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Japan tax alert

Ernst & Young Tax Co.

Tax measures for the real estate leasing sector in response to COVID-19

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Due to the disruptive impact of COVID-19 on businesses, sales are decreasing drastically for companies managing commercial complexes, restaurants and hotels, resulting in severe cash flow constraints and creating fears that tenants of such buildings will find difficulty in paying rent.

The Ministry of Land, Infrastructure, Transport and Tourism relayed through real estate trade organizations a request that real estate companies respond flexibly during this crisis by accepting requests for rent payment deferrals from tenants facing difficulties paying rent, or by implementing other similar measures.

In response, the National Tax Agency (NTA) announced a special measure for the corporate tax imposed on owners of rental properties in the event they reduce or exempt rent to counter the impact of COVID-19.

On 7 April 2020, the Japanese government made a cabinet decision to approve the emergency economic package in response to COVID-19. In light of this decision, the Diet passed two bills on 30 April 2020, which were promulgated on the same day, to mitigate the negative impact on taxpayers from the measures to prevent and end the pervasive spread of COVID-19: (1) A bill on special measures to temporarily revise national tax-related laws in response to the impact of COVID-19 and (2) a bill to partially revise the Local Tax Act.

In this newsletter, we provide explanations of tax measures that are likely to be utilized by companies engaged in the real estate leasing business.

Please refer to the Japan Tax newsletter, "Japan government COVID-19 tax measures," that was released on 20 April 2020 for an outline of tax measures included in the emergency economic package in response to COVID-19.

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1. Losses incurred by real estate owners who exempt tenants from having to pay rent

Under the current tax rules, if an owner of real estate decreases or exempts the rent of a corporate tenant without due reason, in principle, the difference between the rent prior to reduction and after reduction must be treated as expenditures spent as entertainment expenses or donations with the tenant deemed as the recipient.

However, the NTA has made it clear in their "*FAQ: National tax measures in response to COVID-19 prevention measures and temporary tax measures for tax return filing and tax payment procedures*" that, in the event owners reduce or exempt the rent of tenants who are finding difficulty paying rent due to the impact of COVID-19, the amount of losses they incur due to said reduction or exemption during the period such tenants' businesses are adversely impacted by the pandemic will not be deemed as entertainment expenses or donations. Such owners will instead be able to record these amounts as tax losses, provided they meet the following conditions.

(a) The revenues of corporate tenants have declined due to the influence of COVID-19, and business continuity is at risk or it is clear that business continuity will come under risk

(b) The rent reductions were granted for the purpose of assisting corporate tenants restore their businesses (e.g. business continuity and maintaining employment) and such facts are verifiable in writing.

(c) The rent reductions were granted within an appropriate period after corporate tenants' businesses were negatively impacted (i.e. within the period necessary for corporate tenants to resume normal business activities)

The same treatment will also apply to cases where owners reduce or exempt past-due rent (e.g. exemptions of liabilities) and to leases for residential property and parking lots.

In addition, if any tax losses are incurred as a result of utilizing this special treatment of rent reductions or exemptions, owners are required to prepare and preserve documents that verify that they reduced or exempted the rent of tenants adversely affected by COVID-19.

In the event rents on which are applied the transitional measures relating to consumption tax rates pursuant to the provisions set forth in Article 5, paragraph 4 of the 2012 Supplementary Provisions of the Act to Revise the Consumption Tax Act are reduced, then the application of the transitional measures shall be deemed to continue (i.e., the rent amount shall be deemed not to have been revised despite the reduction).

2. Special measures on the deferral of tax payments

A special measure will allow the taxpayer to delay the payment of taxes without providing collateral and without incurring delinquent tax (delinquent charges) for one year, if the taxpayer suffers a substantial decrease in revenue (an approximately 20%[1] or more decrease in revenue (for at least one month) from February 2020 in comparison with the same period of time in the previous fiscal year) due to the impact of COVID-19 and the taxpayer has difficulties in settling tax liabilities. This measure applies to taxes and social security contributions due between 1 February 2020 to 31 January 2021.

Under the existing legislation, the taxpayer can ask for a deferral of tax payments for one year as provided for in the Act on General Rules for National Taxes. However, in principle, the taxpayer is required to provide collateral and delinquent tax also applies to the delayed payment of taxes. (Relief measures are available in certain cases).

[1] Cases where real estate owners decrease or exempt rent payments of tenants or cases where documentation verifying that rent payment deferral are submitted by the tax or social security contribution due date will also be treated as a decrease in revenue or sales.

3. Relief measure for fixed asset tax on depreciable assets and buildings for business owned by SMEs

In the event COVID-19 causes a significant drop[1] in the sales of a small and medium-sized enterprise (SME)[2] whose stated capital is equal to or less than JPY100 million, the taxable base of fixed asset tax and city planning tax on depreciable assets and buildings for business owned by[3] SMEs will be reduced. The reduction percentage will vary depending on the percentage of sales decrease.

Percentage of sales decrease (Note)	Percentage of tax reduction
Decrease of 30% or more but less than 50%	50%
Decrease of 50% or more	100%

(Note) Comparison between the sales for a given three-month period between February 2020 and October 2020 and sales of the previous year's corresponding period.

Moreover, upon application of this relief measure, the taxpayer must first receive certification from a certified business innovation support entity, such as a tax accounting firm or certified public accounting firm and submit a notification to their respective municipality by 31 January 2021.

4. Special measure for tax loss carry back

Under the current rules, an SME whose stated capital is equal to or less than JPY100 million can carry back corporate tax losses filed using blue returns to offset them against taxable income of the previous fiscal year (FY) to get a refund. The planned special measure allows SMEs with stated capital exceeding JPY100 million but less than or equal to JPY1 billion[4] to carry back tax losses to offset against taxable income of the previous FY. The tax losses under this special measure should arise in FYs ending between 1 February 2020 and 31 January 2022.

[2] Excluding companies with ownership interests of 50% or more held by large companies (i.e., companies whose stated capital exceed JPY100 million or companies wholly owned by another company whose stated capital is equal to or greater than JPY500 million) and companies with ownership interest of two-thirds or more held by two or more large companies out of their total ownership interest.

[3] This relief measure is applicable to buildings and depreciable assets owned by SMEs. Accordingly, in the case where trust beneficiary interests of such property are owned, the circumstances of each trustee must be assessed to determine whether or not the measure is applicable.

[4] Excluding certain companies, such as wholly owned subsidiaries of companies whose stated capital exceed JPY1 billion, investment corporations and special purposes companies (TMKs).