

Taxation of J-Sukuk Q&A

April 2019

Financial Services Agency

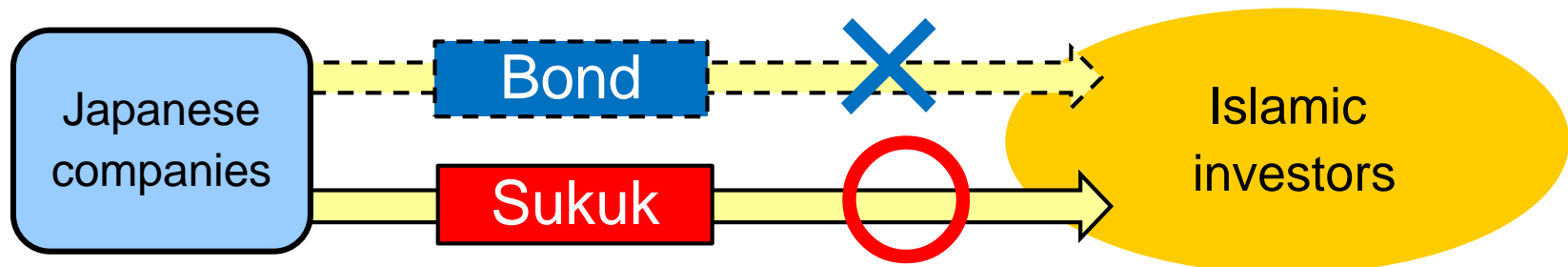


Q1 : What is a Sukuk?

A1 : A Sukuk is a financial instrument compliant with Islamic law with which Islamic investors or issuers who can not deal with interest-bearing bonds can deal, but the nature of which is economically equivalent to a bond.

- The nature of a Sukuk is economically equivalent to a bond. However, a Sukuk is legally structured not as a bond but as a security, distributing cash flows arising from its underlying assets such as real estate properties or business.
- An owner of a Sukuk economically receives a distribution of cash flows equivalent to interest on a bond, but legally receives a distribution of cash flows arising from its underlying assets such as real estate properties or business. Therefore, Islamic investors can invest in a Sukuk.
- The merits of Japanese companies' issuing of Sukuk are as follows:
 - ① Because issuers can issue Sukuk and raise capital from Islamic investors, to whom they have never had access, they can diversify their financing measures.
 - ② By issuing Sukuk compliant with Islamic law, favorable attention to the issuers in the Islamic world is expected. Thus, the issuers are expected to gain favorable positions in marketing in the Islamic world.

<Case of Japanese companies raising capital from Islamic investors>



Q2 : What is a J-Sukuk?

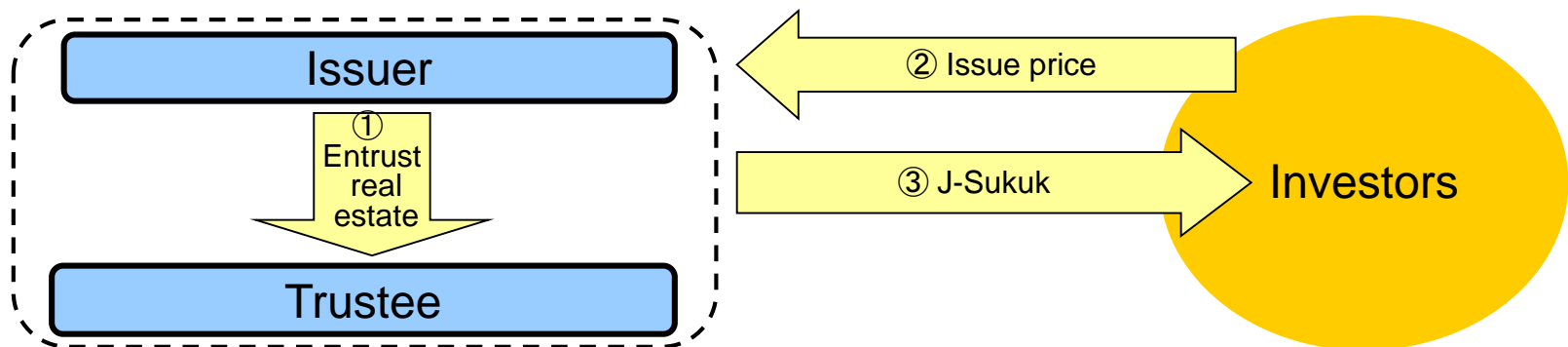
A2 : A J-Sukuk is a financial instrument which enables an issuer to raise capital from not only conventional investors but also from Islamic investors. It is legally not a bond itself, but is treated as if it were a bond for tax purposes.

