

Introduction

Similar to governments all over the world, the Japanese government is implementing various relief measures to alleviate the negative effect on its economy caused by the spread of COVID-19 and government state of emergency shutdown measures. Small and medium-sized businesses are increasingly requesting that the government provide for rent relief to the businesses and argue that they cannot comply with the Japanese government's request to stay home because high rent obligations, which are fixed costs, require them to keep their businesses open to generate income in order to pay rent. Clients have asked us to review the possibility for rent deferral and rent reduction under current laws and regulations and other recently implemented measures that are intended to minimize the impact on lessors of rent deferral and rent reduction.

Our review suggests that, without further government relief measures, the most pragmatic solution for lessees is to seek rent deferral and rent reduction in direct negotiations with lessors. Current government measures implemented to minimize the impact on lessors of rent deferral and rent reduction do not appear sufficient to encourage lessors to be accommodating to lessees in such negotiations. This is a developing area that is the subject of intense discussion within the Japanese government regarding potential direct rent relief measures. We will continue to monitor further developments in this area.

Please note that the purpose of this alert is to provide you with an overview of key issues of rent deferral and rent reduction under building lease agreements as of May 14, 2020 and is not intended to be a substitute for actual legal advice. As always, we stand ready to assist you and render appropriate advice based on your specific circumstances.

Rent Deferral

In principle, a lessee cannot claim rent deferral to a lessor based on the economic circumstances caused by the epidemic of COVID-19 unless there is a provision to allow for such a claim in the building lease agreement or the lessor voluntarily accepts the lessee's rent deferral request. Under the Civil Code of Japan, a debtor cannot be exempted from his/her payment obligations even for the reason of any force majeure event (Paragraph 3, Article 419 of the Civil Code).

However, Japanese law is also favorable for lessees in that a lessor is unable to cancel the building lease agreement immediately after a lessee's failure to pay the rent on the due date. According to one of the Supreme Court's cases, a lessor can cancel the building lease agreement only when the trust relationship between a lessor and a lessee is destroyed.

As such, the fact that rent payments were delayed due to unavoidable economic circumstances caused by the epidemic of COVID-19 may be considered one of the factors demonstrating that the trust relationship has not been destroyed yet. On the other hand, it is also possible that a lessor's weakened financial situation due to COVID-19 may be viewed as a factor supporting that the trust relationship has been already destroyed. Therefore, a case-by-case analysis is required for whether a trust relationship between a lessor and a lessee has been destroyed based on the lessee's failure to pay rent when due.

Rent Reduction

Commercial building lease agreements typically include provisions for rent reduction claims¹, and the Act on Land and Building Leases of Japan also sets forth provisions in connection with a rent reduction claim.² However, these provisions are applicable only when the relevant parties wish to permanently change the rent amount, which became inadequate due to a decline in the real estate value. Thus, it may be difficult to make a rent reduction claim based on these provisions when the parties only intend to temporarily reduce the rent amount for a certain period, such as the period during which a state of emergency is declared due to the spread of COVID-19, unless the real estate value had already declined prior to the COVID-19 crisis³.

Paragraph 1, Article 611 of the Civil Code of Japan provides that "If any part of a leased property has become impossible to use due to loss or other reasons not attributable to the negligence of the lessee, the rent amount will be reduced in proportion to the value of the unusable part."

1 The typical provision related to a rent reduction claim is as follows: "In the event that the rent amount becomes improper due to fluctuations in prices or land/building prices, changes in taxes and public dues, or fluctuations in rents for similar buildings in the vicinity, the rent amount may be modified after consultation between the lessor and the lessee."

2 Article 32 of the Act on Land and Building Leases provides that "In the event that the amount of the building rent becomes unreasonable as a result of an increase or decrease in tax and other burdens relating to the land or the buildings, the rise or fall of the land or building price, or fluctuations in other economic circumstances, or in comparison to the rents for similar buildings in the vicinity, the parties may, notwithstanding the contract conditions, request to increase or decrease the future amount of the building rent."

Please check whether your building lease agreement is a "fixed-term building lease" as set forth in Article 38 of the Act on Land and Building Leases because the right to request an increase or decrease in the rent amount may be excluded in a fixed-term building lease agreement.

3 Please note that when a court when it determines an adequate rent amount it may find that the real estate value has already declined during the early stage of the COVID-19 pandemic. In addition, the court may take the following factors into account to determine the adequate rent amount: the economic value of the real estate, current economic conditions, market prices for the rent of neighboring buildings, the parties' personal circumstances, including attributes of the parties, scale of the business, usage or character of the rented building, history of negotiations, and the parties' intentions at the time of entering into the lease agreement, and various circumstances after the execution of the lease agreement. Depending on the foregoing factors, the court may allow a rent reduction even if the market rent prices for neighboring buildings have not fallen.

However, it is unlikely that a lessee's closure of stores or offices due to COVID-19 pandemic will be deemed a leased property became "impossible to use," since the Act on Special Measures for Novel Influenza, etc. (hereinafter, the "Special Measures Law") (Paragraph 1, Article 45 of the Special Measures Law) under which the Japanese government requested people to stay home for a certain period due to COVID-19 pandemic excluded from its scope people who need to go outside of their homes to make a living, such as for attendance of their workplace⁴. In other words, under the Special Measures Law, a lessee's closure of stores or offices would be likely to be deemed to be a voluntary act of the lessee rather than an act caused by the stores or offices becoming "impossible to use."

