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Commercial real estate investment guide

Japan



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Market overview

Japan's real estate market is one of the largest in the world by transaction size owing to a variety of factors, including long-term low interest rate; Japan's stable returns; and the low-risk investment environment. While the pandemic has affected the real estate market in Japan, its impact has not been as severe as in places such as the US and Europe. During the pandemic period, investors' demand in Japan's real estate remained strong as the market was generally viewed as 'safe' and attractive, and now grows stronger as people's life patterns return to what they used to be.

Generally speaking, the commercial office sector in Japan has been stagnant during the pandemic period with many owners taking a 'wait and see' approach. However, it seems that more and more people are going back to their offices and it is anticipated that this sector will become more active as the year progresses, and the rental rates (and, hence, yields) will continue to look strong in 2024. Also, the hospitality sector was hit hard during the pandemic, but as restrictions on transportation were lifted, foreign investors' demand for this sector has become more robust.

In contrast to the office and hospitality sectors, the pandemic has led to a rise in demand in some asset classes in Japan. Spurred on by the pandemic, the surge in e-commerce and remote working has created the need for large-scale, state-of-the-art logistics facilities and data centres. Several large-scale logistics facilities have been sold over the past years and more are expected to hit the market in the near future. Likewise, major data centre developers and operators have contracted to build several data centres and campuses in Japan. Demand for these asset classes is expected to continue to rise in the foreseeable future.

Other asset classes that have experienced a growth in demand over the past few years and are expected to



continue include:

- multifamily residential portfolios, as they offer investors steady returns and a relatively low default rates by tenants, and
- student housing and senior care facilities, asset classes that are doing extremely well.

Finally, one segment of the market that is small but growing is the ultra-luxury residential market, especially in Tokyo, in Japan's ski resort areas in Nagano, Hokkaido and in Kyoto. Driven mainly by overseas ultra-high net worth individuals, this segment has started to rebound from the effects of the pandemic and is expected to increase in demand.

Overall, the real estate market in Japan remains vibrant, and investor optimism remains high for Japan's real estate market and demand in a variety of asset classes should continue through 2024.

Sale and purchase

Real estate ownership

Forms of real estate ownership

Generally, real estate in Japan is held either in fee simple or in trust.

Major property legislation

The Civil Code is the major property legislation which regulates the ownership, assignment, mortgages and other relevant matters including matters related to sale and purchase agreements and lease agreements in Japan. In addition, other property-related legislation includes:

- The Land Lease and Building Lease Law of Japan (Law no. 90 of 1991)
- Law Concerning Liquidation of Assets (Law no. 105 of 1998)
- Financial Instruments and Exchange Act (Law no. 25 of 1948) (the 'FIEA')
- The Trust Law (Law no. 108 of 2006)

Title registration

Title to real property is registered for purposes of perfecting title and providing public notice. Japanese law treats land and buildings as separate and distinct for ownership and title purposes.

Although it is acknowledged that a seller has title to the registered interest in real property, registration itself does not guarantee good title.

There is no title insurance in Japan. The market practice in Japan is for a purchaser to rely on the representations and warranties of a seller together with the registration to gain comfort regarding ownership of the real property.

Title to real property is evidenced by a real property registry (*fudosan toukibo*) maintained at one of the Legal Affairs Bureaus, which is a local governmental agency primarily in charge of various registries in Japan.

In Japan, title to real property can be transferred by an agreement between a transferor and a transferee and no formalities are required.

The real property registry has the following parts:

- Description of real property.
- Register of rights and interests: ownership and interests other than ownership such as mortgages and surface rights.

The description of the real property includes the location, lot number, type and area of the real property.

The register of ownership includes:

- Name and address of the owner.
- Date of acquisition of the real property.
- Method of acquisition of the real property, such as sale, gift, entrustment and inheritance.
- Type of title such as co-ownership.

If real property is entrusted, the trust information is registered in the trust list attached to the real property registry.

The register of interests other than ownership includes:

- Name and address of the holder of interests.
- Date of creation of the interests.
- Basic information for the interests (for a mortgage, the principal amount, interest rate and default rate of the secured obligations, the names and addresses of the obligor of the secured obligation and the mortgagee) (if applicable).

The information provided in the real property registry is publicly available. However, the information in the underlying documents such as a sale agreement, mortgage agreement and trust agreement are not.

Transfer of real estate ownership

The usual process for the transfer of real estate ownership in Japan includes:

- The purchaser will carry out legal and technical due diligence, including title search at the subject lands and buildings; confirmation of relevant government approvals as to land use; review and confirmation of any unregistered interest and applicable tax payment receipts; inspection of the physical condition of the property; and due diligence on the target company if the property transaction is to be effected via a share transfer.
- The parties should execute a written sale and purchase agreement setting forth the terms of the transfer.
- The parties will file an application to the Legal Affairs Bureaus for the registration of transfer of the title from the seller to the purchaser and issuance of the new title certificate. The seller will be required to pay off any expenses that are on the property such as loans and taxes before proceeding to transfer the title, in accordance with the terms set forth in the sale and purchase agreement.

Direct (i.e. asset transfer) vs indirect (i.e. share transfer) transfer for commercial real estate

Asset transfers can take the form of a direct transfer of ownership of the real property itself or indirectly through the transfer of shares of the property holding company.

Asset transfers involve transfer of ownership of the real property itself. On the other hand, share transfers involve buying and selling of shares in property holding company.

The direct transfer is a simple way, but it is necessary to consider the related taxes required (for tax please see p19 taxes). Therefore, asset transfer by way of acquisition of trust beneficiary interest ('TBI') is one of the possible options in order to avoid such taxes.

In terms of registration tax and real property acquisition tax, an indirect transfer is reasonable. However, it is necessary to consider the cost and procedural burdens that come with due diligence of certain matters such as assets and liabilities of the subject property holding company, and treatment of its employees, since an indirect transfer takes the form of the general M&A transaction.



Considerations for foreign ownership

Apart from specifically regulated industries, there are generally no specific restrictions on non-resident entities and individuals to own or lease real estate (including shares in companies holding real properties). Foreigners are allowed to directly purchase real estate assets in the private market. Please also see p14 offshore direct investment.

Sale and purchase process

Typical process

The typical legal work carried out before the acquisition of a commercial real property in Japan is as follows:

- Legal due diligence including, but not limited to, title confirmation, encumbrance confirmation, boundary confirmation, encroachment issues, regulations compliance, planning and land use issues, litigation documents review, lease terms and key agreements such as trust agreements, agreements among co-owners and management rules for sectional ownership.
- Physical and environmental investigation (an engineering report/environmental report is produced).
- Valuation (an appraisal report is produced).

The title confirmation for real property is usually conducted by reviewing the real property registry. For the title confirmation of TBIs, the trust agreement and trustee's consents on the historical transfers from the initial beneficiary to the seller will be reviewed, as well as the trust register in the real property registry.

