain other QIIs meeting additional requirements fall under the definition of a Tax II or equivalent investor. One of the important steps in setting up a TMK structure is to find a TMK bondholder that is a QII and is a Tax II or equivalent investor.

When using a TMK structure, it is also important for the TMK to comply with strict regulations under the ASA. These regulations include a requirement to file an asset liquidation plan with the relevant governmental authority. The asset liquidation plan of a TMK outlines how its assets are to be liquidated or securitised. A TMK structure requires close attention to be paid to the regulations regarding the asset liquidation plan.

iv J-REITs

A J-REIT is a type of investment fund formed under the Act on Investment Trusts and Investment Corporations (AITIC). A J-REIT established to invest in and manage real estate assets uses investors' funds to purchase real estate assets, in return for which investors receive investment units. The investment units of a J-REIT can be listed and traded on the stock exchange. If a J-REIT's investment units are listed, the J-REIT must comply with the rules of the stock exchange in addition to the AITEC. Under the AITEC, a J-REIT must retain an asset management company (a registered financial instruments operator under the FIEA) to manage its investment. In practice, all investment decisions for a J-REIT are designed to be made by its asset management company.

Unlike an ordinary corporation, which is subject to corporation tax on its profits, a J-REIT is exempt from taxation if certain requirements are satisfied, including:

- a* the J-REIT is not engaged in any business other than that permitted for J-REITs;
- b* the J-REIT would not be classified as a family corporation as defined in the Tax Code at the end of its fiscal period;
- c* the J-REIT distributes more than 90 per cent of its profits as dividends to the holders of its investment units for each fiscal period; and
- d* more than 50 per cent of the investment units on an aggregate issued amount basis have been offered in Japan.

The basic concept underlying the J-REIT legislation is that unlike a GK-TK structure or a TMK structure, a J-REIT's investments are not limited to certain assets specified at the time of its start-up. By raising long-term funds through a combination of debt and equity financing, a J-REIT can continue to accumulate and replace its investment portfolio for a longer term. At the same time, however, it would distribute most of its profits (more than 90 per cent) to the holders of its investment units for each fiscal period as described above, and therefore may not have sufficient internal reserve funds. When structuring a J-REIT, it is important to mitigate the potential risks of not having sufficient funds to deleverage its debt

during an economic downturn. Because a J-REIT would practically be restricted regarding the amount of reserves it may retain, it should adopt another financial strategy to mitigate the potential risks, such as keeping its debt-to-asset ratio at a conservative level.

V REAL ESTATE OWNERSHIP

i Planning

City Planning Act

The City Planning Act is the primary national law that governs real estate development and zoning.

Under the City Planning Act, land development is strictly controlled in urbanisation control areas. Developers are required to obtain approval from local government authorities for developments in areas designated for urbanisation. Approval is given if the proposed development meets certain requirements under the City Planning Act.

There are various local laws established under the framework of the City Planning Act. Local government authorities are granted the power to control land use in accordance with the City Planning Act and the local laws.

Building Standards Act

The Building Standards Act provides regulations with respect to construction of a building, including regulations with respect to its use and the ratio of its total floor area to its site area.

Under the Building Standards Act, the appropriate local government authority must approve construction work for a building before the work commences. Furthermore, a completion inspection of the building by the appropriate local government authority is required upon completion of work.

ii Environment

Under the Soil Contamination Countermeasures Act, if a manufacturing factory that uses certain hazardous materials ceases its operations, the owner, manager or occupant of the land (the landowner) must examine the land and test for contaminants. In addition, in the case of the development of a large area of land (at least 3,000m²), the developer must notify the appropriate local government authority at least 30 days before any change is made to the land. After receiving this notice, if the authority determines that the land may be contaminated in the manner designated by the Soil Contamination Countermeasures Act, it may order the landowner to investigate. The local government authority may also order a landowner to examine land and conduct testing for contaminants if it determines that the land may harm the health of inhabitants in the neighbourhood through underground water or otherwise in the manner designated by the Soil Contamination Countermeasures Act. If the result of an examination of the land reveals that the relevant regulations have not been met, local government authorities will designate the land as a contaminated area and require appropriate measures, including cleaning up the land, to prevent public health from being impaired.

iii Tax

Stamp taxes, registration and licence taxes, and real estate acquisition taxes apply when the ownership title of real estate is transferred.

