Aoyama Sogo Accounting Firm Innovation Speed Quality

NewsLetter

Aoyama Sogo Accounting Firm

Vol.13 7/29/2022

Chairman's Column

Our Year in Review: Residential and Solar show strength

Our firm closes its fiscal year in May, so we are reviewing our financials for the year. As you know much of our business is based on SPC administration of alternative assets and analyzing the year's data has revealed trends into the private real estate market.

During this past year, even with Covid, residential properties have seen tremendous growth. Although, it's often said that residential and logistics facilities are "Covid-tolerant", we haven't necessarily seen any year over year growth for logistics. Meanwhile, residential investments have been growing in popularity perhaps because they have been reassessed for their added value as being workplaces on top of being living quarters. Investment amount per floor area have not dropped at all. Properties along private subway lines which historically have not been considered investment worthy are now picking up, resulting in nearly 80 more investments among our clients.

Another area that has grown is alternative energy investments. There's continued demand particularly with investors in solar power generation which has tailwinds coming in the way of SDG adoption and carbon neutrality. As a result, funding for new projects and bulk purchases of smaller facilities are both growing in volume.

News stories are often about bids for big offshore wind power projects like Akita, but there's still many mega solar generation being developed. Since we provide services like cashflow analysis, the number of solar has grown by nearly 40 such facilities this past year.

We had hopes that Covid would settle down and the weakened yen would usher in not only tourism again, but that funding would pick up for hotel investments and other properties. Unfortunately, infections haven't settled yet and a back and forth continues. I believe there has to be both an easement of border controls and face masks for things to truly move forward.

(Kazuhiro Matsuzawa, Chairman)

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Renewable Energy

Government support of the Regional Decarbonization Market

Leading up to the goal of carbon neutrality by 2050, both public and private sectors of Japan are expected to collaborate on policies that promote the decarbonization market. Below, we have taken excerpts from the Regional Decarbonization Roadmap of the Ministry of the Environment.

Regional decarbonization

From October 2020, our country declares to be carbon neutral by 2050 (bringing down GHG emissions as a whole down to zero). In April 2021, we declared to bring GHG emissions down by 46% from 2013 to 2030. We aim to bring it down by 50% if possible during this time.

In order to achieve these goals, joint and co-creation efforts between the national government and localities are essential. The "Regional Decarbonization Roadmap" (decided on June 9, 2021 by the National and Local Decarbonization Implementation Council) was created with the aim of realizing regional decarbonization that contributes to regional revitalization and the enhancement of regional attractiveness and quality, with local regions playing a leading role. The roadmap shows processes and concrete measures, with a particular focus on initiatives and measures to be implemented by 2030.

The "Regional Decarbonization Roadmap" states that all measures will primarily be executed over the next five years to create a “decarbonization domino" in which regional decarbonization spreads from highly motivated and feasible areas to other regions. It also aims to expand regional decarbonization efforts nationwide in 2030 and beyond, achieve decarbonization in many regions before 2050, and transition to the next generation of resilient and dynamic local communities while solving many of the challenges that exist.

In each region, it is important to promote region-specific decarbonization efforts in all fields such as industry, citizen livelihood, transportation, and the public sector to contribute to revitalization using local strengths. To achieve this, the key is to the expand the implementation of renewable energy. Since most of the energy used in local regions depends on imported fossil fuels, it is expected that the effective use of the renewable potential of regional resources, while utilizing local employment and capital, led by local companies and local governments, will lead to the improvement of local economies.

Leading decarbonization regions

Leading decarbonization regions are regions that achieve 2050 net-zero CO_2 emissions from electricity consumption in the consumer sector (household, business and other sectors) and reductions in other GHG emissions, including those in the transportation sector and heat usage, in accordance with regional characteristics, in line with our country's overall targets for 2030. These regions will serve as models for an "implementation of decarbonization domino".

