

Client Alert

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New Rules for Listed Infrastructure Funds on the Tokyo Stock Exchange

1. Introduction

On April 30, 2015, the Tokyo Stock Exchange (the "TSE") published a new rule (the "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 and concession rights to operate public infrastructure.

The new market for Infrastructure Funds on the TSE will list securities which substantially invest in infrastructure and related facilities. Infrastructure Funds may be listed as (a) investment securities issued by investment corporations, and (b) investment trusts. The trading and settlement rules are similar to the listing rules for the existing Real Estate Investment Trusts ("REIT(s)"). There are two methods by which Infrastructure Funds may invest in infrastructure securities: (a) as a listed infrastructure fund which directly owns infrastructure facilities; or (b) by holding securities issued by such entity which directly owns infrastructure facilities.

2. Outline of the New Market for Infrastructure Funds

(1) Form of Infrastructure Funds

Similar to REITs, there are two new forms of Infrastructure Funds: (a) investment corporations which issue investment securities, and (b) investment trusts issuing beneficiary interests.

(2) Infrastructure Assets

Generally, the target assets of the Infrastructure Fund are (a) Infrastructure Assets (real / physical assets), and (b) Infrastructure Securities (securities investing in Infrastructure Assets).

"Infrastructure Assets" include the following assets:

- (a) Renewable energy power plants;
- (b) Concession rights to operate public infrastructure granted by the national or local government;
- (c) Other assets promulgated by the TSE in its rules (such as roads, airports, harbors, water supply infrastructure, sewerage systems and railways);

- (d) Land, buildings and leasehold rights pertaining to any assets set out in (a) through (c);
- (e) Fixed assets, investments and other assets for the operation of the assets set out in (a) through (c);
- (f) Finance lease receivables and lease assets set out in (a) and (c) through (e);
- (g) Leasehold rights relating to (a), (c) and (e);
- (h) Trust beneficiary interests in the underlying assets set out in (a) through (g); and
- (i) Foreign assets equivalent to the assets set out in (a) through (h).

(3) Infrastructure Securities

"Infrastructure Securities" include the following securities when solely investing in Infrastructure Assets:

- (a) Shares and stocks;
- (b) Interests in *tokumei kumiai* agreements (silent partnership agreement) ("**TK Interest**");
- (c) Preferred shares issued by a *tokutei mokuteki kaisha* (a limited company or TMK) pursuant to the Asset Securitization Act;
- (d) Beneficiary interests of investment trust;
- (e) Investment securities;
- (f) Trust beneficiary interests in specified trusts pursuant to the Asset Securitization Act; and
- (g) Foreign assets equivalent to the assets set out in (a) through (f) above.

(4) Structure of Infrastructure Funds

There are two ways in which Infrastructure Funds set up as investment corporations can be structured:

- (a) First, the investment corporation directly owns the renewable energy power plants and leases the power plant to an operator. The investment corporation receives income in the form of rent paid by the operator. This structure is contemplated by the Taxation Special Measures Act, as discussed further below (See Chart 1); and
- (b) Second, the investment corporation holds the securities (Infrastructure Securities), such as shares and TK Interests, issued by the power plant operator (See Chart 2 below).

We further discuss issues related to these structures below.

3. Conduit Treatment of investment corporations and special exceptions to the delisting rule

(1) 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. 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.

(i) Principle rule:

The ratio of assets other than renewable energy power plants and concession rights (including any TK Interests invested in these assets) 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 3(1)(i) above but only for ten (10) fiscal years ("**Exception Rule**"):

- a. The ratio of concession rights 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) Structural issues related to investment corporations

In order for an investment corporation investing in an Infrastructure Fund to qualify for Conduit Treatment under the tax law, it must satisfy the Exception Rule discussed in 3(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 investment corporation will qualify for favorable tax treatment for only ten (10) fiscal years and, after 10 years passed, it will be subject to corporate tax treatment.

(3) Special Exception for Infrastructure Funds

The TSE provides an exemption from the delisting rule for Infrastructure Funds in respect of the limitation of ten (10) years under the Taxation Special Measures Act. This exemption applies to investment corporations which own renewable energy power plants and qualify for Conduit Treatment under the Taxation Special Measures Act. In this case, the TSE will exempt such investment corporations from delisting, as long as they meet certain criteria (for example, they must prepare and disclose an asset investment plan to qualify for Conduit Treatment).