- To be specific, a J-Sukuk is structured using a quasi-bond beneficial interest of a specified purpose trust prescribed in the Act on Securitization of Assets. A quasi-bond beneficial interest is an interest receiving pre-fixed amounts like interest on a bond. It is legally not a bond, but is treated as if it were a bond for tax purposes by the 2011 tax reform.

Example of the J-Sukuk issuance scheme (in case of Ijara Sukuk)

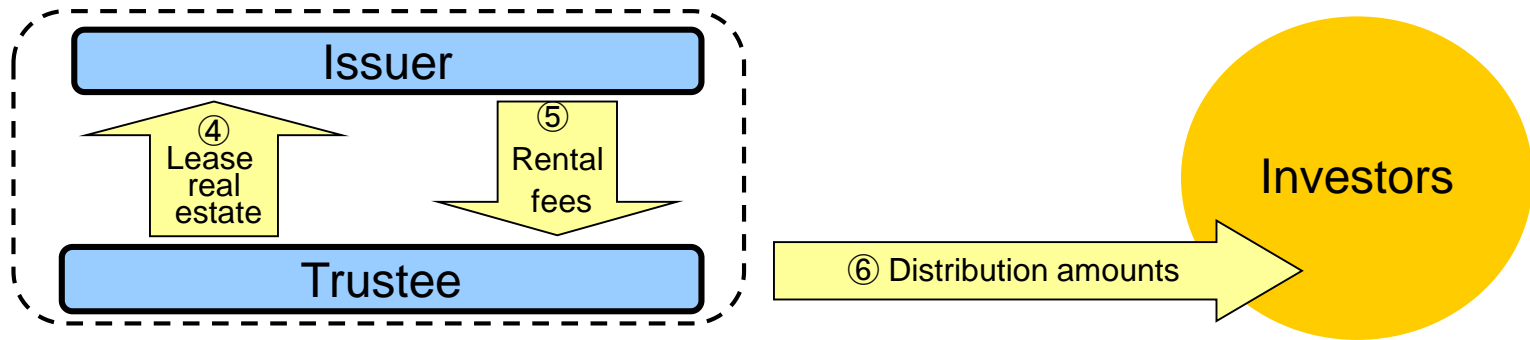
1 At the time of the issuance of J-Sukuk

- ① The issuer entrusts its owned real estate to the trustee of the special purpose trust.
- ② The investors pay the issue price of J-Sukuk to the issuer.
- ③ The issuer issues J-Sukuk to the investors.



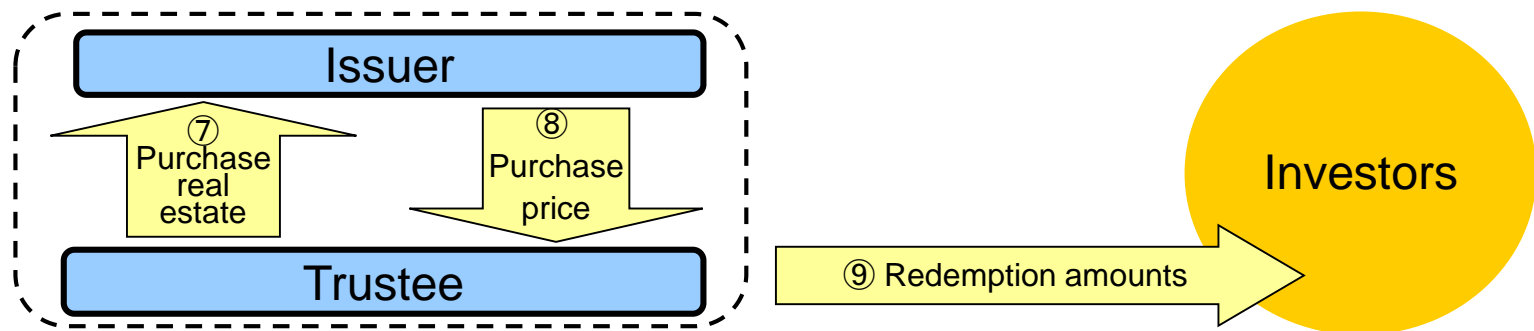
2 From the issuance until the redemption of J-Sukuk