The "Regional Decarbonization Roadmap" will be implemented by FY 2030 in at least 100 leading decarbonization areas, with active support from the Ministry of the Environment, the national government. It will be led by local governments, local companies, and financial institutions, in accordance with the regional characteristics, toward decarbonization, and will be begin by FY 2025. Through this initiative, the plan is to simultaneously resolve regional issues in diverse areas such as rural villages, fishing villages, mountain villages, outlying islands, and urban blocks, and to show the direction for decarbonization efforts while improving

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Renewable Energy

(continued) Assisting the Regional Decarbonization Market

qualify of life for residents. The Ministry of the Environment plans to accept applications approximately twice a year. First round results were announced on April 26, 2022, which received 79 applications from 102 local governments, including joint proposals. 26 municipalities were selected, including Maibara in Shiga prefecture, Maniwa in Miyagi prefecture, Kitakyushu in Fukuoka prefecture and Akita prefecture. In one of the selected areas, a joint proposal with a private company will submit a decarbonization plan for rural areas. The plan calls for the use of 100% renewable energy in public facilities around train stations and in research labs maintained by companies. In one area, shared taxis will operate with EVs derived from renewable energy, leading to a reduction in CO_2 emissions in the transportation sector.

The Minato Mirai district in Yokohama City, where many commercial facilities and office buildings are located, was also selected as a leading decarbonization area. Including Queens Square Yokohama, the district has 64 facilities and 1,800 businesses and shops. They also want to cover electricity used for air conditioning and lighting with renewable energy. Although there are some challenges, such as the need to procure electricity from renewable sources due to limited space for solar panels, decarbonization efforts enhance the attractiveness of such facilities.

Establishing the Decarbonization Support Corporation

Based on the Regional Decarbonization Roadmap, the Ministry of the Environment is preparing for the establishment of the Japan Decarbonization Support Corporation, which will provide funds for businesses. It aims to alleviate the difficulties in securing funds due to lack of precedent or recognition for renewable energy projects and to provide continuous and comprehensive financial support for decarbonization projects by private companies.

The goal is to realize a decarbonization market of 100 billion yen by using the stimulus of 20 billion yen for investments. In addition, through the creation of new business models, the hope is that decarbonization investments ultimately grow to several trillion yen through this initiative.

As we move toward 2050 carbon neutrality, it is expected that there will be more measures to support decarbonization projects in which both the public and private sectors work together. We will keep you informed of developments in future newsletters.

(Kenichi Shimizu, Executive Manager)

Japan Real Estate

A note about Private REITs

In recent years, with the Global Pension Investment Fund (established by the Japanese government) investing in 9 private REITs, the action seems to be picking up overall in the private REIT market. Perhaps this is due to institutional investors that have sought to reduce their risk in a market that is sensitive to global affairs, and instead move into more stable long-term investment management.

9 years after the start of the first J-REIT, private REITs in Japan first began with Nomura Real Estate Private REIT in 2010. Since then, the market has grown steadily to 42 investment corporations that hold total real estate of 4.725 trillion yen.

What are some differences between a private REIT and J-REIT?

① Only "professionals" or qualified institutional investors are able to make investments in a private REIT (differs from J-REIT and private funds that don't require professional investors)

② Much like a J-REIT, a private REIT not have a finite investment period (differs from a private fund with a finite investment period)

③ Low liquidity because it is not publicly listed. In order to cash out, their holding must be transferred to another private investor, or a request is made to sell back to the investment corporation (differs from J-REIT shares which can be sold in the public market)

④ Since pricing is based on appraised values of properties, there is low correlation to traditional assets such as stocks which are priced according to the market (differs from J-REITs which have stronger correlation to market share prices)

Also noteworthy is that private REITs are generally lower in investment amount, so for larger portfolios, J-REITs which fund-raise on a larger scale through the market may be more suitable.

For the distinctions made above, private REITs which investment in alternatives are less affected by global financial conditions and are expected to continue to be in demand by core institutional investors.

(Shigeru Hirai, Client Relations Group)

May 2022	J-REIT(a)	Private REIT(b)	(b)/(a)
Total property investment（Acquisition cost、100M yen)	215,592	47,250	22%
Number of properties	4,481	1,257	28%
Number of investment corporations	61	42	69%
Total property investment/# of investment co.'s (100M yen)	3,534	1,125	32%
# of properties /# of investment co.'s	73	30	41%
Total property investment/# of properties (100M yen)	48	38	78%

(Source：Calculated by our firm based on ARES data)

Security token offering

Challenges for the Real Estate STO

We continue with the current challenges of real estate STOs, first discussed in volume 10.

Real estate STOs from the perspective of protection from third party claims for TK investment transfers have often used Japanese Depository Receipts in their structures, however, there have been cases where GK-TK structures were used for setup.

