Aoyama Sogo Accounting Firm Innovation Speed Quality

NewsLetter

Aoyama Sogo Accounting Firm

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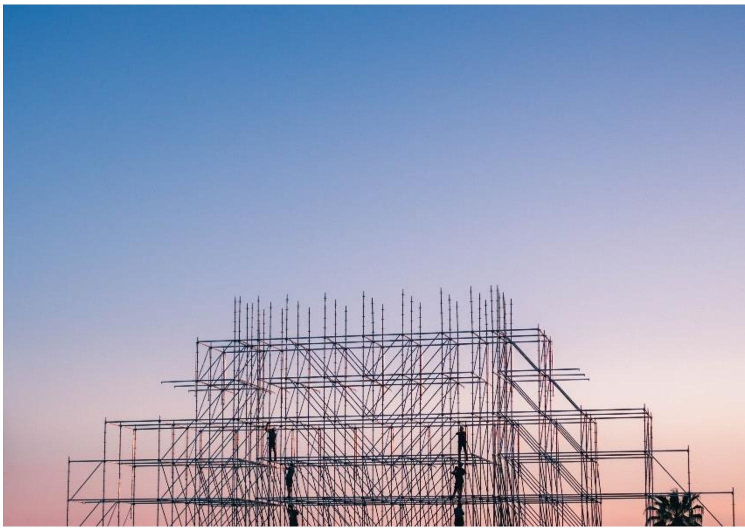
Chairman's Column

The increasing challenges of Medium-term Business Planning



The managerial landscape is changing at an unprecedented speed. Work styles have dramatically changed with Covid, making online and remote work the norm. And new demands and markets are emerging as the economy recovers quite swiftly. New technologies developed from the likes of OpenAI continue to emerge, shaking up industry standards and competition.

One major problem is the rising cost of goods. The prices of essential goods like gasoline and food are becoming even higher. One contributing factor is the rise in worldwide materials and transportation costs. For companies, this leads to higher costs and lower profit.

In addition, securing human resources is another big issue. It's becoming a challenge even by offering higher wages and headhunting for qualified talent. In particular, there is more diversity in workstyles and values. The younger generations seek not just adequate compensation but ways to contribute to society, reduce environmental impact, and realize their own version of success.

With these changes happening in the managerial environment, companies are finding it more difficult than ever to predict the future. Medium-term business plans which typically consist of goals and strategies over 3-to-5-years are becoming challenging to prepare. One of the big reasons a company goes bankrupt is due to "a management style that just goes with the flow." Therefore, it's crucial for management to execute their business according to a plan.

However, it's not easy to prepare a medium-term business plan.

Compared to a decade ago, times change at a more rapid pace and there is substantially more information available. Even the sudden passing of former Prime Minster Abe Shinzo in July of last year seems like distant news. Who would have thought at the time that AI-related tech like ChatGPT would be so prevalent for business applications. As uncertainty increases, fewer public companies are disclosing financial projections.

However, there's no use in being scared. The job of a business owner is to make decisions. Together, let's forge a bright future for our businesses.

by Kazuhiro Matsuzawa, Chairman

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Limited Partnerships

Invoice System impact on Limited Partnerships

The start of the invoice system in October will have various effects on fund businesses. In this edition, we discuss the effects on one of the primary vehicles used in private equity and venture capital, which is the Limited Partnership (LPS).

The first assumption is that the LPS is a partnership and not a corporate entity which means that the concept of taxpayer or tax-exempt status for consumption tax does not apply. The question then becomes, "Can the LPS become a qualified invoice issuer"?

The LPS can become a qualified invoice issuer by assuming that all LPS partners are qualified invoice issuers by submitting a "notification that all voluntary partnership members and such are all qualified invoice issuers." The key point is "ALL partners". The notification is invalid if any partner is an individual and not a business or if the business is tax-exempt. The consideration is unnecessary if the only income earned is interest or dividends, which doesn't include consumption tax.

The issue arises for instance when a PE fund charges an upfront fee associated with acquiring stock. In this case, one may consider the need to register as a qualified invoice issuer.

There are also impacts on general partnerships (GP) and limited liability partnerships (LLP), which are used more often as investment vehicles. For example, the management fees charged by the GP to the LPS will be treated as a taxable purchase for the LPS. If the LLP which is the GP is not a qualified invoice issuer, the LPS (ultimately the partners) will not be able to use the expense as a purchase tax credit. To avoid this, the LLP should submit a notification as previously explained, however the issue is that many LLPs are individuals which makes them ineligible (it is possible if the individual becomes a sole proprietor and subsequently becomes a qualified invoice issuer.)

