Chapter 18

JAPAN

Norio Maeda, Tomohiro Kandori, Naoko Katakami and Kozo Kuromatsu[1]

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 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, on the other hand, 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

1 Norio Maeda is a partner, Tomohiro Kandori is a counsel and Naoko Katakami and Kozo Kuromatsu are associates at Nishimura & Asahi.

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 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 Estate Registration Law.

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 right that can be registered in the real estate registry, the law of the jurisdiction in which the real estate is located shall be the governing law; however, under the Act, any law chosen by the parties can govern a contract. 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, because of the rule that Japanese law governs property rights in Japan.

II OVERVIEW OF REAL ESTATE ACTIVITY

Since the early 1990s, various innovative real estate investment structures have been developed in Japan.

The GK–TK structure and the specified-purpose company (TMK) structure (discussed in detail in Section IV, *infra*) are frequently used for real estate investment. Japanese real estate investment trusts (J-REITs) (discussed in Sections IV and VII, *infra*) 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 accumulated capital of the listed J-REITs has made them major players in the Japanese real estate investment market. The flow of capital through listed J-REITs into the real estate investment market has contributed to the growth of the real estate industry.

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

After recent global economic turmoil affected – and slowed down – activities in the Japanese real estate investment market (including activities by lenders), it also prompted further regulatory developments. The government has brought in various measures to relax regulations and enhance market activities (recent key developments are highlighted in Section VII, *infra*), while the Japanese economy is showing signs of recovery.

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. In theory, under the provisions of the Alien Land Law, a cabinet order may limit the rights of foreign investors related to land in Japan on the grounds of reciprocity or national security. At the time of writing, however, there has been no such limitation, since no such cabinet order has been issued.

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 an agricultural production corporation. It would not be easy for foreign investors to be granted such authorisation.

After a foreign investor's acquisition of shares or equity of a corporation, or acquisition of real estate or a right related to real estate, a post-transaction report to the government authority may be required pursuant to the Foreign Exchange and Foreign Trade Law (the FEFTL). 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 FEFTL.

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 of the types of corporate entities 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 Real Estate Specified Joint Enterprise Act (the REJEA). Therefore, the GK–TK structure has usually been structured to invest in trust beneficial interests in real estate, not in real estate itself. A newly introduced exemption from the licensing requirement under the REJEA (discussed in Section VII, *infra*) will allow the GK-TK structure to invest into real estate itself, if certain requirements are satisfied.

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 Law (the FIEL), unless an exception applies. One of the exceptions available under the FIEL is the QII exemption, which essentially requires that:

a there is at least one qualified institutional investor (QII) under the FIEL among the TK investors;

b the number of non-QII TK investors (if any) is 49 or less;

c none of the TK investors is a disqualified investor as detailed in the FIEL; and

d the GK, as the operator of the TK arrangement, files with the government authority a simple notification regarding the QII exemption.

ii TMK structure

A TMK incorporated under the Asset Liquidation Law (the ALL) 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 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 FIEL and certain other QIIs meeting certain 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 ALL. These regulations include a requirement to file an asset liquidation plan with the government authority. The asset liquidation plan of a TMK outlines how its assets are to be liquidated or securitised. A TMK structure requires close attention being paid to the regulations regarding the asset liquidation plan.

iii J-REITs

A J-REIT is a type of investment fund formed under the Law concerning Investment Trusts and Investment Companies (the ITL). 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 ITL. Under the ITL, a J-REIT must retain an asset management company (a registered financial instruments operator under the FIEL) 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 of its profits) 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. Since 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 Law

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

Under the City Planning Law, 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 Law.

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

Building Standards Law

The Building Standards Law 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 Law, 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 Law, 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 3,000 square metres), the developer must notify the appropriate local government authority at least 30 days before any change is made to the land. After receiving such notice, if the authority determines that the land may be contaminated in the manner designated by the Soil Contamination Countermeasures Law, it may order the landowner to investigate. The local government authority also may 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 Law. 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 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 ownership title to real estate requires a stamp tax of progressive amounts ranging from ¥200 to ¥600,000 based on the purchase price provided in the agreement.