① The TK investment would be tokenized and listed on Singapore's digital securities platform ADDX, where only on this platform would the TK investment be transferred.

② When the investor transfers TK investment shares over ADDX, they would first go through Tokai Tokyo Securities.

③ In receiving issuer approval for TK investment transfers, Tokai Tokyo Securities will create a transaction registry on ADDX which will be shared with the issuer, thus implying that the issuer approval was obtained based on the TK agreement. The transfer of TK investment would be deemed valid once the registry is shared with the issuer.

④ Protection will be secured against third party claims in transferring the TK investment when Tokai Tokyo Securities creates an approval sheet with the set date (the day after the transfer becomes valid) that serves as proof that the transfer was approved implicitly.

The secondary market is being developed as well, with Osaka Digital Exchange Co., the management company of the exchange announcing that it will begin operations in 2023. The Japan Exchange Group also announced in its interim business plan that has set a target develop a digital securities platform for the secondary market that enables trading of new products by the end of 2024. Also, not related to STOs but Osaka Digital Exchange Co. also began operating a proprietary trading system as of June 27, 2022.

Once the secondary market comes to fruition, liquidity should be higher which will allow individual investors to purchase easier. Trading prices should reflect the current real estate values to a certain degree as well. However, if trading volume gets closer to that of a J-REIT, the benefits of a private REIT which was low volatility may be lost, and perhaps there will be less distinction from a J-REIT. Additionally, if the security token (ST) is purchased only with cryptocurrency such as Ethereum, the tax implication would be that the ST was exchanged for crypto and capital gains would be recorded.

For the two points noted above, if higher volatility results and capital gains tax are assessed, individual investors may stay away from real estate STOs and invest in J-REITs instead. It's definitely worth paying close attention to how the secondary market and tax regulations develop over time.

※ As of June 2022, Aoyama Sogo Accounting Firm became a supporting member of the Japan Security Token Offering Association (https://jstoa.or.jp/)

(Masanori Ikematsu, ASA Advisory)

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Japan Tax Update

Revision of SME tax incentives for wage increases

With Japan's 2022 tax reform, the tax credit available under the "system for promoting wage increases" was expanded.

For small and medium-sized enterprises, there are no changes to the requirement of a 1.5% overall wage increase from the previous year to qualify for the 15% (limit applies) tax credit for corporate tax. However, the new reform raises the maximum credit % to 25 to 40% upon meeting certain additional requirements. (Applicable for fiscal year starting April 1, 2022)

However, the maximum tax credit is limited to the amount of "Corporate tax (pre-tax credit) x 20%".

We receive inquiries from companies that are performing well and are considering wage increases and the corresponding tax incentive. However, in practice, the maximum credit set at "Corporate tax (pre-tax credit) x 20%" sometimes proves to be a difficult threshold to cross in maximizing the credit. For example, if wage is increased by 5M yen and all additional conditions are met for the 40% credit (2M yen), the company's corporate tax (pre-tax credit) amount and taxable income would have to be 10M yen and 46M yen, respectively to fully use the allowable credit.

It remains to be seen whether the expansion of the tax incentive under the reform is truly beneficial for SMEs. However, if any wage increases are planned, it is worth looking into the potential tax credits that may be available.

(Sachie Aoki, Tax Group)

<Reform outline for tax credits for SME(※1) wage increases>

		Before Reform		**After Reform** (For FY beginning April 1, 2022 and after ※2)	
Requirements		Increase of 1.5% or more in total employee wages compared to previous year		**No change**	
Basis for credit %		Increase in total employee wage amount from previous year		**No change**	
Tax credit %	【Maximum】	【25%】		**【40%】**	
	Basic	15%		**15%**	
	Additional	+10%	Increase of 2.5% or more in total wages from previous yr and education and training req.	+15%	**2.5% or more increase from PY total employee wages**
				+10%	**10% or more increase from PY total education and training expenses**
Tax credit limit		This period's corporate tax x 20%		**No change**	

※1 This new system is available for a portion of SMEs that file with a blue form. Only companies with less than 100M yen in paid-in capital or contribution amount qualify (excludes companies that receive capital over a certain amount from large corporations).

※2 Available for fiscal years that begin before March 31, 2024.