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## Proposed Reform of the Real Estate Specified Joint Enterprise Law - “GK-TK Structure” with a GK owning a real property in fee

- I. Comparison with a current structure
- II. Overview of the New Structure
- III. Points to be Noted
- IV. Outlook

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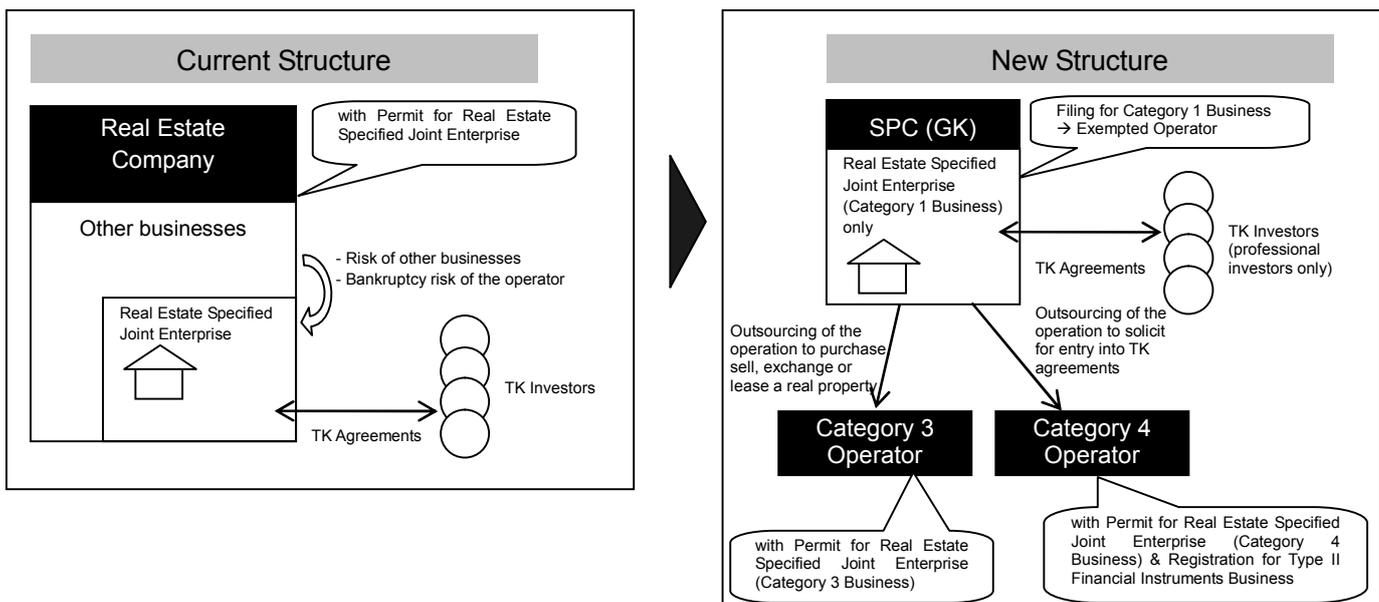
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On February 28, 2012, a bill (the “**Amendment Bill**”) to amend the Real Estate Specified Joint Enterprise Law (the “**RESJEL**”) was submitted to Japan’s Diet. This Amendment Bill is expected to enable investors to set up a real estate investment structure which allows an SPC (primarily, a GK or *godo kaisha*) to acquire and own real property in fee or fee simple by financing the acquisition through *tokumei kumiai* (or TK) investments, without using a TMK or *tokutei mokuteki kaisha*.

This note offers a brief overview of a structure that is expected to become permissible following the passage of the Amendment Bill (such structure, the “**New Structure**”).

### I. Comparison with a current structure

The following illustrates a comparison of the New Structure with one of the structures currently used under the RESJEL:



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Although there are other types of “real estate specified joint enterprise contract (*fudosan tokutei kyodo jigyo keiyaku*)” such as a *nin'i kumiai* (or NK) or a lease agreement under the RESJEL, this note assumes that the more commonly used *tokumei kumiai* (or TK) agreement would be employed in a real estate investment structure.

## II. Overview of the New Structure

Under the current RESJEL regime, if a person (a) enters into a TK agreement as a TK operator (*eigyo sha*), (b) purchases, sells, exchanges or leases a real property by using funds contributed by a TK investor under the TK agreement, and (c) distributes profits of the TK business to the TK investor, that person will be regarded as carrying out activities referred to as “real estate specified joint enterprise (*fudosan tokutei kyodo jigyo*)” and will be required to obtain a permit (*kyoka*) to engage in such activities from the relevant ministers or prefectural governor (Articles 2.4.1 and 3 of the RESJEL).

Under the Amendment Bill, if that person is an SPC which satisfies the following requirements, it will be an “Exempted Operator (*tokurei jigyo sha*)” and will not be required to obtain a permit to engage in the activities referred to in clauses (a) through (c) in the previous paragraph (which, under the Amendment Bill, are referred to as “**Category 1 Business**”), provided that it files a prior notification (*todokede*) with the relevant ministers (Articles 2.6 and 40-2 of the Amendment Bill):

- (i) An SPC: The person must be a corporate entity existing solely to carry out Category 1 Business;
- (ii) Outsourcing: The person must outsource (a) the business operations of purchasing, selling, exchanging or leasing real property to a real estate specified joint enterprise operator who has a permit for “Category 3 Business” (such operator, the “**Category 3 Operator**”); and (b) the solicitation activities for entering into TK agreements to a real estate specified joint enterprise operator who has a permit for “Category 4 Business” (such operator, the “**Category 4 Operator**”);
- (iii) Targeting professional investors only: The TK investors who may enter into TK agreements with that person are limited to investors who *either* have certain expertise and experience in real estate investments *or* are joint-stock-corporations (*kabushiki kaisha*) whose paid-in capital is no less than a certain amount (such investors, the “**Special Investors**”). The detailed criteria for Special Investors will be laid out in the ordinance to be promulgated under the Amendment Bill (the “**Ordinance**”); and
- (iv) Other requirements that may be set out in the Ordinance.