General

Stamp taxes are paid by affixing a revenue stamp on a taxable document. An agreement to transfer the ownership title to real estate requires a stamp tax of progressive amounts generally ranging from ¥200 to ¥600,000, based on the purchase price provided in the agreement. A range from ¥200 to ¥480,000 will apply to an agreement entered into between 1 April 2014 and 31 March 2022.

Registration and licence taxes are imposed when registering certain matters with respect to real estate with the appropriate local registry. The tax rate to register a transfer of ownership title to buildings is generally 2 per cent. A rate of 1.5 per cent will apply to a registration regarding a transfer of land occurring between 1 April 2013 and 31 March 2023, and a rate of 0.3 per cent will apply to a transfer of ownership title to certain qualified residential buildings that are acquired by an individual by 31 March 2022, to be used for residential purposes.

Real estate acquisition taxes are imposed on a purchaser of real estate at a rate of 3 per cent (for land and for residential buildings), or 4 per cent (for non-residential buildings); provided that the reduced tax rate of 1.5 per cent will apply to residential lands that are acquired by 31 March 2024.

Beneficial treatment

Transfer to a TMK

If a TMK acquires real estate and meets certain requirements, it may qualify for the following tax benefits:

- a* the registration and licence taxes to register the acquisition until 31 March 2023 will be reduced to 1.3 per cent; and
- b* the real estate acquisition tax rate is currently two-fifths of the original rate, and this reduced rate will apply until 31 March 2023.

Transfer of trust beneficial interest

Using a trust structure where the trustee holds ownership title to real estate provides certain tax benefits. Stamp taxes for real estate trust agreements and for sale and purchase agreements for a trust beneficial interest in real estate is ¥200, which is substantially less than stamp taxes for a sale and purchase agreement of the real estate itself. While registration and licence taxes and real estate acquisition taxes will be imposed on the purchaser of real estate, the following reduced registration and licence taxes will be imposed on real estate being placed in trust, and on a trust beneficial interest in real estate being transferred from the initial holder to the purchaser:

- a* on placing the real estate in trust: 0.3 per cent (for land, until 31 March 2023), or 0.4 per cent (for buildings); and
- b* on the transfer of the trust beneficial interest: ¥1,000 for each building and piece of land.

Real estate acquisition taxes are not imposed on real estate when it is placed in trust or on the transfer of the trust beneficial interest.

However, when the holder of a trust beneficial interest in real estate (other than the initial holder) terminates the trust agreement and receives delivery of the real estate from the trustee, registration and licence taxes at a rate of 2 per cent will be imposed upon registration

of the real estate transfer. Upon such a transfer, real estate acquisition taxes will also be imposed on the beneficiary at a rate of 3 per cent (for land and for residential buildings), or 4 per cent (for non-residential buildings).

By applying the tax benefits of a trust structure as described above, a substantial amount of taxes related to the real estate acquisition can be deferred until the trust agreement is terminated and the real estate is delivered to the beneficiary.

Transfer of real estate to a GK-TK structure under the ASJREV

Preferential tax treatment applies to certain GK-TK structures under the ASJREV.

