

Client Alert

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Outline of the 2016 Tax Reform Proposals: Impact on Infrastructure Funds

1. Introduction

On December 16, 2015, the ruling Liberal Democratic Party and its coalition partner, Komeito, published the Outline of the 2016 Tax Reform Proposals (the "**Tax Reform Proposals**"). The Tax Reform Proposals includes changes to the special taxation treatment of investment corporations. Under current law, the period during which an investment corporation holding renewable energy power plants can enjoy favorable tax treatment is limited to only ten (10) fiscal years. However, the Tax Reform Proposals provide that such a period shall be extended to twenty (20) fiscal years.

On April 30, 2015, the Tokyo Stock Exchange (the "**TSE**") published a new rule to create a new market for infrastructure funds ("**Infrastructure Fund(s)**"). The new market targets investments in infrastructure and related facilities, including renewable energy power plants such as mega-solar power plants.

The investment corporations are expected to serve as vehicles of the listed Infrastructure Funds similarly to the listed real estate investment trusts (REITs). However, due to taxation issues, no investment corporation has been listed on the market for Infrastructure Funds on the TSE to date.

If taxation of the investment corporations is reformed in accordance with the Tax Reform Proposals, new listings of investment corporations on the market for Infrastructure Funds (the "**Infrastructure Investment Corporation(s)**") are expected.

2. Current Taxation Issues for Investment Corporations

(1) Current requirements under the Taxation Special Measures Act

A key tax benefit for an investment corporation is the ability to treat dividends paid as tax deductible if certain requirements are met pursuant to Article 67-15 of the Taxation Special Measures Act ("**Conduit Treatment**"). This allows a de facto pass through treatment to apply to an investment corporation for tax purposes. Currently, in order for an investment corporation holding infrastructure assets to qualify for Conduit Treatment, it must satisfy either the "principle rule" or the "exception rule", discussed below, pursuant to Article 39-32-3 of the enforcement order of the Taxation Special Measures Act.

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(i) Principle rule:

The ratio of assets (i.e., real estate and securities, etc.) other than renewable energy power plants and concession rights to operate public infrastructure should exceed 50% of the total assets held by the investment corporation.

(ii) Exception rule:

The investment corporation which owns and begins to lease renewable energy power plants from September 3, 2014 to March 31, 2017 and satisfies all of the following requirements will be exempt from satisfying the principle rule 2(1)(i) above but only for ten (10) fiscal years ("**Exception Rule**"):

- a. The ratio of concession rights to operate the public infrastructure is less than 50% of its total assets;
- b. The investment securities were publicly offered upon its incorporation (with total issuance price equal to or exceeding 100 million Japanese Yen) or its investment securities are listed; and
- c. The investment corporation only leases the renewable energy power plants to third parties pursuant to its articles of incorporation.

