

Investing in real estate in **Japan**

Purchasing property is one of the biggest and most difficult investment decisions to make, more so in a foreign country.

The tax and legal systems that apply to property transactions differ with every jurisdiction and therefore investors need to understand the local implications of their proposed transaction.

To maximise opportunities from investing in Japan, it is vital that investors consider as early as possible, both tax planning opportunities and specific tax obligations their investment in Japan presents.

Grant Thornton Japan is experienced in dealing with these issues and is able to assist investors in structuring their investments, identifying Japan tax planning opportunities and provide compliance services regarding Japan tax filing requirements.

The information detailed below should not be taken as a substitute for specific advice.

Who can invest?

There are no restrictions on who can purchase property in Japan: resident or non-resident individuals or companies may invest in property located in Japan.

Investment strategy

Residency status, as well as whether an individual chooses to hold the property in their name or in the name of a local or offshore entity will impact on the tax planning opportunities available and the level of tax compliance required.

Financing

While traditionally onshore financing has been difficult for non-Japanese citizens to obtain, both Japanese and foreign banks are becoming more aggressive in the lending market, opening up more opportunities for

investors wishing to take the plunge into Japanese real estate.

Tax implications

Japan imposes property taxes on the acquisition and ownership of property located in Japan. There is one acquisition tax and two holding taxes currently suspended in order to stimulate the Japan property market. It is unknown if or when these taxes will return. The amount of tax levied on rental income will depend on whether the beneficial owner of the property is a resident or non-resident of Japan. For both individuals and corporations, rental income is included with the investor's other assessable income and taxed at the applicable marginal rate.

Tax Breakdown (As of 1 April, 2008)

A property owner / investor, needs to consider the following taxes:

- Taxes on acquisition - Real Estate Acquisition Tax (REAT), Registration Tax (RT), Consumption Tax (CT) and Stamp Tax (ST) is payable on the purchase of a property
- Taxes on holding – Fixed Asset Tax (FAT) and City Planning Tax (CPT) is payable on the assessable value of the property.
- Rental income – rental income from Japan property is generally included with investors' other Japan source income and taxed at marginal rates. Withholding is deducted from payments to non-resident investors and is treated as a prepayment of the investor's income tax liability.

	Acquisition	Holding	Rental income
Individual (Japan resident)	REAT 3% RT 0.1 - 3% CT 5% (Building only) ST (ad valorem)	FAT 1.4% CPT 0.3%	Included in individual's gross income and taxed at marginal rate.

	rates)		(10 - 50%)
Individual (non-resident)	As above	As above	As above except no local taxes (10%) levied.
Japan resident corporation	As above	As above	Included with company's gross income and taxed (35 - 42% depending on size of taxable income).
Foreign corporation (with no PE in Japan)	As above	As above	Taxed at 22 - 30% (no local taxes levied).

Depreciation and other deductions

Japan's tax laws relating to depreciation are complex but potentially a big tax saver for real estate investors. Depending on the type of structure and age of the building at acquisition, investors may be able to write the acquisition costs off their income in a relatively short period of time. Expenses related to income-generating property are deductible when calculating the beneficial owner's assessable income.

Interest

For individual investors, a proportion of the interest repayments (structure value / land value) is fully deductible, while the remaining portion may be deductible, subject to certain conditions. For corporate investors, the entire amount of interest repayments is deductible.

Capital gains on the sale of real property

In Japan, tax levied on any capital gain from the sale of property will vary according to whose name the property is in (an individual's or company's), the length of time the property has been held, and whether the owner is a resident or non-resident of Japan. Investors who choose to hold their investment in a property holding company may elect to sell their interest in such a company, creating a capital gains event.

Capital gains derived by individuals

For individual taxpayers, gains / losses are taxed separately from other income. Gains on property held by a resident for more than five years are taxed at 20%, for five years or less, 39%. For non-residents, it is 15% and 30% respectively. Owner-occupiers are given a JPY30m deduction on any gain made upon sale.

Capital gains derived by corporations

For corporate investors, capital gains derived on the sale of real property are included with its other income and taxed at the corporate level.

Capital losses

For individual resident investors, capital losses can only be offset against capital gains similar in nature in that particular tax year: i.e. such losses cannot be carried forward to subsequent years. For owner-occupiers, a capital loss can be carried forward three years and offset against other income, provided the taxpayer purchases a new residence within the acceptable timeframe. Owner-occupiers with an outstanding loan may also be able to offset some of their capital loss against their other income.

For resident companies, capital losses can be offset against other income and carried forward seven years, however certain compliance requirements must be met.

Capital gains on sale of shares in a holding company

A foreign individual shareholder who sells their interest in a Japan resident company holding property will be taxed 15% on any associated gain they make on the value of their shares. Any capital gain made by a non-resident corporate shareholder on the sale of their shares in such a company will be taxed at 30%.

Inheritance tax

Inheritance tax is levied on the recipient of assets located in Japan or on permanent residents for Japan tax purposes who are the recipients of assets located offshore. The tax rates range from 10 to 50%, however spousal allowances are available to reduce the tax burden.

Gift tax

Gift tax is levied on the recipient of assets located in Japan or on permanent residents for Japan tax purposes who are the recipients of assets located offshore. The highest marginal rate of Gift tax is 50%, levied on the transfer of assets with a value of JPY10m or more. A JPY1.1m allowance is available to the recipient.

Tax reporting obligations

Investors in real estate located in Japan are required to file a tax return.

Practical considerations

Investing in Japanese real estate requires planning, patience and a clear idea of what you want to achieve and the time-line you hope to achieve it in. Building relationships and developing trust with landowners, real estate agents and banks is all part of the Japan real estate investment experience. Grant Thornton Japan is highly

experienced and well positioned to assist you in this regard.

Tax planning

Japan's tax rates for both corporations and individuals are among the highest in the world and extreme care must be taken to ensure the structure implemented is tax efficient. There are a number of 'exotic' investment structures in Japan available to investors that provide for planning opportunities. One such structure is a Tokumei Kumiai (TK). A TK is favoured with many foreign investors looking to potentially reduce their onshore tax liability and simplify their tax liability / compliance on any income distributions to non-resident investors.

Grant Thornton's Tax team can advise investors on these and other related opportunities.

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