(4) Infrastructure Funds through the form of investment trust

In addition to investment corporations, the New Rule also permits Infrastructure funds to be structured as domestic or foreign investment trusts. As a practical matter, it is difficult for an investment trust (which is usually

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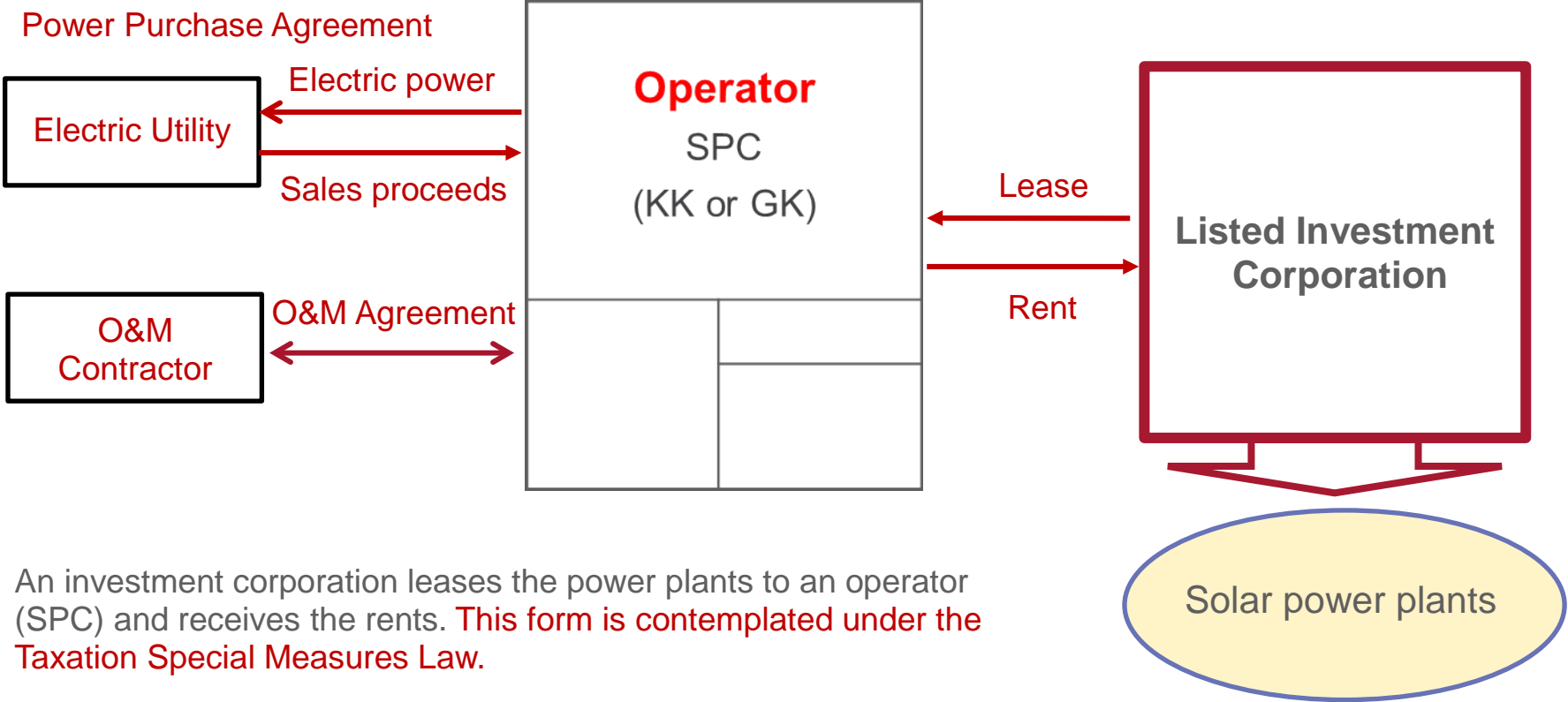
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designed to invest in securities) to directly own any physical Infrastructure Assets other than securities. Therefore, the more practical structure for an investment trust is for it to hold securities (such as shares and TK Interests) issued by an operator of power plants or any kind of infrastructure. For example, an Infrastructure Fund may be created as a Cayman investment trust which then holds the TK Interests issued by a solar power plant operator located in Japan.

Chart 1 Investment Corporation – Lease Type

Power Purchase Agreement



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

Chart 2 Investment Corporation - Indirect Investment (TK Interests)