However, if a lessor makes a decision to close the building, which makes the building unavailable for lessees, or a local government makes a request to restrict or halt the use of the facilities⁵ (Paragraph 2, Article 45 of the Special Measures Law⁶), then the lessee's closure of stores or offices due to COVID-19 pandemic may be deemed a part of a leased property that has become "impossible to use." That said, it is uncertain whether a court would agree with the foregoing analysis.

In light of the foregoing, the most pragmatic way for a lessee to seek rent relief would be to attempt to negotiate directly with a lessor for an immediate and temporary reduction of the rent for the period during which the impact of COVID-19 is expected to be significant.

The Japanese Government's Measures to Minimize the Impact of Rent Deferral and Rent Reduction to Lessors

As of the date hereof, the Japanese government has announced the following measures to minimize the impact of rent deferral and rent reduction:

- Request to lessors for their voluntary rent deferral⁷

On March 31, 2020, the Ministry of Land, Infrastructure and Transport made an announcement that asked lessors to voluntarily accept rent deferral claims from lessees who face a difficulty in paying rent due to the economic circumstances caused by COVID-19, such as restaurants. As this is only an announcement that is not legally binding, compliance is entirely voluntary, and a lessor has no obligation to accept a lessee's request for rent deferral.

- Deferral of national tax, local tax and social insurance for one (1) year

If the following conditions are met, then a taxpayer (including a lessor) can apply for deferral of national tax⁸ (including income tax, corporate tax and consumption tax), local tax⁹ (including individual resident tax, two local corporation taxes and property tax) and social insurance¹⁰ (including welfare pension insurance premiums) for one (1) year:

- i. Income has decreased by approximately 20% or more in a given period (e.g., a month or more) from February 1, 2020 to January 31, 2021 compared to the same period of the previous year; and
- ii. It is difficult to pay all the national tax, local tax and social insurance at once.

- Rent reduction to be tax-deductible¹¹

If a lessor agrees to a rent reduction (excluding rent deferral), the reduced amount is usually treated as a "donation" for the purpose of calculating corporate tax and cannot be included as a part of a tax deduction. However, the National Tax Agency of Japan announced on April 30, 2020 that the amount of a rent reduction can be tax deductible if the following requirements are satisfied:

- i. Business partners are having difficulty in continuing their businesses due to a decline in income triggered by the COVID-19 crisis or it has become obvious that the business partners will have such difficulty;
- ii. The rent reduction is for the purpose of supporting the recovery of business partners, such as continuation of their businesses and employment security, and the agreement regarding rent reduction can be confirmed in writing; and
- iii. The rent reduction is implemented within a considerable period (i.e. the recovery period to resume ordinary business activities) after damage has been incurred by the business partners due to COVID-19.

4 "Guidelines for measures against new influenza" (June 26, 2013) p. 74 https://www.cas.go.jp/seisaku/fuj/keikaku/pdf/h300621gl_guideline.pdf (Japanese only)

5 The examples of the facilities are theaters, meeting venues, exhibition halls, exercise facilities, and night clubs.

6 "Facilities that are particularly required to make a request under the provisions of Paragraph 2, Article 45 of the Act on Special Measures for Novel Influenza, etc. to prevent the spread of COVID-19 (enforcement notice)" ("Ken-Hatsu" 0407 No. 7, the Ministry of Health, Labor and Welfare) dated April 7, 2020 <https://www.mhlw.go.jp/content/000620109.pdf> (Japanese only)

7 "Re: How to deal with COVID-19 (request)" (Notice No. 149, the Ministry of Land, Infrastructure and Transport) dated March 31, 2020 <https://www.mlit.go.jp/common/001340555.pdf> (Japanese only)

8 "Special system for tax payment deferral" (the Ministry of Finance) https://www.mof.go.jp/tax_policy/brochure1.pdf (Japanese only)

9 "About publicity regarding tax measures (draft) in emergency economic measures for new coronavirus infection" (Ministry of Internal Affairs and Communications) dated April 7, 2020 https://www.soumu.go.jp/main_content/000681330.pdf (Japanese only)

10 "Special system for the payment deferral of welfare pension insurance premiums" (the Ministry of Health, Labor and Welfare) <https://www.mhlw.go.jp/content/12500000/000626844.pdf> (Japanese only)

11 "Tax Handling FAQ with regard to how to deal with the prevention of the spread of new coronavirus infectious disease in national tax, and with regard to the filing and tax payment" (National Tax Agency) p.29 <https://www.nta.go.jp/taxes/shiraberu/kansensho/pdf/faq.pdf> (Japanese only)

In addition to the foregoing measures provided by the Japanese government, some local governments in Japan also implemented their own measures to minimize the impact on a lessor of rent deferral and rent reduction. For instance, Kobe City will provide a lessor with a subsidy, which amounts to 80% of the amount of the rent reduction, if the lessor has reduced the rent to less than half of the original rent amount¹².

Potential direct rent relief measures are still under discussion within the Japanese government. If you have any questions about a particular lease, would like an update or have any other legal question or issue in connection with COVID-19, our experienced team stands ready to assist.

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¹² "Reduction of rent burden on small and medium-sized enterprises" (Kobe City) <https://www.city.kobe.lg.jp/a31812/yachin.html> (Japanese only)