The Amendment Bill proposes to define the following categories of businesses as additional types of “real estate specified joint enterprise”:

- “**Category 3 Business**” means the business of performing, on behalf of an Exempted Operator, activities to purchase, sell, exchange or lease a real property in accordance with the TK agreements which the Exempted Operator enters into as TK operator; and
- “**Category 4 Business**” means the business of being an agent or an intermediary of an Exempted Operator for purposes of executing TK agreements.

A Category 3 Operator and a Category 4 Operator will be required to obtain a permit under the Amendment Bill for engaging in Category 3 Business or Category 4 Business, to have a paid-in-capital of a certain amount (the amount will be defined in the Ordinance) and to have adequate financial resources and human resources to pursue a Category 3 Business or a Category 4 Business (Articles 7(1) and 7(6) of the current RESJEL). Furthermore, a Category 4 Operator will be required to register as a Type II Financial Instruments Business under the Financial Instruments and Exchange Law (the “**FIEL**”) (Article 6(8) of the Amendment Bill).

### III. Points to be Noted

#### 1. Special Investors

As mentioned above, an Exempted Operator can enter into a TK agreement only with a Special Investor, and the detailed criteria defining a Special Investor will be set out in the Ordinance. In this regard, one issue the resolution of which is awaited by practitioners, advisors and investors is whether the criteria will include domestic investment vehicles (other than entities currently categorized as Special Investors under Article 46-2 of the current RESJEL), and whether they will welcome foreign investment vehicles.

#### 2. Predetermined terms and conditions

Under the Amendment Bill, the TK agreements that an Exempted Operator may enter into must be based upon the predetermined terms and conditions (*yakkan*) which its Category 3 Operator submitted when the latter applied for permit under the RESJEL. As a general rule, an addition or amendment to those predetermined terms and conditions requires the approval of the relevant authority. Although approval will not be required for “minor” additions or amendments (as may be defined by the Ordinance) and the requirements regarding predetermined terms and conditions will

presumably be relaxed if the TK investor is a Special Investor (as they are under Article 8.2 of the current ordinance of the RESJEL), as a practical matter, it may be difficult to customize or change the terms of a TK agreement or to change the investment structure (in particular, replacing a Category 3 Operator with another operator), as we expect that changes to important terms and conditions will likely continue to be subject to approval.

### 3. The Building Lots and Buildings Transaction Law (the “BLBTL”)

The Amendment Bill also proposes to amend the BLBTL to exempt Exempted Operators from licensing requirements under the BLBTL, although these operators will engage in the building lots and buildings transaction business. Furthermore, the Exempted Operator will not be required to have the presence of a registered transaction manager (*torihiki shunin sha*) at its office.

Unlike a TMK, which is completely exempted from the application of the BLBTL, however, the Exempted Operator will be deemed a licensed real estate transaction firm (*takuchi tatemono torihiki gyosha*) and subject to restrictions under the BLBTL to a certain extent. In particular, under the BLBTL:

- (i) An Exempted Operator will be required to set aside (*kyotaku*) a deposit for its operations (*eigyo hoshokin*) at a public office that acts as a deposit office (Article 25 of the BLBTL). Under the current cabinet order of the BLBTL, the amount of the required deposit is JPY 10 million for the principal office of a licensed real estate transaction firm.
- (ii) The sale contract of an Exempted Operator selling a real property will, except where the purchaser is a licensed real estate transaction firm, be (a) subject to a restriction on the amount of liquidated damages payable by it or the purchaser and a restriction on the amount of down payment (*tetsuke kin*) payable by the purchaser, in either case at a rate no greater than 20% of the sale price (Articles 38 and 39 of the BLBTL); and (b) prohibited from limiting the duration of its liability for defects to less than 2 years from the date of delivery (Article 40 of the BLBTL).

### 4. TK investor’s rights under a real estate specified joint enterprise contract as securities under the FIEL

Under the current FIEL, the investor’s rights under a real estate specified joint enterprise contract (including a TK agreement) are not categorized as “securities” under the FIEL. However, the Amendment Bill proposes to amend the FIEL and categorize those rights as securities. As a result, TK investor’s rights under a TK agreement in the New Structure will be subject to securities regulations under the FIEL.

5. No special tax measures are expected for the acquisition of a real property in fee

It should be noted that, when an Exempted Operator acquires real property, it will be subject to real estate acquisition tax and registration license tax at normal rates. At this stage, no special tax rates are expected to be available to the acquisition in the New Structure.

#### IV. Outlook

The Amendment Bill has just been proposed, and at this stage no one is certain whether it will be passed by the Diet. Even if the Amendment Bill as currently proposed is passed, uncertainties remain as details of the implementation remain to be seen as the draft of the cabinet order or ordinance implementing the Amendment Bill. Nonetheless, the availability of an additional investment structure is surely a welcome development in the real estate investment market, especially in cases where the target property is not suitable for entrustment to a trust bank/company or to be managed under a TMK structure.

#### News

Several Mori Hamada & Matsumoto practice groups, including Structured Finance, have been awarded top rankings by the 2012 editions of Chambers Global and Chambers Asia, and a number of our lawyers have been recommended as leaders in these areas.

Mori Hamada & Matsumoto opened a Singapore office on February 1, 2012.

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