Sale and purchase contract

General components of a SPA

Preliminary agreements

It is very common in the market that as a first stage of negotiation, a purchaser delivers a letter of intent ('LOI') to a seller and the seller delivers a letter of acceptance ('LOA'), under which the purchaser is often granted an exclusivity period during which the seller agrees not to negotiate with other potential purchasers.

These letters typically outline:

- Indicative sales price.
- Key terms of the sale (including defect liability, representations and warranties).
- Anticipated closing date.
- Exclusivity regarding potential sale.
- Time and information to conduct due diligence on the subject real property.

These letters are generally subject to the result of the due diligence and conclusion of a definitive contract.

Sale and purchase contract

The typical provisions of a sale and purchase contract of real property in Japan are:

- Details of the parties;
- Property address;
- Purchase price and payment mechanism, including deposit provision (if applicable);
- Closing date;
- Prorations;
- Closing deliveries and activities;
- Conditions precedent;
- Representations and warranties;
- Pre-closing covenants (if applicable);
- Risk of loss (i.e. casualty);
- Termination;
- Default and remedies, indemnification and limitations on indemnity (caps, baskets, survival); and
- Miscellaneous provisions (e.g. notice, confidentiality).

Transfer of occupational leases and income

If the real property is sold as an asset transfer subject to a lease, the sale and purchase agreement will normally specify that the purchaser will assume all the rights, obligations and liabilities under the subsisting lease. Under the Japanese laws and court precedents in Japan, the contractual status as lessor of the lease agreements will be automatically transferred to the purchaser of the real property together with transfer of the ownership of the real property (which needs to be registered in the relevant real estate registry) without the consent of the lessee. Therefore, a novation agreement is not entered into to replace the purchaser as the new lessor who shall continue to receive the rental income after completion of the purchase of the property.

If the property transaction is effected by a share transfer, there is no change in the registered owner and the benefit of any occupational leases and income remains the same.

Common rights and interest

Property rights and interests include:

- Ownership;
- Leaseholds;
- Surface rights; and
- Easements.

Typical representations and warranties

There are no legal or legislative requirements for a seller to give a buyer any representations and warranties. However, a buyer will often require a seller to give it representations and warranties on the following matters

- Sole ownership of real estate
- No encumbrances
- No defects
- Boundary confirmation and no encroachment
- No litigation
- No contamination and no hazardous materials in or on the property
- Compliance with the applicable laws
- No termination of and no default under leases
- In the case of a TBI, sole ownership of the TBI, due establishment and valid existence of the TBI and validity and enforceability of the trust agreement

Whether or not the seller gives the representations and warranties will depend on the bargaining power of the parties and the commercial imperatives behind the deal. Representations and warranties can be limited by disclosure of specific matters and imposing time limits.

Remedies against misrepresentations

The seller is liable to the buyer when the seller makes an untrue statement of fact. The buyer may rely on the untrue statement when entering into the sale and purchase, and may suffer a loss as a result of such reliance.

Cost relating to sale and purchase of real estate

Tax

Stamp duty

Stamp duty is imposed on the preparation of certain documents. A real property transfer contract is subject to stamp duty ranging from JPY200,000 to JPY600,000 (currently, ranging from JPY200,000 to JPY480,000), depending on the purchase price stated in the contract.

Stamp duty is generally paid by attaching revenue stamps on the buyer and seller's respective originals of the contract and cancelling them by way of stamping a seal or signing a signature on them, which should be done on or before the execution of the contract.

Real estate acquisition tax

A person acquiring real property is subject to a real property acquisition tax at the rate of 4%. The base for this tax is calculated based on the amount of the property value assessed by the local tax authority. Up until March 31 2024, the tax rate has been 3% in cases of acquisition of land or a residential building. No acquisition tax is imposed on the transfer of a beneficiary interest in the real property and the entrustment of real property.

Registration tax

Registration tax on the acquisition of real property is calculated based on the assessed value of the real property upon registration of a change in ownership. Registration tax rates for a transfer of real estate are 1.5% for land (2.0% for transfers from April 1, 2026) and 2.0% for buildings. This tax is payable at the time of application.

Income tax (transfer of real estate by individuals)

Capital gain from the sale of real estate is subject to income tax at the rate of 39.63% (20.315%, if the holding period is more than 5 years).

Broker's fees

A real estate broker arranges for listing and viewing of the property. A broker also facilitates the negotiation between a seller and a buyer of the sale and purchase agreement's key terms. The broker may provide a standard provisional agreement (which may be reviewed and commented on by the parties' lawyers) to be signed by the parties to record such key terms. The broker also assists the buyer in matters like passing of keys, and arranging for inspection of the property if vacant possession must be delivered on completion. Broker's fees are usually charged at a usual rate of 1 to 2% of the purchase price but this is open to negotiation. Typically, the fees are payable by both the seller and the buyer.

Legal fees

Lawyers are appointed to negotiate, prepare and execute the documents necessary for the conveyance of property (e.g. sale and purchase agreement, and directors' and shareholders' resolutions).

The buyer's lawyer will conduct due diligence including reviewing registration of the property and related agreements, while the seller will answer the questions raised by the buyer, and arrange to remedy any title defects to the possible extent.

When it comes to share transfer, similarly, the legal, corporate and financial due diligence will be carried out by the buyer's lawyers while the seller will answer any question that arises in the process.

The buyer's lawyers will also help the buyer in the legal documentation for the financing of the purchase.

There is no fixed legal fees, and the parties will negotiate the applicable fees with their respective lawyers.

Investment vehicles

Types of investment vehicles

Legal forms of typical investment vehicles

There are two structures commonly used for private real estate transactions in Japan: the GK-TK Structure and the TMK Structure.

TMK structure

The *tokutei mokuteki kaisha* ('TMK') is a type of special purpose company under Japanese law that holds real estate assets for investment. Although a TMK has many similarities to other types of corporate entities, there are certain important features that are unique to TMKs.

Basic overview of the TMK structure and; certain financing issues

Overview of the TMK structure

A TMK is a special purpose company established under the Law Concerning Liquidation of Assets (Law No. 105 of 1998, the 'TMK Law'). A TMK is similar to a typical corporate entity in that it is required to adopt Articles of Incorporation ('AOI') which typically sets forth, among other things, its corporate purpose and matters relating to its shares, shareholder meetings, corporate governance and fiscal year.

What distinguishes the TMK from other corporate entity is its primary organisational document which is known as an Asset Liquidation Plan ('ALP'). Under the TMK Law, a TMK must be operated in accordance with an ALP which sets forth terms relating to the acquisition, management and disposition of certain specified assets. While the ALP creates some amount of administrative burden for the TMK (as discussed in greater detail below), this burden is much less an issue today than it was in the past as the TMK structure has become more familiar to investors. Moreover, any additional burden is countered by the certainty and predictability from a legal and tax perspective afforded to the TMK by virtue of the TMK Law and Japanese tax rules applicable to TMKs.

Pay-through tax treatment

Subject to satisfying the requirements set forth below, any dividends declared to be paid by a TMK will be tax-deductible, resulting in a pay-through tax treatment (i.e. no double taxation).