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 real estate is generally 2 per cent. A rate of 1.5 per cent will apply to registration regarding a transfer of land occurring between 1 April 2013 and 31 March 2015. The transfer of ownership title to certain qualified residential buildings that are acquired by an individual to reside in will be 0.3 per cent or 0.1 per cent.

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).

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 2015 will be reduced to 1.3 per cent; and

b three-fifths of the price for the acquisition will be excluded when calculating the related real estate acquisition taxes until 31 March 2015.

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 real estate itself. While registration and licence taxes and real estate acquisition taxes will be imposed on a 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 or 0.4 per cent (for land) or 0.4 per cent (for buildings); and

b on 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 transfer of the trust beneficial interest.

When the holder of a trust beneficial interest in real estate (other than the initial holder), however, 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 registering the transfer of real estate. Upon such 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 a 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 newly introduced under the amendment to the REJEA

If a GK-TK structure newly introduced under the amendment to the REJEA (discussed in Section VII, *infra*) acquires an old building that needs to be rebuilt or renovated (defined as a building older than 10 years or a building seriously damaged by a disaster); land planned to be used for a newly built building replacing an old building or built on unimproved land; or land used for a building planned to be renovated, by meeting certain other requirements, it may qualify for the following tax benefits:

a the registration and licence taxes to register the acquisition until 31 March 2015 will be reduced to 1.3 per cent; and

b half of the price of the acquisition will be excluded when calculating the related real estate acquisition taxes until 31 March 2015.

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 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 ALL. The statutory general security interest will also secure (by operation of law under the ALL) all the TMK bonds subsequently issued. In many cases, therefore, 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 Law, and additional costs to establish such a trust arrangement are not considered economically justified in many cases.

VI LEASES OF BUSINESS PREMISES

The Land Lease and Building Lease Law (the LLBLL) and the Civil Code regulate real estate leases. The general rule is that the LLBLL 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 LLBLL takes precedence over the Civil Code when their provisions overlap.

i Types of lease

The LLBLL 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 LLBLL, 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. Such 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 such 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 LLBLL; 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 in order 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 LLBLL, 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 LLBLL; however, the parties are not prohibited from entering into a new lease agreement at the expiration 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 LLBLL, 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 the 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 such 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 Amendment to the REJEA

Background

Under the REJEA, a TK operator that was formed to invest in real estate directly, not a trust beneficial interest in real estate, is subject to a licensing requirement. To obtain the licence, a TK operator must satisfy certain requirements, including standards of financial capability and human resources. Such requirements have made it practically impossible for a TK operator vehicle to obtain that licence. To work around the licensing requirement, investment platforms involving TK arrangements have mostly invested into trust beneficial interests in real estate.

However, converting real estate into a trust beneficial interest involves relatively strict scrutiny by the trustee of the subject real estate. Just as there are investors who would like to have their TMKs invest into real estate directly, rather than a trust beneficial interest in real estate, there have also been investors who would like to have their GK-TK structures invest into real estate directly, if possible.

To respond to this demand from investors, the REJEA was amended in June 2013 (such amendment came into effect on 20 December 2013) to enable a TK arrangement to invest into real estate without requiring the TK operator vehicle itself to obtain a licence.

New investment structure

The amendment to the REJEA allows a GK-TK structure to invest into real estate directly, without the GK as the TK operator vehicle needing to obtain a licence, if certain requirements are met.

The first requirement is for the GK as the TK operator to delegate (1) the management of transactions related to the subject real estate and (2) the solicitation of investments into the TK operator by the TK investor (or investors) to a real estate specified joint enterprise business operator (REJEB operator) that is licensed under the REJEA.

The requirements for the licence of a REJEB operator are the same as those under the REJEB prior to the amendment. Under this new requirement, the amended REJEA allows a licensed REJEB operator to be involved in a TK arrangement investing into real estate, not as a TK operator itself, but as a manager for the TK operator vehicle, as long as the delegation of the management covers (1) and (2) as described above. The second requirement is that only investors falling into one of the categories of 'special investors', which include a licensed REJEB operator and a QII (as defined under the FIEL), make TK investments in the TK operator.