If the GK as the operator of a 'special venture' under the ASJREV (except where the GK delegates management of transactions related to the subject real estate to a registered operator of a 'small-scale specified joint real estate venture') or as the operator of a 'venture only for qualified special investors' under the ASJREV (where the GK delegates the management of transactions related to the subject real estate entirely to a real estate broker licensed under the Real Estate Brokerage Business Act) acquires one or more of the following: (1) land satisfying certain requirements to be used as a site for a building with certain scale and quality, provided that such building will be newly constructed or reconstructed by rebuilding a building older than 10 years or seriously damaged by natural disasters, newly constructed on vacant land or created by extension, repair or remodelling of a building older than 10 years or seriously damaged by natural disasters; and (2) a building older than 10 years or seriously damaged by natural disasters to be rebuilt, extended, repaired or remodelled on land satisfying certain requirements, by meeting certain requirements, it may qualify for the following tax benefits until 31 March 2023:

- a* the registration and licence taxes to register the acquisition is reduced to 1.3 per cent; and
- b* the value of the real estate for the purpose of real estate acquisition tax is deemed to be half of the applicable value with respect to the subject real estate.

The GK as the operator of a 'small-scale specified joint real estate venture' under the ASJREV or as the operator of a 'special venture' under the ASJREV (where the GK as the operator of a 'special venture' delegates the management of transactions related to the subject real estate to a registered operator of a 'small-scale specified joint real estate venture') may qualify for the following tax benefits until 31 March 2023, if the GK meets certain requirements:

- a* the registration and licence taxes to register the acquisition of a building for the purpose of new construction or reconstruction by rebuilding, or extension, repair or remodelling will be reduced to 1.3 per cent; and
- b* the value of real estate for the purpose of acquisition tax is deemed to be half of the applicable value with respect to the subject real estate, if the real estate is one of the following:
 - a building constructed before 1 January 1982 and acquired for the purpose of extension, reconstruction, repair or remodelling; or
 - land acquired as a site for the building.

iv Finance and security

Mortgages on real estate are the most frequently used form of security interest in real estate.

In general, once the mortgage is registered, it is granted priority over unsecured creditors; however, even a registered mortgage is subordinate to tax claims against the mortgagor that

became due prior to the registration of the mortgage. The registered mortgage will also be subordinate to any previously registered mortgages or other previously registered security interests on the same real estate.

Another form of security interest in real estate that is frequently used is a pledge over a trust beneficial interest in real estate. If real estate is held in the form of a trust beneficial interest in real estate, the lender would create a pledge over the trust beneficial interest and not a mortgage on the real estate itself. Perfection of the pledge is made by obtaining the consent of the trustee with a date certified by a notary public.

TMK bondholders are granted a security interest by operation of law, which is a statutory general security interest on all the current and future assets of the TMK granted in their favour under the ASA. The statutory general security interest will also secure (by operation of law under the ASA) all the TMK bonds subsequently issued. Therefore, in many cases, holders of TMK bonds do not create a mortgage or pledge on the real estate or trust beneficial interest in real estate held by the TMK. This is mainly because the mortgage and pledge securing the bonds need to be held by a trustee in accordance with the Secured Bond Trust Act, and additional costs to establish such a trust arrangement are not considered economically justified in many cases.

VI LEASES OF BUSINESS PREMISES

The Act on Land and Building Leases (ALBL) and the Civil Code regulate real estate leases. The general rule is that the ALBL is applicable to land leases that are made for the purpose of the lessee owning a building on the land, and to building leases. The ALBL takes precedence over the Civil Code when their provisions overlap.

i Types of lease

The ALBL provides for various types of lease, including the following.

Land lease for the purpose of a lessee owning a building on the land

Ordinary land lease

Under the ALBL, a land lease made for the purpose of the lessee owning a building on the land (other than a fixed-term land lease as discussed below) has a 30-year term, unless the parties agree to a longer term. These land leases are automatically renewed for a term of 20 years for the first renewal and 10 years for subsequent renewals unless otherwise agreed by the parties. The lessor cannot object to renewal without a justifiable reason. Generally, a justifiable reason is not easy to establish, and the lessor's refusal to renew the lease is strictly restricted.

Fixed-term land lease

A fixed-term land lease made for the purpose of the lessee owning a building on the land is not renewable under the ALBL; however, the parties are not prohibited from entering into a new lease agreement at the expiry of the lease. Fixed-term land leases were introduced because concerns of landowners about the strict restrictions on the ability of the owners of land to refuse to renew a land lease were considered to inhibit effective use of real estate. There are three types of fixed-term land leases:

- a a general fixed-term land lease available for either residential purposes or business purposes (the fixed term is 50 years or longer);

- b 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); and
- c a fixed-term land lease for business purposes (the fixed term is 10 years or more but must be shorter than 50 years).

