

Lease Agreement (From the Standpoint of the Lessor) - I

Due to the spread of COVID-19, tenants have demanded that rents be suspended, reduced or exempted due to a sharp decline in business sales. Is the owner obligated to respond to such requests from tenants?

The owner has no obligation to accept any request for payment deferral, reduction or exemption of rents. However, please refer to the Q&A (to be discussed later) as appropriate.

Japan's Ministry of Land, Infrastructure, Transport and Tourism (MLIT) has requested, through real estate-related organizations, that companies operating real estate rental businesses consider flexible measures considering the current situation, such as granting a grace period for payment of rent to tenants who have difficulty paying due to the effects of COVID-19. It should be noted that such request is not legally binding, and it is up to the owner to decide whether to accept the request for payment deferral, reduction or exemption of the rent.

Please feel free to contact us for more specific details.

[Reference]

“Measures Against Novel Coronavirus Disease (Request)” by the Ministry of Land, Infrastructure, Transport and Tourism
<http://www.mlit.go.jp/report/press/content/001339166.pdf>
(Japanese)

Lease Agreement (From the Standpoint of the Lessor) – II

Even if a tenant voluntarily refrains from operating its business due to the spread of coronavirus, is the owner obliged to accept any request for payment deferral, reduction or exemption of rents?

If the tenant voluntarily refrains from operating its business when business operation is permissible, the owner will not be obliged to accept any request for payment deferral, reduction or exemption of rents.

Lease Agreement (From the Standpoint of the Lessor) – III

When a tenant receives a request or instruction from a prefectural governor to suspend the use of a facility based on the Act on Special Measures for Pandemic Influenza and New Infectious Diseases Preparedness and Response, is the owner obliged to respond to the tenant's request for payment deferral, reduction or exemption of rent?

If a prefectural governor requests or gives an instruction to suspend the use of a facility under the Act on Special Measures for Pandemic Influenza and New Infectious Diseases Preparedness and Response, the owner may be ordered to reduce the amount of rent in proportion to the degree to which it no longer makes use of and profit from the facility, as a result of circumstances for which the tenant could not be held responsible. (Article 611, Paragraph 1 of the Revised Civil Code applies to lease agreements entered into or renewed on or after April 1, 2020, and there is a possibility that the amount of rent will be reduced as a matter of course in proportion to the extent that use of the facility has become unprofitable.).

The final determination will depend on each case; therefore, we need to consider how to handle such issues considering the possibility of the rent reduction being granted.

Please contact us for more specific details.

Lease Agreement (From the Standpoint of the Lessor) – IV

In response to requests by tenants, we are considering payment deferral, reduction, or exemption of rents. Can we receive some kind of support from the government if we agree to the payment deferral, reduction or exemption of rent?

When rent is reduced or exempted for tenants whose sales have decreased due to the spread of COVID-19, the amount equivalent to the reduced or exempted rent can be recognized as deductible expenses for tax purposes.

If there is no attributable reason for a rent reduction or exemption, filing such as a deductible expense may be denied as it would be considered a donation. However, the following

conditions are clearly stipulated as examples of cases that do not fall under the category of donations:

- (i) The tenant's income has decreased, and it has become or is clearly likely to become difficult for the tenant to continue its business as a result of COVID-19;
- (ii) Reduction of rents to be implemented is intended to support the recovery of tenants (such as continuing business and securing employment), and this can be confirmed by documentation, etc.; and
- (iii) Reduction of rents must have been carried out within a reasonable period after the tenant suffered damages (the period of time during which normal business activities are being resumed in the recovery process).

