Aoyama Sogo Accounting Firm Innovation Speed Quality

NewsLetter

Aoyama Sogo Accounting Firm

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Chairman's Column

The Age of a 100-year Life

I recently read the international bestseller "LIFE SHIFT", written by London Business School Professor Lynda Gratton and Andrew Scott. Like other nations, we often hear of a 100-year life in Japan. This book gives us hints on how we might go about our working lives assuming a longer life expectancy. My takeaway is that life is not a one-time and irreversible process of "learn-work-retire" but depending on the person, this process can occur numerous times over the course of one's life. This may be a reality that comes with a 100-year life.

Noriyuki Yanagikawa, a professor at University of Tokyo Graduate School also explains a theoretical retirement at age 40, and the importance of recurrent education in subsequent years. You may have noticed especially during this pandemic that product lifecycles are becoming shorter. Considering the turnover of products and even people, it may be difficult to spend age 20 to 60 with just one period of education. This new age we are entering may demand that we re-learn and pivot to a different type of work at some point.

As an accounting firm, our employees who work in tax and accounting are often referred as professional accountants. Regardless of job type, organizational structure, individual or company, as long as economic activities occur, there will always be a need for tax and accounting work.

In recent years however, the topic of SDGs and ESG has gained momentum and non-financial disclosures of environmental, social, and corporate governance have become just as vital as accounting. Although our primary services are tax and accounting, we view the provision of only such services as a business risk. To maintain true value for our clients, we are constantly looking to raise our level of expertise. Like the afore-mentioned authors suggest, we will continue to engage in lifelong learning.

(Kazuhiro Matsuzawa, Chairman)

Financial Assets

About Our Services for Financial Assets

In Japan, the securitization of financial assets began in the mid-90s. Our firm has supported funds for financial assets since our founding in 1999.

In the first few years in business, most of our work was for non-bank financial assets, however with the elimination of gray zone interest rates, SPC assets have changed dramatically. Currently, the main SPC asset types are:

- Loans receivable, accounts receivable, and other
- Financial instruments (stocks, bonds, trust beneficiary interests, investment shares)
- Marine vessels, airplanes, and other movable assets

Financial assets differ from real estate in that they are non-tangible and investors may want comfort through confirming the existence of claims. <u>We offer the following agreed-upon procedures:</u>

- Confirmation of existence
- Confirmation of eligibility criteria for securitization
- Confirmation of instrument instructions

In recent years, we are receiving more inquiries and are actively providing assistance for PE funds and those other than LPS structures. When using an SPC for fund-raising and setting up investment products, we are sure we can help. More details and latest trends will follow in future newsletters.

(Toshihiko Hatta, Executive Manager)

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Japan Real Estate

ESG Investments in the Real Estate Industry

Under its international pledge, Japan's net zero GHG emissions goals are set at 46%[1] reduction by 2030 and 100% reduction by 2050. However, recent figures[2] show that only a 18% reduction has been achieved, signaling that a greater effort is needed to reach the 2030 target.

It seems that Japan is now responding to two demands, namely from investors and the government.

Firstly, with pension funds and institutional investors leading the way for ESG investments, real estate as an alternative asset is being demanded similar ESG investment requirements as financial assets.

The news of GPIF (government pension fund investment) starting ESG investments had a big impact on publicly listed REITs in Japan, and this trend is expected to continue.

Secondly, the Building Energy Conservation Act requires adherence to energy conservation standards and will be a requirement in building inspections. Existing buildings that don't follow such standards may be at risk of becoming stranded assets unable to recoup their investment, so investors must be cautious of tighter government policies

in the future. In the U.K., there are far stringent regulations that prohibit new leasing of buildings that are energy inefficient.

When considering future investments, it may be wise to look beyond short-term economics, and to sufficiently consider ESG investments from a compliance standpoint to avoid future unexpected losses.

* 1) 2013 comparison 2) 2020 estimation

(Shigeru Hirai, Client Relations Group)

Security Token Offering

Security Token Offering (STO) for Real Estate

An **"STO"** or **security token offering** is an issuance of a security token based on the system of blockchain and used in fund-raising. It is defined as "electronic record transfer right" under Japanese law.

Since 2021, STO have been used for setting up numerous securitized real estate structures. Investment firms then sell such ownership stakes to individual investors.

Previously setup asset types include residential, office, commercial, logistics, boutique hotels, and others.

Structure-wise, there are two types. One is a tokenized Japanese Depositary Receipt (beneficiary certificate for entrusted securities), and the other is a tokenized TK investment share under a GK-TK structure.

Prior to the STO, individuals traditionally invested through J-REITs, however with the introduction of structures using an STO, we may see an influx of individual investors that invest in private real estate funds.

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Security Token Offering

STO (continued)

Generally, a **real estate STO** has **benefits** over a J-REIT in the following ways:

- Investors can gain access to properties not available under J-REITs.
- Ownership stakes are in single properties, so investment targets are clear.
- Not publicly listed, so volatility is low.

However, tax regulation and related laws are still a work in progress, and the following **challenges** exist:

- Under the GK-TK structure, protection from third party claims is difficult to secure when transferring TK investment shares.
- Under the GK-TK structure, distributions are subject to an overall tax, which differs from treatment for a J-REIT.
- For Japanese Depositary Receipts, dividends are non-deductible.
- No secondary market, so liquidity is low.

Our firm will continue to update you on tax reforms, changes in laws, and the latest news. Please reach out to us for any considerations about setting up an STO structure and ongoing management.

(Masanori Ikematsu, ASA Advisory)

Japan Tax Update

Group Tax Relief System begins

The consolidated group tax system ended in March and was replaced by the **group tax relief system** which started on **April 1, 2022**.

First implemented in 2002, the consolidated group tax system was used to treat the entire group as one reporting entity for corporate tax filings. By consolidating group income and losses and using NOLs, the purpose was to reduce tax. However, due to complex tax calculations and adjustments at company levels affecting the entire tax calculation, many groups did not elect this method due to cumbersome administration. Also, other considerations including the start date of application, valuation necessary for parent and subsidiaries at the time of becoming part of the group, and net losses carried from new group companies were not consistent with the corporate reorganization tax system, and there was criticism that it lacked objectivity.

Under the **new group tax relief system**, while income and losses are aggregated and NOL available for use within 100% controlled group companies, each company will be regarded as a reporting unit and will each calculate and submit tax. The new system is consistent with the corporate reorganization tax system as well. In order to enjoy the reduced corporate tax rate, the group companies must all be small and medium sized entities, and the applicable income for each entity will be based on % of total group income (group income up to 8 million JPY is applicable at the reduced rate).

Companies should consider the benefits of combining income and losses and use of NOL for the entire group. If a company wants to file under this method, as a general rule they must submit an application form 3 months prior to the beginning of the first fiscal year of applying this method. If a group was previously reporting under the consolidated group tax system, they will automatically be transferred to the new system.

Not only will group tax be reduced but the parent entity will be able to assess the subsidiaries' tax risks. In that respect, the new system is gaining attention from a corporate governance standpoint as well.

(Reiko Handa, Tax Group)