For any future structure setups and investment offerings (LP), this is another consideration that is gaining attention.

by Kota Toba, Executive Manager

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Private Real Estate Funds

Market Report: Private Real Estate Funds

As summarized in this year's January/February edition, we follow up with the most recent "Market Report for Private Real Estate Funds" conducted by ARES (Association for Real Estate Securitization) and SMTRI (Sumitomo Mitsui Trust Research Institute). See chart right.

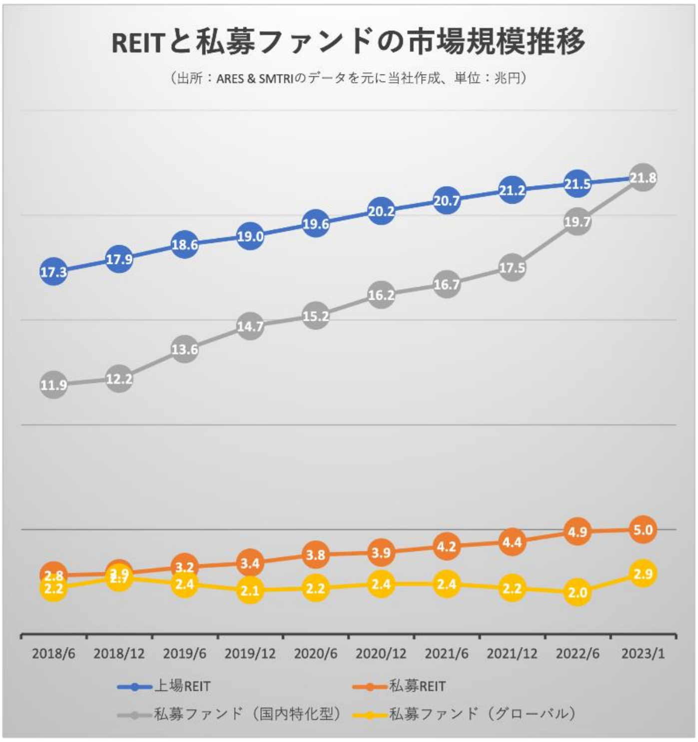
Since the last report 6 months ago, the private fund market as a whole has grown by about 3.3 trillion yen (approximately 12.4%).

"Private Funds (Domestic)" has especially grown rapidly with an increase of 2.1 trillion yen, nearly the same as the last period. This constitutes over 60% of the growth in the private fund market for this period. It has finally reached the public REIT market in size (21.8 trillion yen).

Meanwhile, public REITs which have grown by about 600 billion yen in assets on a semi-annual basis, have only risen by half or 300 billion yen since the last 6-month period. It seems that the asset purchasing power of public REITs is continuing to decline.

Additionally, to compensate for this stall for public REITS, private REITs which grew by 500 billion yen in the last period, has settled down to an increase of 100 billion yen.

Also, "Private Funds (Global)" which shrank by 200 billion yen last period, grew by 900 billion yen. The report analyzes that "Global funds have increased their investments in Japanese real estate compared to prior periods, with hopes that the Japanese economy would normalize post-Covid and capitalizing on high yield gaps that continue compared to higher interest rates in Europe and America."



Market size of REITs and Private funds
Public REIT, Private fund (domestic)
Private REIT, Private fund (global)

However, the report on investment attitude also uncovers that 17% of foreign investors have a "decrease in investment appetite", a 3% increase from the last report. The report speculates that "from an asset allocation perspective, traditional assets have dropped in value and the higher weight in Japanese real estate makes additional investments harder to make." Future activity by foreign investors is certainly worth keeping an eye on.

We will follow up with a summary for the next market report.

by Shigeru Hirai, Clients Relations Group

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Consumption Tax

Rising Inbound consumption and Tax-free shops

You may have noticed lately that sightseeing spots are packed with foreign visitors, hotel rates are up, and reservations are harder to make. The Japan National Tourism Organization estimates that in April of this year, 1.95 million or roughly 60% of pre-Covid tourists visited Japan.