- ④ The issuer leases the entrusted real estate from the trustee.
- ⑤ The issuer periodically pays rental fees to the trustee.
- ⑥ The trustee periodically pays distribution amounts funded by the rental fees to the investors.



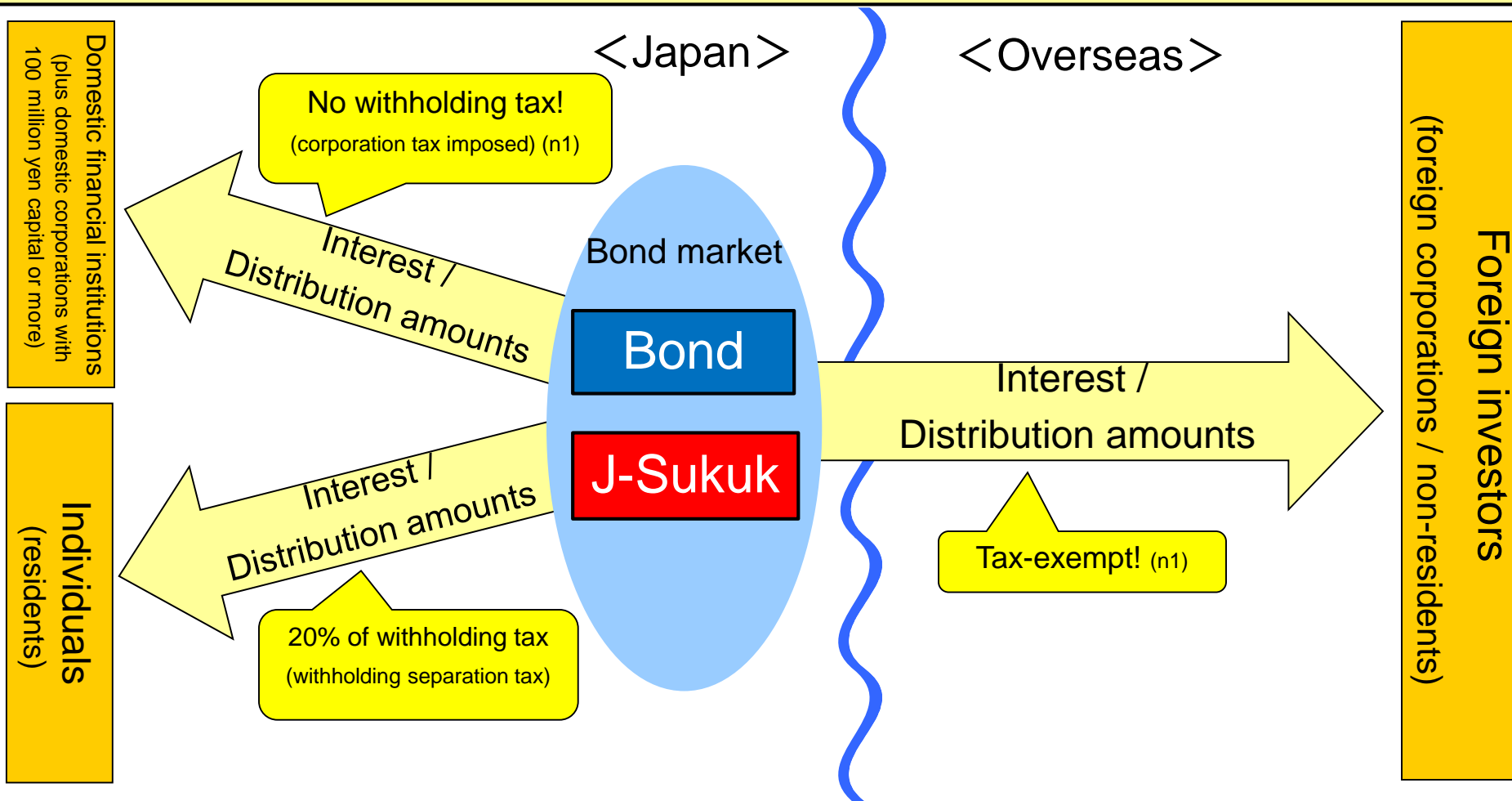
3 At the time of the redemption (maturity) of J-Sukuk