It is hoped that the new GK-TK structure will enhance investment into real estate without the need to involve a trustee at the underlying real estate level.

To enhance the use of the new GK-TK structure, a GK-TK structure satisfying the above-mentioned requirements will benefit from reduced registration and licence tax, and real estate acquisition tax, when such GK-TK structure acquires a building that is over a certain age, or acquires a building for the purpose of reconstruction. For more details on the reduction of these taxes, see Section V, *supra*.

ii Amendment to the ITL and the FIEL in connection with J-REITs

Background

Because more than a decade has passed since the introduction of J-REITs under the ITL, various issues regarding the legal framework of J-REITs have been discussed. The issues include:

- *a* improving the diversity available to J-REITs regarding their capital strategy;
- *b* the application of insider trading rules to achieve greater transparency in the management of J-REITs and in the trading of J-REIT investment units with the goal of securing more investor trust;
- *c* achieving stronger investor protection against potential conflicts of interest between a J-REIT and the controlling shareholder of the J-REIT's asset management company, where practically the shareholder can influence the management of the J-REIT;
- *d* stronger investor protection in the event that the issue price of a J-REIT's investment units does not reflect the fair market value; and
- *e* expansion of a J-REIT's scope of investment to include foreign real estate.

To address the issues that have been discussed, the ITL and the FIEL were amended in June 2013 (to become effective in June 2014).

Diversification of the methods available to J-REITs regarding their capital strategy

As described in Section IV, *supra*, to enjoy the tax benefit available to a J-REIT, the J-REIT must distribute more than 90 per cent of its profit as dividends to the holders of its investment units for each of its fiscal periods. This requirement makes it difficult for J-REITs to maintain internal reserves. In addition, the term of debt financing available to J-REITs is normally shorter than debt financing available to normal operating companies. As a result, there is an inherent weakness in the financial capability of J-REITs. Diversification of the methods available to J-REITs regarding capital strategy has been discussed to address such weakness.

The methods newly made available to J-REITs regarding their capital strategy under the amendment to the ITL include a rights issue and a right to purchase their own investment units. In the case of normal operating companies a rights issue has, together with a public offering of shares and third-party allocation of newly issued shares, been one method to increase the share capital. The amendment to the ITL will make the rights issue available to J-REITs. In the rights issue, the current holders of a J-REIT's investment units are granted the rights to purchase the newly issued investment units in the J-REIT. The holders of its investment units may instead sell the rights to third parties.

The right to purchase its own investment units will enable a J-REIT to reduce the effect of the movement of the price of its investment units in the financial market, especially if the investment units are traded in a stock exchange.

Insider trading rules

After the amendment to the ITL and the FIEL, transactions involving investment units issued by listed J-REITs will be subject to the insider trading rules under the FIEL. Transactions regulated under the FIEL's insider trading rules include the sale and purchase (and the like) of certain designated securities regarding listed companies made by company insiders who have come to know certain material facts regarding the business or other matters of the listed companies, unless such facts are already publicised.

Company insiders under the amended FIEL include:

a a J-REIT, its asset management company, and the officers of a J-REIT and its certain designated affiliates;

b the holders of a J-REIT's investment units, and the shareholders who have the right to request inspection of the books of a J-REIT's asset management company and a J-REIT's certain designated affiliates; and

c a person who has entered into an agreement with a J-REIT, its asset management company or a J-REIT's certain designated affiliates.

The amended FIEL will consider not only the material facts regarding a J-REIT, but also the material facts regarding its asset management company, as the material facts subject to the insider trading rules. While the insider trading rules will apply to listed J-REITs, private J-REITs will not be subject to the insider trading rules.

Investor protection from potential conflicts of interest between a J-REIT and a controlling shareholder of a J-REIT's asset management company

The asset management company retained by a J-REIT has broad discretion regarding the management of the assets of the J-REIT. As a result, a controlling shareholder of the asset management company can exercise a significant influence on the management of the assets of the J-REIT. Such issue is more relevant if the J-REIT is to purchase real estate from an affiliate of the controlling shareholder of the J-REIT's asset management company. There may be an issue with respect to, for example, the selection of the investment opportunity, the purchase price of the real estate and the timing of the purchase. The amendment to the ITL requires certain designated transactions, such as transactions between the J-REIT and an affiliate of its asset management company, to be approved in advance by the board of officers of the J-REIT.