Building leases

Ordinary building lease

A building lease usually has an agreed term. Under the ALBL, a building lease with an agreed term (other than a fixed-term building lease as discussed below) is automatically renewed and the lessor cannot object to the renewal of the building lease without a justifiable reason. Generally, a justifiable reason is not easy to establish and the lessor's refusal to renew the lease is strictly restricted.

Fixed-term building lease

A fixed-term building lease is not renewed under the ALBL; however, the parties are not prohibited from entering into a new lease agreement at the expiry of the lease term. The parties can agree on the fixed term without restriction on its duration.

ii Typical provisions

There are typical provisions for leases of business premises in Japan regarding increase or reduction of rent, termination and assignment of lease or sublease.

Rent increase or reduction

Under the ALBL, if the amount of rent payable becomes inappropriate (e.g., if it differs significantly from the market rent), the lessor or the lessee may request that it be increased or reduced. This applies both to land leases made for the purpose of the lessee owning a building on the land and to building leases. The parties to the lease agreement, however, can eliminate the right to request an increase in rent by agreeing not to increase the amount of rent for a certain period. The right to request a reduction cannot be eliminated from a lease that is not a fixed-term building lease.

Termination

Under the Civil Code, if one party breaches an agreement, the other party can terminate it; however, under Supreme Court precedents, a lessor cannot terminate a real estate lease agreement if the lessee can establish the existence of a special circumstance where a relationship of mutual trust remains between the lessor and the lessee even after the breach. Failure to pay rent for several months would usually entitle the lessor to terminate the lease because this non-payment would usually be regarded as destroying the relationship of mutual trust.

Assignment of lease or sublease

Lease agreements usually prohibit the lessee from assigning the lease or subletting without the consent of the lessor.

VII DEVELOPMENTS IN PRACTICE

i Specially permitted business for foreign investors

Effective from November 2021, specially permitted business for foreign investors (the foreign investors exemption) has been introduced as a new type of exemption from the registration requirement under the FIEA imposed on the securities investment management business. This exemption can be used to exempt GK-TK structures that invest in trust beneficial interests in real estate. Following the introduction of the foreign investors exemption, GK-TK structures can be exempted by way of either the foreign investors exemption or the QII exemption, depending on who the TK investor is in a GK-TK structure.

Investors who qualify for the foreign investors exemption are limited to those that fall within the definition under the FIEA, such as:

- a* foreign corporations;
- b* certain individuals domiciled in an foreign country; and
- c* professional investors.

The exemption also requires that more than 50 per cent of the investment in a securities investment management business be made by non-residents.

Under the foreign investors exemption, in contrast to the QII exemption, there is no requirement for a QII investor and no limitation on the number of investors. However, the securities investment management business to be exempted by way of the foreign investors exemption (in the case of a GK-TK structure, the GK or the operator of the TK arrangement) must have a personnel structure capable of appropriately conducting the securities investment management business. This requirement for a certain level of personnel structure will need appropriate attention in establishing a GK-TK structure to be exempted by way of the foreign investors exemption.

ii Enactment of the Important Land Survey Act

The Act on the Survey of Land Use and Regulation of Land Use in the Vicinity of Important Facilities and Border Remote Islands (Important Land Survey Act) was established on 16 June 2021, and is scheduled to come into effect partially from 1 June 2022 and comprehensively from 1 September 2022.