- ⑦ The issuer purchases back the entrusted real estate from the trustee.
- ⑧ The issuer pays the purchase price of the real estate to the trustee.
- ⑨ The trustee pays the redemption amounts funded by the purchase price of the real estate to the investors.



Q3 : How are the distribution amounts of J-Sukuk received by investors treated for tax purposes?

A3 : The distribution amounts of J-Sukuk received by investors are treated as if they were interest on bonds for tax purposes.



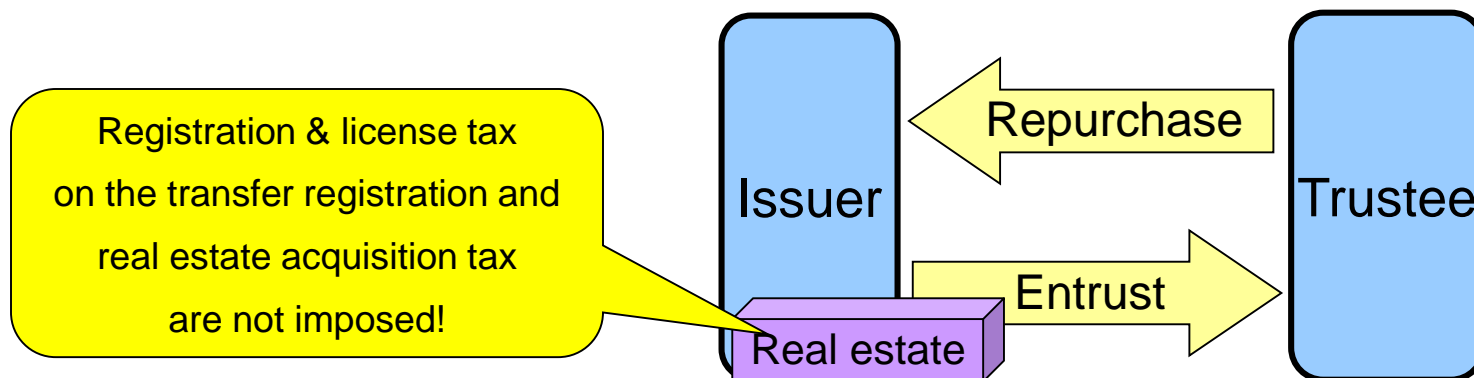
(n1) It is necessary for J-Sukuk to be treated in the book-entry transfer system.

(n2) In order for the distribution amounts of J-Sukuk to be treated as pay-through payments for tax purposes, it is necessary for J-Sukuk to be publicly offered (with an aggregate issue price of 100 million yen or more) or subscribed by institutional investors only.

Q4 : How is a formalistic transfer of a real estate along with the structuring of J-Sukuk treated for tax purposes?

