

income derived from the real estate, while taxes are levied again when profits are distributed to the investors. In order to avoid double taxation, dividends paid to investors in these structures may be deducted as corporate expenses provided the entity satisfies certain criteria set by the tax authorities. However, corporate tax at its normal rate is levied on any retained earnings not distributed as dividends.

② **Reduction of Real-Estate Distribution Taxes**

Measures have also been taken to reduce the taxes imposed when a vehicle purchases real estate or other assets such as real-estate acquisition taxes and registration license taxes. These measures are often special exceptions that are only available in specific structures. However, revisions to the tax law in 2003 led to a general reduction in the rates of these taxes applicable to acquisition of real estate (see Figure 6-1).

## 2. Tax on the Earnings of the Vehicle

This section provides more detail on the types of vehicles and structures that can be used to avoid or minimize the corporate taxes imposed on a regular Japanese corporation (i.e., Kabushiki Kaisha or Yugen Kaisha).

### (1) Investment Trusts and Investment Corporations Law (Investment Corporations and Special Investment Trusts)

① **Investment Corporations**

Investment corporations are vehicles that hold assets for investment, such as securities and real estate, and distribute the earnings from such assets to investors. Investment corporations are in general taxed as regular corporations. However, in order to promote investment in such assets, the tax law permits an investment corporation that satisfies certain conditions to deduct, as an expense, dividends paid to investors in determining its taxable income.

Overview of Requirements for Deduction of Dividends Paid to Investors for Investment Corporations  
Special Taxation Measures Law Article 67 Item 15, etc.

■ **In order to qualify for the deduction of dividends, an Investment Corporation must satisfy all of the following requirements:**

- A. It is registered with the prime minister
- B. One of the following is satisfied:
  - (1) Shares were publicly placed at the time of establishment and the total issue value was greater than 100 million yen

- (2) At the end of the business year the shares are either held by at least 50 individuals or held solely by qualified institutional investors
- C. The bylaws state that more than 50% of the issued shares must be held domestically
- D. The business year does not exceed twelve months

■ **In addition, all of the following requirements must be satisfied in the relevant business year:**

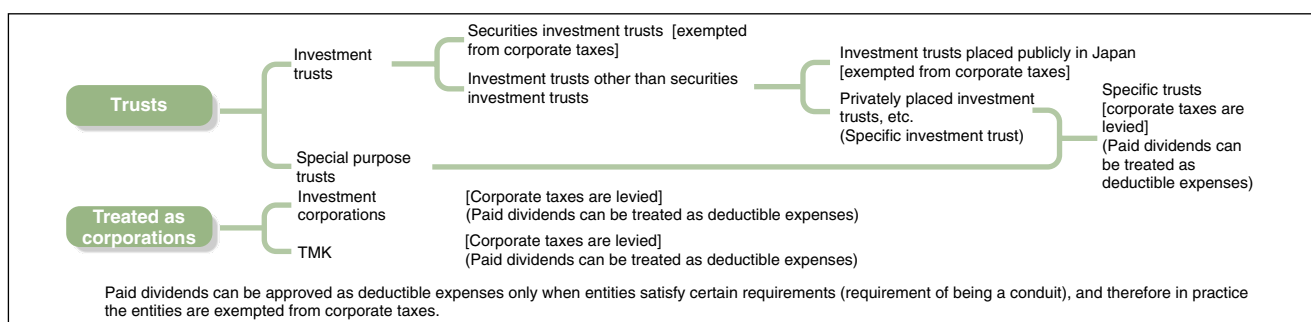
- A. There is no infringement of the regulations on the activities of the investment corporation
- B. The asset management work is entrusted to an investment trust manager
- C. The asset custodian work is entrusted to an asset custodian
- D. The investment corporation is not classified as a family corporation at the end of the relevant year
- E. More than 90% of the net income is distributed to investors as a dividend. When the profit is greater than that derived from ordinary activities the minimum distribution is calculated as follows:

$$\text{Amount of money distributed} > \text{possible dividend amount} \times 90\%$$

$$\text{Possible dividend amount} = \text{Income for the given business year} + \text{excess profit}$$

- F. (1) The investment corporation does not own or control 50% or more of another corporation's outstanding equity
- (2) Any loans are from qualified institutional investors

Figure 6-2 Taxation under the Asset Monetization Law and Investment Trust Law



## ② Special Investment Trusts

Typical investment trusts are not subject to corporate taxes. However, changes to the tax laws in 1999 introduced a new class of "special" investment trust that, like the TMS, is in principle subject to corporate tax on its income. However, as with investment corporations, they may deduct, as an expense, dividends paid to investors provided certain criteria are satisfied. This structure is identical to the structure created for investment corporations.