In order to be tax-qualified, a TMK must comply with certain requirements, including:

- the TMK must meet one of the following conditions:
 - 1) Total issue price of specified bonds issued by the TMK under a public offering is JPY100 million or more;
 - 2) All specified bonds issued by the TMK are held only by tax-qualifying qualified institutional investors (discussed below);
 - 3) Preferred shares issued by the TMK are subscribed to by fifty or more investors; or
 - 4) All preferred shares issued by the TMK are subscribed to only by tax-qualifying qualified institutional investors (discussed below)
- the ALP of the TMK must stipulate that more than 50% of each of the common shares and the preferred shares are offered in Japan (if the common shareholders waive their rights to receive dividends and residual assets in the ALP, all common shares may be offered and subscribed offshore);
- the fiscal year of the TMK must not exceed one year;
- the business of the TMK must be conducted in accordance with its ALP;
- the TMK does not engage in any businesses other than the business described in its ALP;
- the assets of the TMK must either be entrusted as trust assets or, if not, the management and disposition of the assets must be delegated to an eligible asset manager; and
- the TMK must make dividend distributions of more than 90% of its 'distributable amount' for each fiscal year.

Qualified institutional investors

A TMK may issue or obtain several kinds of equity/obligations/indebtedness, including:

- common (or specified) shares (*tokutei shusshi*);
- preferred shares (*yuusen shusshi*);
- specified bonds (*tokutei shasai*);
- specified commercial paper (*tokutei yakusoku tegata*); and
- specified loans (*tokutei kariire*) and other loans permitted under the TMK Law (*sonota kariire*).

The most common way a TMK becomes qualified to receive preferential tax treatment on dividends is to issue specified bonds to parties which are tax-qualifying 'qualified institutional investors' under Japanese law (collectively, 'QIIs'). Generally speaking, QIIs include Japanese banks, foreign banks with a Japan branch, securities houses, insurance companies and certain other entities, including certain TMK.

Management of the TMK: asset manager/property manager

A TMK must have at least one director and one statutory auditor, each of whom must be individuals.¹ Legally, the director and the statutory auditor need not be a resident of Japan. The primary duty of the director is to manage the TMK and the primary duty of the statutory auditor is to audit the TMK's financial statements.

¹ A TMK may also elect to have an 'accounting specialist' (*kaikai sanyo*) for the purpose of assisting directors in the preparation of the financial statements of the TMK. But it's not common to have *kaikai sanyo*.

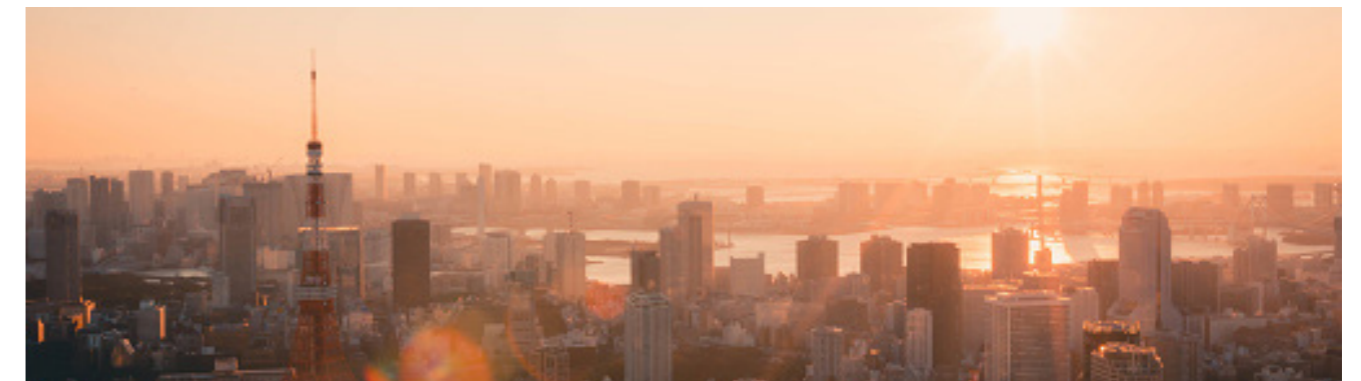
In addition, where either (i) the aggregate financing (specified bonds and specified loans) amount authorised under the ALP is JPY20 billion or more or (ii) the ALP authorises the issuance of preferred shares or specified commercial paper, an independent auditor will be required in addition to the statutory auditor. The independent auditor will need to be either a certified public accountant or an incorporated accounting firm.

The director(s) of the TMK shall be responsible for the overall administration and management of the TMK's affairs, subject to the ALP. Each director of the TMK owes a fiduciary duty to the TMK.

If the assets are not entrusted with a trust company, the day-to-day management of the properties cannot be performed directly by the TMK but must instead be sub-contracted to a third-party asset manager and/or property manager ('Qualified Manager') with a real estate broker's license. To be qualified, the third party must be experienced in asset management and property management and have sufficient resources and personnel. The TMK Law (Articles 200 and 203) provides, among other things, that the following parties cannot serve as asset manager:

- a party that is not a legal entity (i.e. a natural person may not serve as an asset manager);
- a party that does not have a real estate broker's license to the extent the specified assets are real estate; or
- a party who has violated certain laws or administrative orders, as more fully set forth in the TMK Law.

While not required under the TMK Law, appointing an asset manager for entrusted properties is common.



Typical equity structure

A typical TMK equity structure will take the form of the diagram attached hereto as Exhibit A².

Withholding tax implications

As a Japanese taxpayer, an onshore shareholder will be taxed at a blended national and local tax rate of approximately 35% on any income, including any distributions from the TMK. On the other hand, dividends to offshore investors will generally be subject to 20.42% withholding tax which may be reduced under applicable tax treaty depending on the ultimate investors in the TMK.

In the case where an offshore investor is a Singapore tax resident company, provided that certain conditions are satisfied, the withholding tax rates under the tax treaty may become available as follows:

- 5% for dividends made to the beneficial owner that has held more than 25% of the voting interests in the TMK throughout the six-month period prior to the dividend; and
- 15% in all other cases.

Advantages and disadvantages of the TMK structure

Advantages

- potentially substantial tax benefits;
- greater certainty of applicable rules and regulations in comparison to GK-TK structures (discussed below); and
- fewer 'control issues' than the GK-TK structure (i.e. no passive investor requirement).

Disadvantages

- preparation and filing of the ALP can be more costly and time-consuming than in the case of setting up a GK-TK structure;
- amendment of ALP can be burdensome;
- only assets specified in the ALP may be acquired;

² Please note that this structure is set-up for fee properties. A similar structure can be used for trust properties. In some cases, the Property Manager may contract with the Asset Manager rather than the TMK.