Injunction by holders of investment units of a J-REIT against new issuance of investment units

Under the ITL, prior to the amendment, holders of a J-REIT's investment units did not have a right to petition for an injunction against the J-REIT's new issuance of investment units, even when the issue price did not reflect the fair market value of the investment units. However, the amendment will give investment unit holders a right to petition for an injunction. The injunction will be granted if the issuance of the investment units is made in violation of the constitution of the J-REIT or under significantly unfair conditions. With the right to petition for an injunction, the holders of investment units will be given stronger protection economically, by preventing dilution of the value of the investment units of the J-REIT in advance.

Expanded capability of J-REITs to invest in foreign real estate

Under the ITL, even prior to the amendment, J-REITs were not prohibited from investing in foreign real estate. However, there has been an obstacle in practice, because before the amendment, J-REITs were prohibited from owning a majority of shares in a company. Due to this prohibition, J-REITs were not able to acquire foreign real estate through any investment vehicle.

The amendment to the ITL includes an exception to such prohibition. Under the exception, J-REITs will be allowed to acquire a majority of shares in an investment vehicle established mainly for the purpose of investing in foreign real estate.

VIII OUTLOOK AND CONCLUSIONS

The amount of real estate assets acquired by J-REITs in 2013 is the highest ever recorded. Compared with 2013, the amount of acquired real estate assets was around three times the amount acquired in 2012. The improvement of the legal framework for J-REITs through amendments to the ITL and the FIEL, such as the diversification of the methods available to J-REITs with regard to their capital strategy (see Section VII, *supra*), will provide a more stable basis for the growth of J-REITs' real estate investments. The amendment to the REJEA (see Section VII, *supra*) will also provide more flexibility to structure real estate investment by enabling a GK-TK structure (that is not licensed but satisfies certain requirements) to invest in real estate without the need to hold it using a trust structure (i.e., a trust beneficial interest in real estate), as has typically been used. While these amendments are certainly a great stride forward in light of the growth of the real estate market, it is hoped that the government will keep improving the legal framework for real estate investment to bring about further long-term growth in this market.

Appendix 1

ABOUT THE AUTHORS

NORIO MAEDA

Nishimura & Asahi

Norio Maeda is a partner with expertise in transactions involving the acquisition of, investment into and financing of Japanese real estate assets. He has represented domestic and foreign investors, including investment funds, financial institutions, investment managers and developers from the United States, Europe and Asia, in numerous investment and development projects involving sophisticated structures. He has also represented lenders in numerous structured finance transactions involving real estate assets. His expertise extends to the restructuring of distressed real estate asset investments. He is admitted to the Bars of Japan and New York.

TOMOHIRO KANDORI

Nishimura & Asahi

Tomohiro Kandori is an associate whose practice focuses mainly on real estate finance and ship finance. He has advised on numerous transactions as counsel for lenders, arrangers, trustees, general contractors, real estate developers, equity investors and sponsors. He has also worked as an in-house counsel at a Japanese bank in London. He was admitted to practice in Japan in 2002.

NAOKO KATAKAMI

Nishimura & Asahi

Naoko Katakami is an associate with expertise in asset management and real estate investment trusts, including listed J-REITs. She also specialises in capital market transactions, loan securitisations and financial regulations with respect to financial institutions. She has also worked as a foreign attorney at a leading law firm in Australia. She was admitted to practice in Japan in 2005 and in New York in 2013.

KOZO KUROMATSU

Nishimura & Asahi

Kozo Kuromatsu is an associate with an expertise in tax planning, tax investigation and tax litigation. He was admitted to practice in Japan in 2010.

NISHIMURA & ASAHI

Ark Mori Building
1-12-32 Akasaka, Minato-ku
Tokyo 107-6029
Japan
Tel: +81 3 5562 8500
Fax: +81 3 5561 9711
info@jurists.co.jp
www.jurists.co.jp/en