However, securities investment trusts and investment trusts distributed by domestic public placement of the beneficial interests are taxed in the traditional manner of trusts and are not assessed corporate taxes.

See Figure 6-4 for Overview of Requirements for Deduction of Dividends Paid to Investors for Special Investment Trusts under Special Taxation Measures Law, Article 68 Item 3 Subparagraph 4, etc.

## (2) Tokutei Mokuteki Kaisha and Special Purpose Trusts (SPC Law)

### ① Tokutei Mokuteki Kaisha (TMKs)

Unlike companies that are governed by the Commercial Code, TMKs are special purpose companies introduced for the purpose of promoting real-estate securitizations and increasing the liquidity of assets. However, double taxation would result if TMKs were subject to taxation in the same manner as regular companies. Accordingly, the tax law permits a TMK that satisfies certain conditions to deduct, as an expense, dividends paid to investors in determining its taxable income.

Overview of Requirements for Deduction of Dividends Paid to Investors (Special Taxation Measures Law, Article 67 Item 14, etc.)

■ In order to qualify for the deduction of dividends, a TMK must satisfy all of the following requirements:

- A. Registration as a TMK
- B. One of the following:
  - (1) Public placement of specific corporate bonds with a total value of issued and outstanding bonds greater than 100 million yen
  - (2) Issuance of specific corporate bonds underwritten by a qualified institutional investor
  - (3) Issuance of preferred equity securities purchased by at least 50 individuals
  - (4) Issuance of preferred equity securities purchased solely by qualified institutional investors
- C. The Asset Monetization Plan requires that more than 50% of the specific corporate bonds or preferred equity securities be purchased by Japanese investors
- D. That the business year is no more than twelve months

■ In addition, all the following requirements must be satisfied in the relevant business year:

- A. The operations must be conducted in accordance with the Asset Monetization Plan
- B. The TMK is not conducting another business
- D. The TMK is not classified as a family corporation at the end of the relevant year (this requirement is waived when the TMK has issued specific corporate bonds totaling more than 100 million yen through a public placement or when the specific corporate bonds have been underwritten by a qualified institutional investor)
- E. More than 90% of the net income is distributed to investors as a dividend
- F. Only qualified assets are possessed by the TMK
- G. Specific purpose borrowings (specific corporate bonds, etc.) are only extended by accredited institutional investors that are not equity investors in the TMK

### ② Special Purpose Trusts (TMS)

Revisions to the tax laws in 1999 introduced a unique system of taxation for special purpose trusts under the new SPC Law and investment trusts under the Investment Trusts and Investment Corporations Law. These are referred to as "special" trusts in the Corporate Tax Law and they are in principle subject to corporate taxes. This is due to the similarity of their functions to investment corporations and TMKs, despite being structured as trusts without juridical personality. However, as with TMKs and investment corporations, they may deduct as an expense dividends paid to investors provided certain criteria are satisfied. Consequently, they achieve the function of being a tax-free conduit for investment.

See Figure 6-5 for Overview of Requirements for Deduction of Dividends Paid to Investors under Special Taxation Measures Law, Article 68 Item 3 Subparagraph 3, etc.

## (3) Real-Estate Special Business Law (Nini Kumiai and TK)

Japan's tax law has a "Principle of Taxation of the Beneficial Earner of Income." Based on this principle, if a Nini Kumiai under the Civil Code or a TK under the Commercial Code has joint business qualities, the profit or loss is taxed in the hands of the investor, regardless of whether or not an operator is conducting the actual business. Based on this, TK and Nini Kumiai are not subject to corporate tax. Instead all of the profits or losses are passed through to each investor and the investor is taxed on its share of profit or loss based on its own facts and circumstances.