- need for an ALP prior to commencing business (including entering into any contracts);
- inability to borrow other than from a QII with respect to specified loan;
- limited collateral securing bonds (bondholder disadvantage only);
- portfolio financing across multiple TMKs is difficult (no cross-collateralisation);
- some investors may find the requirement that 90% of distributable profit be distributed problematic (though, in practice, most TMKs would distribute all profits);
- refinancing may require a transfer from the existing TMK to a new TMK to realise gains, which is time-consuming and costly; and
- difficult to pay 'all-cash' for assets and re-finance at a later date.

GK-TK structure

In addition to a TMK, the other structure commonly used by foreign investors to acquire real estate assets in Japan is the *godo kaisha-tokumei kumiai* ('GK-TK') structure.

Overview

A *tokumei kumiai* ('TK') is not a separate entity, but rather a contractual relationship between a TK Investor (*tokumei kumiai-in*) and a TK Operator (*eigyosha*) pursuant to a TK agreement through which the TK Investor invests in the business of the TK Operator in exchange for a share of the profits and losses. Although often called a 'silent partnership', it is simply a contractual relationship. For real estate investments, the TK Operator, which owns the real estate, is usually not a stock company (*kabushiki kaisha*) ('KK') but instead a Japanese limited liability company (*godo kaisha*) ('GK'). The TK Operator exercises complete control over the business of owning and operating the real estate. The TK Investor is not permitted to engage in management of the business and is required to be a passive investor. All profits distributed to the TK Investor can be deducted for Japanese tax purposes as expenses of the TK Operator. In essence, the TK Operator serves as a pass-through vehicle from the point of view of the TK Investor. The TK Investor's liability is limited to the extent of its TK investment unless otherwise set forth in the TK agreement.

The Exhibit B shows an outline of a typical GK-TK structure.

Exhibit A | Sample TMK structure

This chart assumes that the common shareholder waives the right to receive dividends and residual assets in the ALP.

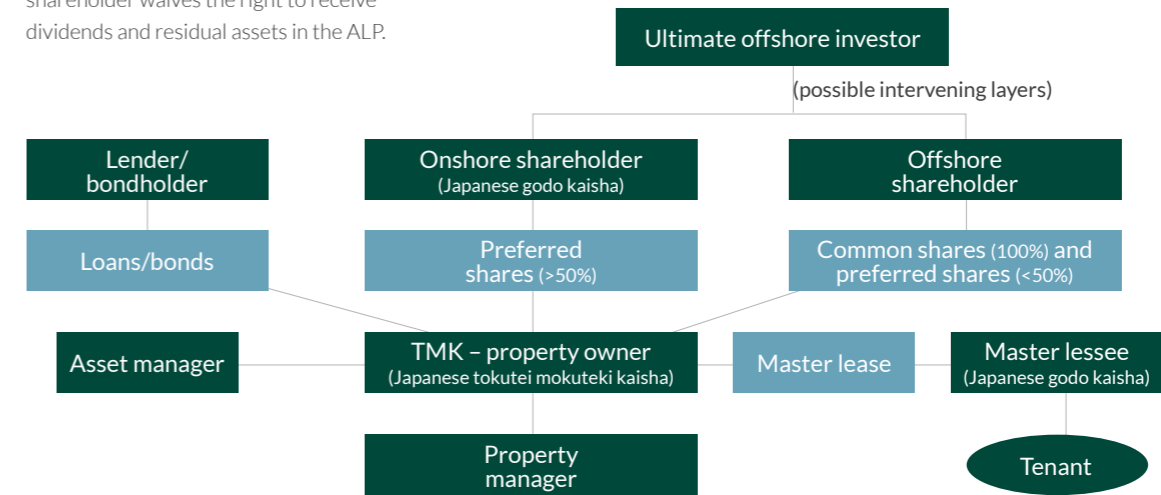
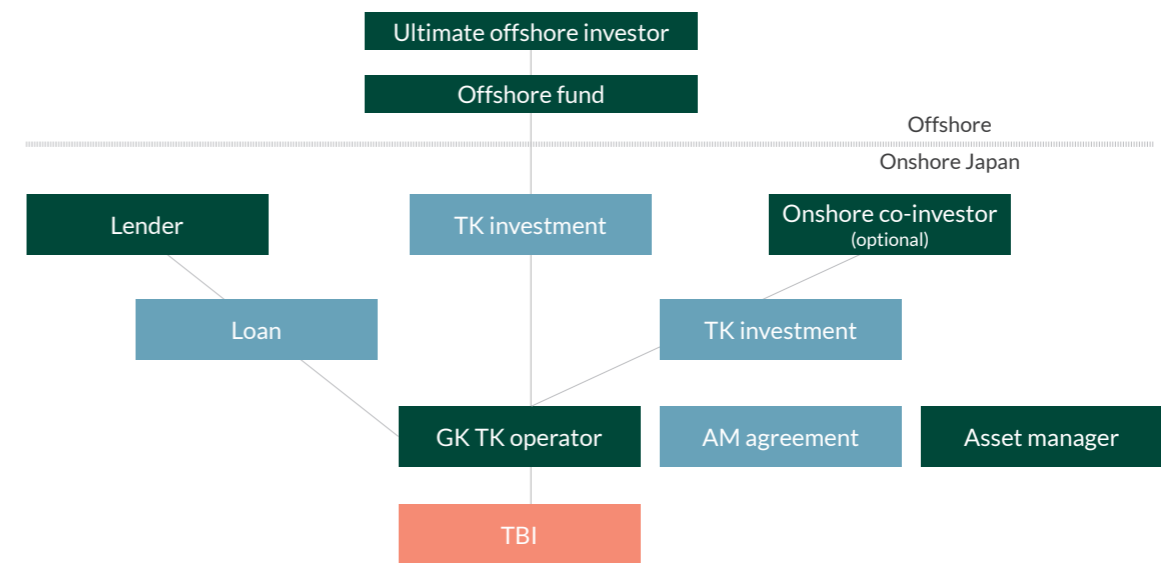


Exhibit B | Sample GK - TK structure



Reasons for using a GK as TK operator

There are two main types of entities under Japanese corporate law. One is the KK, which is a stock company, and the other is the GK, which is similar to a U.S. LLC. A GK is used as the TK Operator more often than a KK for the following reasons:

- The organisation of a GK is simpler and more flexible. For example, a GK requires no governing body, has no minimum paid in capital and allows flexibility in allocation of profits. Also, a GK can generally be formed at a lower cost and in less time than for a normal KK.
- The corporate reorganisation law does not apply to GKs but does apply to KKs. GKs, instead, are subject to other insolvency/reorganisation procedures. As a result, lenders often prefer a GK as the property owner because secured loan claims are less restricted under GK insolvency proceedings than under corporate reorganisation law.

TK Investor

A TK may have one or more TK Investors. Each TK Investor may be either an onshore or offshore investor. Distributions to the TK Investor will generally be subject to the withholding tax for dividends, which is 20.42%.

Double-TK structure

Some foreign investors choose to utilise a ‘double-TK’ structure, in which the offshore investor (the ‘Master TK Investor’) makes a TK investment into a Japanese entity (the ‘Master TK Operator/Sub-TK Investor’) which in turns acts as the TK investor with respect to one or more TK operators (each a ‘Sub-TK Operator’). The Sub-TK Operators would then make individual investments.