With visitors on the rise again, inbound spending is considerably up as well. Much of the spending is done at tax-free shops, which are popular among foreign visitors throughout the cities. The items bought at such tax-free shops are becoming a problem as they are sold illicitly to another reseller for profit.

At a tax-free shop in Japan, specific procedures are followed at the time of purchase. The goods are wrapped accordingly and purchased at the tax-free price. Goods available for purchase tax-free are assumed to be consumed overseas (i.e., not consumed in Japan). If the goods are consumed within Japan and are not held in possession at the time of departure, consumption tax will be collected.

When tax-free goods are illicitly sold and not held in possession at the time of departure, the tax agency often is often unable collect the consumption tax for reasons that the visitor doesn't have money and simply departs. After departure, it's difficult to detain the person and the consumption tax consequently isn't collected.

The difficulty in collecting the tax is seen with this statistic. According to a report from the Ministry of Finance, of the inspections that revealed the lack of tax-free goods in possession at time of departure, roughly 2.2 billion yen in consumption tax was assessed but the majority (2.1 billion yen) could not be collected.

To thwart such attempts for illicit reselling, the consumption tax law reform placed equal responsibility on the reseller receiving the goods which may have had some effect. However, in practice, it is likely difficult to identify the receiving party and enforce the law. There seems to be consideration under way for a refund method in which visitors purchase taxed goods at the tax-free shops and receive a refund at the time of departure. The downside is the administrative burden which results, but the wide-spread adoption of a similar system in other countries may be good reason to seriously consider this.

On one hand, it would be unfortunate to see inbound spending fall due to tax-free shops becoming less accessible. However, since consumption tax is one important funding source for Japan's four social insurances (pension, elderly care, medical, children and child rearing assistance), I hope that the tax is fairly collected moving forward.

by Masanori Ikematsu, ASA Advisory

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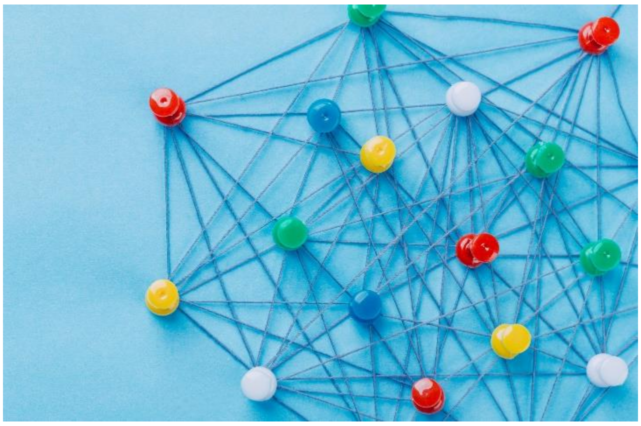
Japan Tax Update

A New International Tax : Implementing the Global Minimum Tax



Under Japan's 2023 tax reform, the income inclusion rule (IRR) will take effect as part of the internationally agreed global minimum taxation. Multi-national companies with annual revenues of 750 million Euro or more will be subject to a 15% minimum tax on income for each country, excluding any specific exemption.

Leading up to this was the 2015 BEPS Final Report in which international agreement was reached regarding "Tax challenges of the digital economy". The OECD/G20 subsequently discussed the "BEPS Inclusive Framework" and in October 2021, the resolution of "Two Pillars" was reached. The two pillars consist of Pillar One "Reallocation of new tax rights across market jurisdictions" and Pillar Two "Global Minimum Taxation." Japan's tax reform includes the application of Pillar Two under Japanese law.

One of the reasons for this international response and agreement resulted from a growing number of companies conducting business without a permanent establishment (PE) in a market jurisdiction. It became apparent that levying tax in market jurisdictions under PE, which is the current general principle of international taxation was no longer effective (only when a foreign company has a branch or other place regarded as a PE within the country will income generated from the PE be taxable). Furthermore, to attract foreign companies, low corporate tax rates and tax incentives became prevalent in countries which have led to continuously low corporate tax rates. This has weakened corporate tax revenue structures and has inhibited fair competition among companies from a tax perspective.

As explained above, global minimum taxation itself is applicable to large multi-national companies. However, there is significant adjustment from the PE taxation rule. With the application of Pillar One "Reallocation of new tax rights across market jurisdictions," this may be a big turning point for general rules of international taxation.

by Masaaki Kidokoro, Tax Consulting Group