Under the Important Land Survey Act, if an area falls within a ‘special attention area’, one of the parties that intend to enter into a contract to transfer ownership title to the subject real estate within the special attention area (excluding real estate with an area smaller than the size to be specified by a Cabinet Order, but not less than 200 square metres, the ‘non-special-attention real estate’) must notify the Prime Minister in advance of the following:

- a* the name and address of the parties concerned and, in the case of a juridical person, the name of its representative;
- b* the location and area of the non-special-attention real estate as the subject of the relevant contract;
- c* the type and details of the title to the non-special-attention real estate as the subject of the relevant contract;
- d* the contemplated use of the non-special-attention real estate after the ownership title to the non-special-attention real estate has been transferred under the relevant contract; and
- e* any other matters to be specified by Cabinet Office Ordinance.

The Prime Minister will look into the matters as notified. A special attention area includes an area within 1,000 metres of an ‘important facility’ such as a self defence force facility, a Japan coast guard facility, and a facility related to the daily lives of the people (limited to facilities whose functions are necessary to avoid significant possible harm to the lives, bodies or properties of the people) to be specified by the Cabinet Order.

Once the areas and facilities that will be designated as special attention areas and important facilities have been clarified, investors will have clarity on what restrictions will be implemented. Investors in real estate in Japan should pay due attention to the regulatory updates while waiting for the Important Land Survey Act to come into effect, and should ensure compliance with the prior notification requirement in connection with special attention areas and important facilities.

iii Regulatory developments regarding land with unknown owners

The Civil Code and the Real Property Registration Act have been amended and are scheduled to come into effect on 1 April 2023 (partially on 27 April 2023) and 1 April 2024, respectively. The legislative background to these amendments is based on concerns about a growing number of cases where land is not appropriately used:

- a* due to the owners of the land not being immediately identifiable through the real estate registry; and
- b* even if the owners are identified, their whereabouts are unknown due to an inheritance of ownership not being registered in the real estate registry.

The scheduled amendments, such as (1) the amended Civil Code allowing other co-owners of land to acquire the co-ownership interest of an unidentified co-owner and to dissolve such interest of the unidentified co-owner under the supervision of the court, and (2) the amended Real Property Registration Act requiring heirs who have inherited real estate from a decedent to apply for inheritance registration in the real estate registry, once they come into effect, are expected to provide solutions to nationwide issues that exist concerning land utilisation and enable, for example, large-scale real estate development projects to progress in a more efficient manner.

iv Real estate security token offering

Recent developments in distributed ledger technology have attracted attention to security token offerings (STO), including those involving real estate tokenisation (real estate STO). Tokenised securities in a real estate context are typically TK investments in real estate assets or trust beneficial interests in real estate.

A series of new regulations on tokenised securities were introduced in May 2020 under the FIEA, the Japanese securities law.

The introduction of the foregoing regulations on tokenised securities under the FIEA has drawn the attention of traditional real estate market players to real estate STOs. In 2021, the market saw a couple of real estate STOs. While discussions are still ongoing within the government to introduce appropriate regulations on stablecoins, which are useful as a means for DVP (delivery versus payment) on transactions involving security tokens, and the relevant industry players are discussing the development of the secondary market for security tokens, it is hoped that once such regulations are implemented and the secondary market is developed, there will be more real estate investments through a more established and efficient STO practice.

VIII OUTLOOK AND CONCLUSIONS

The global outbreak of the covid-19 pandemic, which began in 2020, has caused unprecedented challenges and difficulties, and has had a severe effect on commercial activities in Japan. The real estate sector has been invariably affected, with the hotel real estate sector experiencing the most striking impact, due to various restrictions on leisure activities and the movement of people, and the office leasing market seeing a decline in demand for office space, due to the prevalence of remote work and the uncertain future of the economy. While Japan also saw a slowdown of the activities of foreign investors in the real estate market in 2021, it is hoped that the real estate market will experience a recovery soon, given the increase in vaccination rates worldwide and the prospect of the pandemic coming to an end in the near future. Multiple, large-scale developments are also underway, and scheduled for completion in the next 10 years, notably in the metropolitan areas, which are expected to have a stimulating effect on the real estate market. We hope that even during the current difficult time, established but still evolving real estate investment platforms such as the ones discussed above will continue to provide overall confidence in the Japanese real estate market and, more importantly, a basis for its sustainable growth.

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