One advantage of the double TK structure is that it allows netting of profits and losses at the Master TK Operator/Sub-TK Investor level, prior to the application of any withholding taxes on TK distributions to the offshore Master TK Investor.

If a double-TK structure is utilised, care must be taken to ensure compliance with the FIEA and other licensing requirements by both the Master TK Operator/Sub-TK Investor and the Sub-TK Operator. In many cases, each of the Master TK Operator/Sub-TK Investor and the Sub-TK Operator will appoint an asset manager with the required licenses in order to comply with the FIEA.

TK Agreement

The TK Agreement establishes the respective rights and obligations of the TK Operator and TK Investors in a manner similar to a limited partnership agreement. Normal provisions include:

- **Contribution and profit terms.** The amount of the TK contribution from each TK Investor and the resultant percentage split of profits are provided in the TK Agreement. Tax advisors generally recommend that the TK Operator has at least a 1 to 3% economic interest in the TK business if all TK Investors are offshore entities.
- **A description of the ‘TK business’.** The TK business does not have to be the only business of the TK Operator, so a specific description of business purpose, assets and liabilities is essential to avoid confusion over which amounts should be allocated to the TK business. In many financing transactions, however, the TK Operator is a bankruptcy-remote SPC with no business other than the TK business.
- **Additional obligations.** Unless specifically stated, the TK Investor has no obligation to make any additional TK contributions after the initial contribution.
- **Control.** The TK Investor has no decision making authority or control. All decisions are made by the TK Operator.

‘Control’ issue and tax implications

The Japanese taxing authorities have challenged and overturned TK structures where there was found to be affiliated ownership, at the parent level or above, of both the TK Operator and TK Investor. In some transactions, a sponsor, such as an offshore investment bank, may wish to have a subsidiary act as the TK Operator and then utilise one of the Sponsor-managed investment funds as the TK Investor. If the courts find that the decision makers at some level in the ownership chain are the same, they may conclude that the TK Investor is participating in the management of the TK business and in violation of the law. The result is that the relationship between the TK Operator and TK Investor will be treated as a partnership for tax purposes, which may make the offshore TK Investor subject to Japanese corporate tax.

The prohibition on the exercise of control by the TK Investor may conflict with requirements for minimum levels of

control over investments imposed on certain offshore investors by their own regulatory agencies. In some cases, it may be possible to devise a structure that complies with such control requirements without jeopardising the Japanese tax status of the TK structure, but depending on the case, a TMK structure may be a more appropriate investment method.

TMK-GK-TK structure

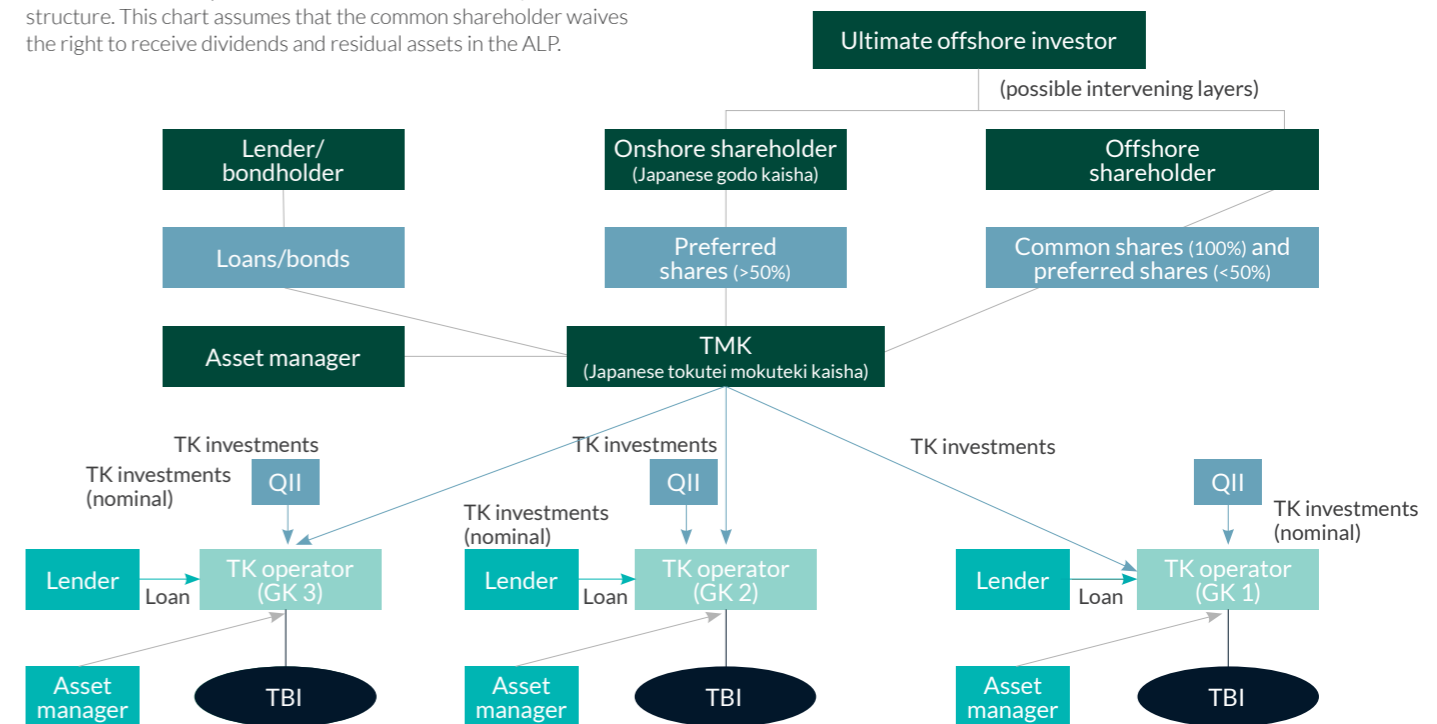
In addition to a TMK and a GK-TK structures, the other structure commonly used by foreign investors to acquire real estate assets in Japan is a GK-TK structure with a TMK as a TK Investor (‘TMK-GK-TK’) structure. A typical TMK-GK-TK structure will take the form of the diagram attached hereto as Exhibit C.

Before the 2011 amendment to the TMK Law, a TMK was allowed to acquire a TK Investment only when the TK Operator conducted the real estate syndication business qualified under the Real Estate Syndication Law. The amendment has alleviated the restriction to the effect that a TMK may acquire a TK Investment to the TK Operator with real estate asset (in fee or in trust) if the TK agreement (and the trust agreement) does not allow the change of the real estate asset.

Today, this TMK-TK-GK structure has become popular in the market. Under this structure, the same TMK may acquire multiple TK Investments to different TK Operators. A different lender (to a TK Operator) for a different class of assets can also be used. This structure may give more tax efficiency than a GK-TK structure, depending on the country of residence of the investor and substance.