(2) Limitation of ten (10) years for Conduit Treatment

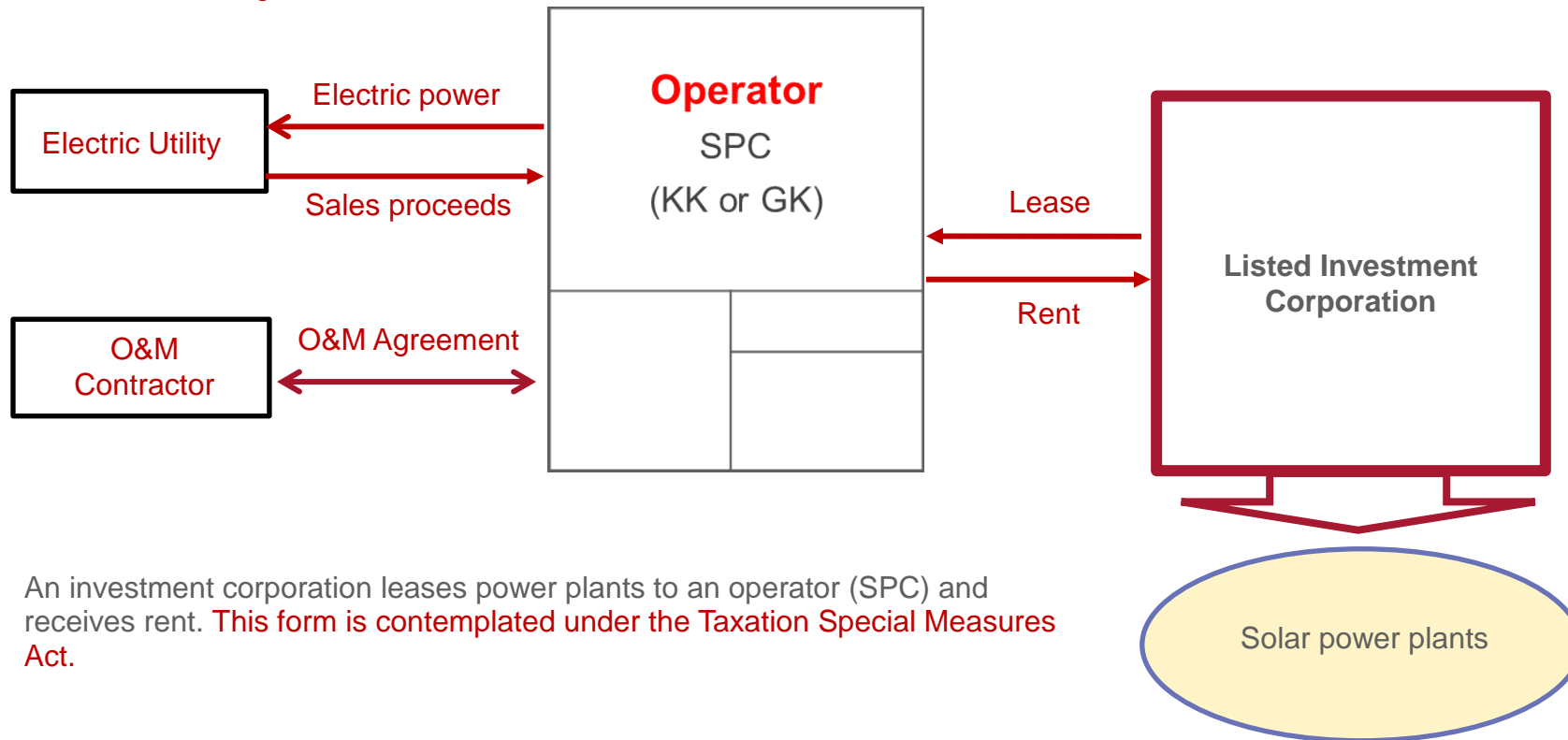
Under the TSE rule, 70% or more of the total assets held by an Infrastructure Investment Corporation must be infrastructure or related assets. In order for an Infrastructure Investment Corporation to qualify for Conduit Treatment under the tax law, it must satisfy the Exception Rule discussed in 2(1)(ii) above. In other words, it must directly own and lease the renewable energy power plant to an operator (as illustrated in Chart 1). However, in this case, the Infrastructure Investment Corporation will qualify for favorable tax treatment for only ten (10) fiscal years and, after 10 years have passed, it will be subject to corporate tax. This limitation of 10 years is the major obstacle preventing the Infrastructure Investment Corporations from listing on the TSE.

3. Impact of Tax Reform Proposals

As discussed, the Tax Reform Proposals propose to extend the period in which the Conduit Treatment of the Infrastructure Investment Corporation will be permitted from ten (10) years to twenty (20) years. Therefore, if the taxation of the investment corporations is reformed in accordance with the Tax Reform Proposals in 2016, it is expected that new listings on the market for Infrastructure Funds on the TSE will come into reality.

Chart 1 Investment Corporation – Lease Type

Power Purchase Agreement



An investment corporation leases power plants to an operator (SPC) and receives rent. This form is contemplated under the Taxation Special Measures Act.