A4 : In a case where a real estate is entrusted on issuing J-Sukuk, registration & license tax on the real estate transfer registration and real estate acquisition tax are not imposed. In addition, the repurchase of the real estate is neither subject to registration & license tax nor real estate acquisition tax, if following requirements are mainly satisfied:

- ① On entering into the specified purpose trust (“SPT”) agreement, the issuer grants an option to sell back the entrusted real estate to the trustee.
- ② The issuer treats such real estate as its fixed asset for accounting purposes in between the effective time of the SPT agreement and its ending time (on-balance transaction).
- ③ The issuer continuously owns part of the principal of the beneficial interest of the SPT from the effective time of the SPT agreement.
- ④ The issuer leases the entrusted real estate.
- ⑤ The issuer repurchases such real estate at the ending time of the SPT agreement.
- ⑥ The redemption period of J-Sukuk is within 20 years.

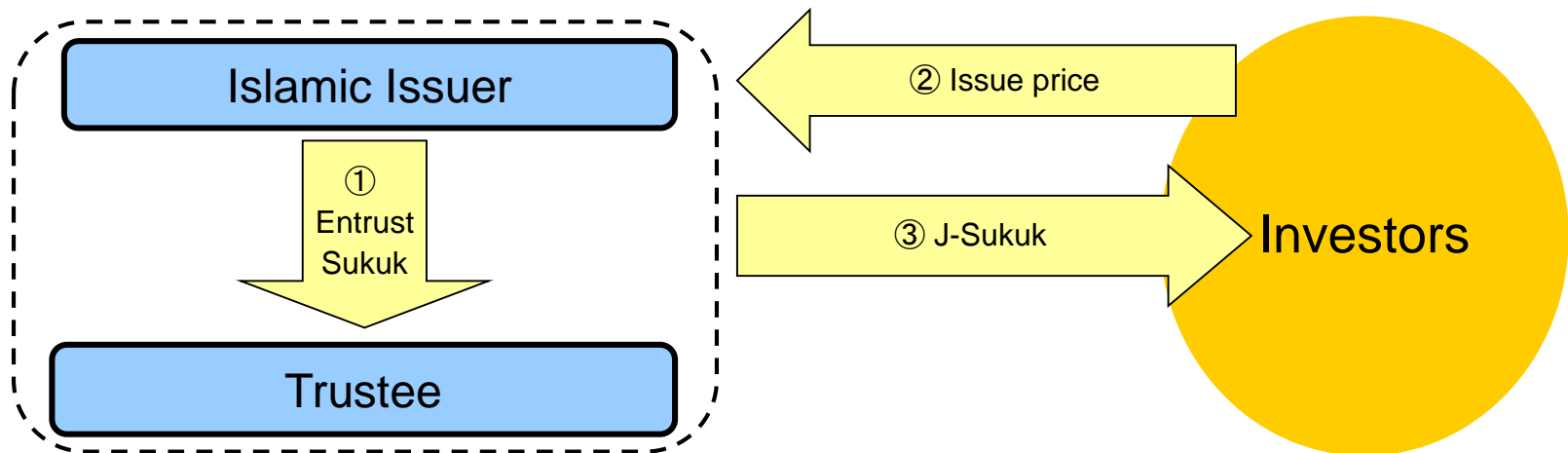


Q5 : What is a Samurai-Sukuk?

A5 : A Samurai-Sukuk is a J-Sukuk issued in Japan by a foreign government or foreign company.

- A Samurai-bond is a yen-denominated debt security issued in Japan by a foreign government or foreign company.
- One of the uses of J-Sukuk is that foreign governments or foreign companies in the Islamic world use J-Sukuk as financing measures in Japan. In this case, J-Sukuk economically have the same function as Samurai-bonds have.
- To be specific, various schemes may be taken into consideration. For example, it is considered that a foreign government or foreign company in the Islamic world would entrust its own Sukuk (originated in its jurisdiction) to the trustee of the specified purpose trust and issue J-Sukuk.