Exhibit C | Sample TMK-GK-TK structure chart

Please note that the preferred shareholder must be a QII in this structure. This chart assumes that the common shareholder waives the right to receive dividends and residual assets in the ALP.



Regulation under real estate syndication law

As described above, the TK Operator under the TK-GK structure generally holds TBIs. This is to avoid the application of the Real Estate Syndication Law (*fudousan tokutei kyoudo jigyo ho*, the 'FTK Law'). If the TK Operator holds fee properties, its business to distribute the interests from real estate transactions³ to the TK investors will be considered to be the real estate syndication business (*fudousan tokutei kyoudo jigyo*) under the FTK Law, and the TK Operator is required to obtain a permit for the business from the Minister of Land, Infrastructure, Transport and Tourism and the Commissioner of the Financial Services Agency⁴ though it is practically impossible for a special purpose company like the TK Operator to meet the requirements for the permit.

³ Real estate transaction under the FTK Law means purchase or sale, exchange of, or leasing of real estate.

⁴ If the GK establishes its office for the real estate syndication business only within the boundaries of a prefecture, the permit is to be obtained from the governor of the prefecture.

The FTK Law, however, has been amended and now the law provides a way to deal with this problem which is a special venture (*tokurei-jigyo*) under the FTK Law. To conduct this, the TK Operator must outsource both the real estate transaction business and the solicitation of TK investment business to an asset manager specially licensed under the FTK Law. In addition, the TK investors for a special venture must consist only of special investors⁵ (*tokurei toudshika*) with professional knowledge and experience in relation to investment in real estate. As administrative procedure to be followed, the asset manager must file a notification to the authorities.

When the TK Operator acquires a fee property, the TK Operator enjoys same favorable registration tax treatment as a TMK and acquisition tax treatment with a deduction of one-half of the tax base.

⁵ This includes QIIs and professional investors (*tokutei toudshika*) under FIEA.

Setting up an investment vehicle

	TMK	GK
Costs	Total set-up cost is around JPY90,000 to JPY110,000 including the following: <ul style="list-style-type: none"> Notarization of Articles of Incorporation: Around JPY50,000 Stamp duty on AOI: zero Registration tax: JPY30,000 Corporate seal: JPY5,000 to JPY10,000 	Total set-up cost is around JPY110,000 to JPY130,000 including the following: <ul style="list-style-type: none"> No notarization of Articles of Incorporation is required Stamp duty on AOI: JPY40,000 (zero if electric AOI is selected.) Registration tax: JPY60,000 (0.7% of stated capital, but minimum is JPY60,000.) Corporate seal: JPY5,000 to JPY10,000
Typical time frame for setting up the vehicle	Around 2 weeks until complete set-up registration. Please note that TMK is required to prepare the initial ALP and file a Notice of Commencement of Business with the initial ALP to the authority to acquire the specified assets. The filing is made after the signing of the PSA and before the completion of acquisition.	Around 2 weeks until complete set-up registration.

Governance	<p>The incorporation of TMK requires at least:</p> <ul style="list-style-type: none"> One common shareholder (For financing purposes, the common shareholder is typically a bankruptcy-remote special purpose company); One director (such director is typically an independent director, who is dispatched from an accounting firm, to secure the nature of bankruptcy remoteness at TMK for financing purposes); and One auditor (ordinarily dispatched from the same accounting firm above). <p>The basic information of TMK including corporate name, address and stated capital will be registered and open to the public.</p> <p>TMK is required to hold an annual ordinary general meeting of shareholders within 3 months after the fiscal year end.</p>	<p>The incorporation of GK requires at least:</p> <ul style="list-style-type: none"> One member (For financing purposes, the member is typically a bankruptcy-remote special purpose company (i.e. not a natural person). If a member is a juristic person including such special purpose company, such member needs to appoint a manager to act on its behalf); and One manager if the member is a juristic person (ordinarily independent manager, who is dispatched from an accounting firm, to secure the nature of bankruptcy remoteness at GK for financing purposes). <p>The basic information of GK including corporate name, address and stated capital will be registered and open to the public.</p> <p>GK is not required to hold an annual ordinary general meeting of members.</p>
Compliance Costs	<p>The financial statements of TMK are required to be audited.</p> <p>TMK is required to submit an annual report to the authority with its financial statements within 3 months after the fiscal year end.</p>	<p>The financial statements of GK are not required to be audited.</p> <p>GK is not required to submit an annual report to the authority under the Companies Law. However, under the GK-TK structure stated above, GK will typically file a notification to enjoy certain exemptions of license requirements under the FIEA, and need to submit an annual report to the authority under the FIEA.</p>
Taxation	<p>Profits received by the shareholders of the TMK are taxed at corporate or personal income tax rates. For offshore shareholders, the 20.42% withholding tax (which might be reduced under the applicable tax treaty) is the final tax.</p>	<p>Profits received by the TK investors are taxed at corporate or personal income tax rates. For offshore TK investors, the 20.42% withholding tax is the final tax.</p> <p>Income for TK Operator's interest is subject to normal Japanese corporate tax.</p>

Offshore direct investment

Although most foreign investors choose to invest in Japanese real estate through an onshore structure such as a TMK or a GK-TK structure, there is generally no prohibition on direct foreign ownership in Japanese real estate. However, direct investment in multiple real estate may increase the risk that a foreign investor would be deemed to have a 'permanent establishment' in Japan and thus be subject to Japanese taxes (including local tax) on its income.

The risk of the foreign investor being deemed to have a permanent establishment in Japan is reduced if the investor acts as a passive investor (for example, by entrusting management of the property to an asset manager and master leasing the property) and invests in only one, or a very small number, of properties in Japan.

A foreign investor should consult with tax advisors prior to making any direct investment in Japanese real estate in order to manage the risk of being deemed to have a permanent establishment in Japan.

Real estate financing

Common ways of financing commercial real estate acquisitions

Real estate acquisitions are generally financed by debt and equity.

Typical security created

For loan-providers to TMK/GK:

Typical security interests include:

- Mortgage over the real property (in the case of the TBI acquisition, pledge over the TBI and conditional mortgage over the real property);
- Pledge over the common shares in TMK (in the case of GK, pledge over the member interest in GK);
- Pledge over the insurance claim (in the case of the TBI acquisition, conditional pledge over the insurance claim);
- Negative pledge agreement regarding the preferred shares in TMK (for TMK only); and
- Sponsor letter (if required by lenders).

For bondholders of specified bonds issued by TMK:

To the extent the TMK obtains acquisition financing, the bondholder's security interest will be limited to a 'statutory preferential lien' (*ippan tanpo*) over the assets of the TMK¹. The *ippan tanpo* constitutes a security interest similar to a floating charge, and no perfection procedures are necessary (*ippan tanpo* can be registered in the real estate registry if the specified asset is a real property in fee simple).

The bondholder would typically obtain negative pledge agreements with equity holders and other contractual protections designed to give the bondholder certain limited contractual protection in the case of a default under the financing documents.

¹ A bondholder could technically take a mortgage or pledge, but doing so would subject it to the Secured Bond Trust Law (Law No. 52 of 1905) which is considered to be cumbersome and time-consuming.

Restrictions for foreign lenders

There are no restrictions on granting security over real estate to foreign lenders.

Cost relating to the granting and enforcement of security

Stamp duty is payable on loan agreements, mortgages or security documents.

A registration tax for registration of mortgage over the real property will also be payable.

While the Japanese law does not impose any time limit for the perfection procedures (including registration) of security instruments, late perfection procedures may lead to loss of perfection priority.

Green finance

For environmentally focused borrowers, green finance is available to finance a green project and/or to incentivize the borrower's contribution to environmental sustainability goals. Green finance provides the following benefits to the borrower:

- Positive impact on the environment;
- Positive impact on reputation and credibility;
- Building stronger relationships with investors and other stakeholders;
- Gaining access to investors with a positive ESG focus; and
- Meeting regulatory, strategic and policy targets and commitments.

There are two types of green finance available, green loans and sustainability-linked loans.

Under international standards, green loans are any type of financings made to finance, refinance or guarantee new and/or existing green projects which are aligned with the Green Loan Principles (the 'GLP') jointly published by the

Loan Market Association ('LMA'), Asia Pacific Loan Market Association ('APLMA') and the Loan Syndications Trading Association ('LSTA').

Unlike green loans, sustainability-linked loans do not require the borrower to use loan proceeds to finance a green project. Rather, under international standards, sustainability-linked loans focus on incentivizing improvements to the borrower's sustainability performance by aligning the loan terms (usually in the form of a decrease in the interest rate) with pre-defined sustainability performance targets. The documentation

for a sustainability-linked loan should align with the Sustainability-Linked Loan Principles (the 'SLLP') jointly published by the LMA, APLMA and the LSTA.

In Japan, the Ministry of the Environment ('MOE') has created the guidelines in accordance with the GLP and the SLLP. Since the publication of the MOE guidelines, numerous green loans and sustainability-linked loans have been closed. According to the MOE, the green loans and sustainability-linked loans issued in Japan amounted to JPY 76,583,000,000 and JPY 657,332,000,000, respectively, in 2022.

Commercial leases

Lease agreements

Types of leasing arrangements

Two types of leases

A lease of real property in Japan is governed by a number of Japanese laws including, the Land Lease and Building Lease Law of Japan (Law No. 90, of 1991, the 'Lease Law'). There are two types of building leases normally used in Japan: (i) the so-called standard or typical building lease (*futsuu chintai shaku*) and (ii) the fixed term building lease (*teiki tatemono chintai shaku*). The principal difference between these two types of leases relates to the renewal provisions.

Standard lease

A standard lease has an initial term. However, it is automatically renewed for an unspecified term under the existing terms and conditions unless (i) the lessee does not desire to continue the lease agreement or (ii) the lessor has a 'highly-reasonable basis' to terminate the lease under the Lease Law and gives at least six months' notice of termination. Either the lessor or the lessee may request an increase or decrease of the rent due to changes in market conditions, irrespective of the terms of the lease. However, the lessor cannot demand an increase of the rent if the lease prohibits such an increase.

Fixed-term lease

An amendment to the Lease Law in 2000 somewhat mitigated the effects of the Lease Law by permitting the lessee of a fixed-term lease to waive the right to renew its lease. Automatic renewal will not apply if the lease, in writing, provides for a definite term with no right of renewal, and the lessee has received a written explanation of the non-renewal provisions before entering into the lease. For fixed-term leases, the parties may also waive their statutory right to rent adjustment by special agreement, provided if the terms of any adjustment or non-adjustment can be objectively measured (to be clear, agreement not to make any adjustment during the lease term is valid under a fixed-term lease).

Master lease / sublease

If the property is entrusted with a trust bank, the trust bank does not need to enter into lease agreements with the end tenants or assume the role of a landlord. Similarly, the beneficiary of the trust ordinarily wants direct control of the property. In most instances, the beneficiary will have the trust bank enter into a master lease agreement with a master lessee, which is often a special purpose company and affiliate of the beneficiary (in some cases, the beneficiary itself). The master lessee then enters into the sublease agreements with the end tenants. In recent market trends,

there are cases (particularly if the building is an office building) where a trust bank directly enters into lease agreements with the end tenants without using a master lease arrangement.

At the time the master lease agreement is entered into, any existing lease agreements with end tenants may be transferred only upon consent by such end tenants. In the event the end tenants consent to only the master lessee being responsible for returning security deposits, the beneficiary and the trustee will be exempt from such responsibility and such tenants will only have rights against the special purpose master lessee, which usually has no assets. Nonetheless, it is common practice for tenants to sign such consent letters.

Common terms in commercial leases

There is no prescribed form of commercial leases; parties are free to negotiate and agree on the terms of commercial leases as they wish.

The typical provisions of commercial lease contract in Japan are:

- Details of the parties;
- Address of the demised premises;
- Rent;
- Lease term;
- Extension/Renewal Options (for standard lease only);
- Security deposits;
- Use;
- Repair/Maintenance;
- Restoration Upon Termination / Expiration; and
- Miscellaneous provisions (i.e. confidentiality).

Managing lease agreements

Early termination by landlord

Common contractual termination events that entitle the lessor to terminate a lease in Japan include failure to pay rent, breach of contract and insolvency of the tenant. Japanese courts, however, have restricted a lessor's right to terminate the lease in cases where the tenant's breach is serious enough to destroy the relationship of trust between

the lessor and the tenant. A one-time failure to pay rent is unlikely to justify termination because the non-payment would not suffice to destroy a relationship of mutual trust between the parties.

Termination by tenant

Tenants can cancel a lease by giving advance notice. However, in the case of a fixed-term building lease, it is common for the lease agreement to prohibit a tenant from canceling the lease before the expiry of the lease term.

Security for protecting against failure by lessee to meet obligations

Security deposits (*Shiki-Kin*)

Upon entering into a lease agreement, the lessee is often required to deliver a security deposit to the lessor as security for over-due rent and compensation for damages caused by the tenant. The residual amount will be refunded to the lessee after surrender of the leased premises. For commercial properties, the security deposit is equivalent to six to twelve months' worth of rent, which is a significant issue. The landlord is not obliged by law to segregate security deposit amounts in a separate account or otherwise hold the security deposit, but may legally spend the money for any purpose. In many financing transactions, the lenders require for the security deposit amount be reserved.

Key Money (*Kenri-Kin*)

The lessor may also require the lessee to pay 'key money' as consideration for certain benefits. In western Japan and some other regions, the practice of requiring both security deposits and key money is not unusual. In principle, key money is not refundable even after the leased property is surrendered, but rather is looked upon as consideration to obtain the lease.

Transfer of lease

The owner can transfer real property to a third party without the tenant's consent unless otherwise agreed in the lease. The tenant may not, without the owner's consent, transfer or dispose its lease rights with respect to all or any part of the property to any third party (including a sub-lease) unless otherwise agreed in the lease.