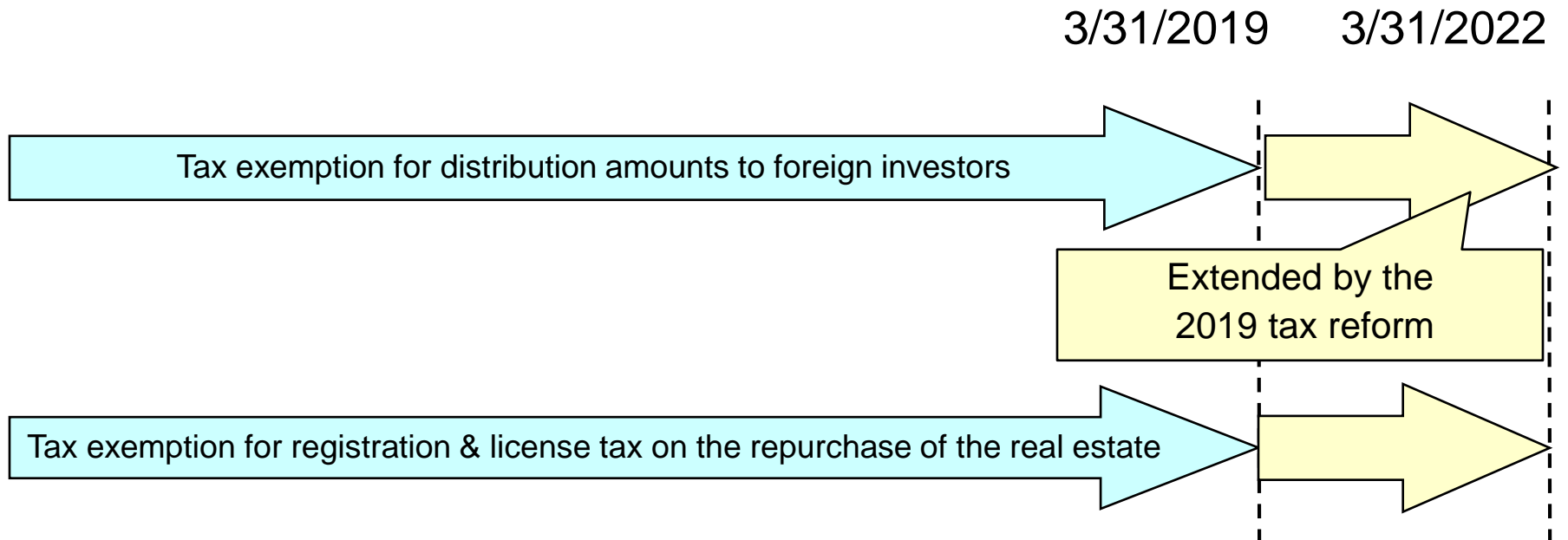
<Example of the Samurai-Sukuk>



Q6 : Is there a sun-set provision for the tax measures regarding J-Sukuk?

A6 : Yes, the tax exemption for the distribution amounts of J-Sukuk received by foreign investors and the exemption of registration & license tax on the repurchase of the real estate along with the J-Sukuk issuance scheme will expire on March 31, 2022.

- Since the above sun-set provisions are applied on an issue-date basis of J-Sukuk, if J-Sukuk are issued by the time limits, the tax exemption can be applied to the distribution amounts and repurchase of the real estate for the same J-Sukuk thereafter.
- An extension of the above time limits or a perpetuation of the tax exemptions, based on increased precedents of issuing J-Sukuk in Japan from now on, would be a touchstone of development of Islamic finance in Japan.



Q7 : How are the formalistic transfer of real estate and other similar matters along with the structuring of J-Sukuk treated under the current tax laws of Japan?

A7 : A J-Sukuk to be issued in accordance with the example of an issuance scheme in Q2 is, in principle, treated as shown below.

- The transfer of the real estate will be deemed non-existing with respect to both the issuer and the trustee under the Corporation Tax Act and Consumption Tax Act upon the entrustment and purchase-back of the real estate along with the structuring of the J-Sukuk.
- The issuance of a J-Sukuk by the issuer does not fall under the transfer of assets under the Consumption Tax Act and, therefore, is not counted in either the numerator or denominator in the calculation of the taxable sales ratio with regard to the consumption tax.