Managing a leased real estate

Restrictions on use

Tenants must abide by the permitted use set out in the lease agreement as well as under the laws and regulations relating to the permitted use of the premises, such as the Building Standards Act (Law no. 201 of 1950).

Alterations

Leases typically limit the extent of or prohibit alterations or improvements to the demised premises. Structural repairs which involve alteration of the building's form and framework are usually not allowed. Typically, alterations requiring the lessor's consent are usually set forth in the lease agreements.

Under the Civil Code of Japan, tenants have a right to repair the demised premises without the lessor's consent in cases where:

- the lessor does not make the necessary repairs within a reasonable period of time even after (i) the tenants notify the lessor that repairs are necessary or (ii) the lessor recognises that repairs are necessary; or
- there is an urgent situation. The lease agreements can provide that tenants do not have such right.

Rent

Rent variation

Leases will either set out a fixed rent payable, or a mechanism to calculate the adjustable rent payable, for the entire duration of the lease term.

Taxes for rental

Consumption tax is imposed (currently at the rate of 10%) on rent under the lease agreements (other than the residential property lease agreements).

Costs for lessees/tenants other than rent

Cost payable by leases at start of lease

Typically, the lessee needs to pay the fitting-out cost, the security deposit (the key money if any (please see p17 managing lease agreements)), advance rent and common service fee (*kyoekih*).

Utilities and telecommunications

Such services are usually subscribed and paid for by tenants directly with third-party suppliers.

Insurance

Tenants are responsible for insuring the demised premises and the landlord will typically require the tenants to take up an insurance policy (i.e. fire insurance).

Tax

Tax on acquisitions and disposals

Acquisitions

a) Registration tax

Acquisition of fee interest in real property

Registration tax rates for a transfer of real estate in Japan are 1.5% for land (2.0% for transfers from April 1, 2026) and 2.0 for buildings.

TMKs which purchase real property pursuant to their Asset Liquidation Plan are subject to a 1.3% registration tax rate (2.0% for transactions from April 1, 2025).

Acquisition of beneficiary interest in real property

The acquisition of beneficiary interest in property is subject to the nominal registration tax duty for JPY1,000 for each change in the real property registry. The entrustment of real estate is subject to registration tax of 0.4% for entrustments (0.3% for entrustments of land until 31 March 2026).

b) Real property acquisition tax

Acquisition of fee interest in real property

The acquisition tax is assessed on a tax base figure, which is based on the assessed value of the property. The rates of real property acquisition tax are as follows:

Residential buildings and land – 3.0% through March 31, 2024 (4.0% thereafter)

Non-residential buildings – 4.0%

For land acquired until March 31, 2024, the tax base figure is reduced by one-half of the assessed value.

A TMK which purchases property under certain qualifying conditions, is entitled to reduce the tax base further to two-fifth up through March 31, 2025.

Acquisition of beneficiary interest in real property

No acquisition tax is imposed on the transfer of a beneficiary

interest in the real property and the entrustment of real property.

Disposals

a) Taxation of TMK structure

Taxation of TMK

The TMK is a Japanese corporation subject to the normal (approximately 35%) rates of Japanese corporate tax. However, as discussed above, by satisfying certain conditions under the TMK Tax Law, the TMK is able to deduct in determining its taxable income dividends declared to its equity holders. Any income of the TMK after deduction of the dividends will be subject to Japanese corporate income tax of approximately 35%.

Taxation on shareholder of TMK

Japanese corporate shareholders

Dividends paid by a TMK to Japanese corporate shareholders are subject to a withholding tax at the rate of 20.42% (20% from 1 January 2038).

Dividends paid by a TMK are aggregated with other sources of income and are subject to full taxation at normal corporate income tax rates. Any withholding tax of the dividend corresponding to the holding period of the shares should be creditable against the shareholders' corporate tax liabilities through filing the Japanese corporate tax return. Dividend received deduction is not available for dividends paid by a TMK.

Capital gains incurred on the disposal of shares of a TMK are aggregated with other sources of income and are subject to full taxation at the normal corporate income tax rate.

Foreign shareholders

Dividends paid by a TMK to foreign shareholders are subject to a withholding tax at the rate of 20.42% (20% from 1 January 2038). The rate may be reduced under applicable tax treaties.

The sale of an equity interest in a TMK (holding real estate in Japan) by a foreign shareholder for a gain will generally result in Japan capital gains taxation. Gains realised by a foreign investor on transfers of equity units in a TMK where 50% or more of the gross asset value of the TMK represents real estate in Japan are generally subject to Japan capital gains taxation, if the foreign investor (and persons treated as specially related shareholders to the foreign investor) owns, on the day immediately preceding the start of the fiscal year when the sale is made, more than 2% of the TMK shares.

b) Taxation of GK-TK structure

Taxation of TK operator

The operator is subject to Japanese corporate tax on its worldwide net income, as determined under Japanese tax law. The operator's taxable income is determined in the same manner as that of other Japanese corporations, except that the operator is entitled to receive the deduction of the profit TK distribution allocable to the TK investor from the business pursuant to the TK Agreement.

Taxation of TK investor

Taxation of Japan corporate TK investor

A domestic corporate TK investor is required to recognise its share of profit or loss associated with that business under the accrual basis of accounting. Such profits are subject to corporate tax rates, and such losses can be used by the corporation to offset its other income.

Taxation of foreign TK investor

A foreign TK investor is subject to a Japan withholding tax at the rate of 20.42% (20% from 1 January 2038) for any distributions payment of profits from the business by the operator. The withholding rate may not generally be reduced to a lower rate under existing tax treaties of Japan.

Others

Fixed assets tax

The holding of real properties and/or beneficiary interests in real properties as of 1st January is subject to fixed asset tax at the rate of 1.4%. City planning tax of 0.3% is also imposed depending on the area such as Tokyo.

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How we can help

Our real estate team represents a one-stop shop for all types of investors' real estate needs, covering the full life cycle of a property transaction. We have a great deal of experience on the sale and purchase of investment properties and our particular strength is structuring cross-border property transactions effectively.

Our clientele spans across the industry from developers, landowners, investors, lenders and borrowers, banks and fund managers. We aim to establish long-term relationships with our clients at all levels.

Our real estate services include:

- Joint ventures and mergers and acquisitions
- Sale and acquisitions
- Tenancy agreements
- Leases and licenses for residential, commercial and industrial properties
- Development and real estate financing / re-financing

We collaborate across our global offices to provide integrated local and international legal solutions for our clients, wherever their property holdings are located.



Legal services

- Banking and finance
- Corporate and commercial
- Employment
- Family law
- Insolvency
- Insurance and professional indemnity
- Intellectual property
- Litigation and arbitration
- Mergers and acquisitions
- Project finance
- Restructuring
- Tax
- White collar crime/criminal law

Sectors and clients

- Brands and fashion
- Charities and education
- Financial services
- Hotels and hospitality
- Investment funds
- Real estate
- Sport
- Technology

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