[Reference]

“Measures Against Novel Coronavirus Disease (Supplement)” by the Ministry of Land, Infrastructure, Transport and Tourism

<https://www.mlit.go.jp/totikensangyo/const/content/001340447.pdf> (Japanese)

“Clarification of the Tax Treatment of Losses in the Case of Exemption of Rent from the Tenant” *by the Ministry of Land, Infrastructure, Transport and Tourism

<https://www.mlit.go.jp/common/001340572.pdf> (Japanese)

“Measures Against Novel Coronavirus Disease (Supplement II)” by the Ministry of Land, Infrastructure, Transport and Tourism

<https://www.mlit.go.jp/common/001342992.pdf> (Japanese)

“Frequently Asked Questions: Measures to Prevent the Spread of Novel Coronavirus Disease in Relation to National Tax and Current Tax Treatment on Filing of Tax Returns and Payment of Taxes” by National Tax Agency

<https://www.nta.go.jp/taxes/shiraberu/kansensho/pdf/faq.pdf> (Japanese)

Lease Agreement (From the Standpoint of the Lessor) – V

After discussion with the tenant, we agreed to reduce the rent. What important related points should we consider?

In order to prevent disputes, it is necessary to clarify in writing, the amount of rent to be reduced, the period during which the rent would be reduced, and how to treat the rent after the period has elapsed, etc.

To avoid any risk of having the rent reduction denied as a deductible expense and considered a donation, it is necessary to have the tenant submit materials showing that sales have declined due to the spread of COVID-19, and to clearly state in writing that the rent reduction is to support the tenant’s recovery.

Lease Agreement (From the Standpoint of the Lessor) – VI

I have heard that if sales decrease, property tax and town planning tax will be reduced or exempted. Will property tax and town planning tax be reduced or exempted even if I agree to the payment deferral, reduction or exemption of rent?

If you grant a payment deferral, reduction or exemption of rent, it will be treated as a reduction of income for the business, and the fixed asset tax and town planning tax will be reduced or exempted (subject to the enactment of relevant laws and regulations).

Specifically, if revenues from any 3 consecutive months of business from February to October 2020 decrease by 30% or more, but less than 50%, from that of the same period of the previous year, the property tax will be halved (reduced by 50%), and if revenues decrease by 50% or more, the property tax will be fully exempted.

[Reference]

“Measures Against Novel Coronavirus Disease (Supplement II)” by the Ministry of Land, Infrastructure, Transport and Tourism

<https://www.mlit.go.jp/common/001342992.pdf> (Japanese)

Lease Agreement (From the Standpoint of the Lessor) – VII

The spread of COVID-19 has prevented tenants from paying rent on time. In such a case, is it possible to terminate the lease agreement?

If the lessee fails to pay the rent, the lessor may generally terminate the lease agreement.

However, if the cancellation is due to the nonpayment of rent, you have to show that the relationship of trust between you, as the lessor, and the tenant, as the lessee, no longer exists.

If the non-payment of the rent is considered temporary due to COVID-19, the non-payment or delay in paying the rent may not be considered as a complete breakdown of the relationship of trust.

Lease Agreement (From the Standpoint of the Lessor) – VIII

Tenants, whose sales have declined due to the spread of COVID-19, are demanding that deposits be used for the payment of their rent. Does a lessor have an obligation to accept such a request from tenants?

As the security deposit guarantees a lessee's monetary obligation to the lessor, the owner has no obligation to apply the security deposit to the payment of the rent.

Lease Agreement (From the Standpoint of the Lessor) – IX

In response to a request from a tenant, we are considering applying their security deposit to the payment of rent. Is it possible to do so during the term of the lease? What should we be mindful about when we take this measure?

Under Japanese law, the lessor may apply the security deposit to the payment of the rent even during the lease term (Judgment of Daishin-in (former Supreme Court) on March 10, 1930; Minshu (Supreme Court Civil Case Reports) Vol. 9, p. 253).

If the security deposit is applied to the payment of rent, the non-payment of the rent by the lessee will be temporarily canceled by such application. Therefore, it is necessary to keep in mind that, if the non-payment of the rent continues thereafter, if the time comes for lease termination due to the non-payment of the rent, it is possible that such termination will be delayed accordingly.

In addition, if the security deposit is applied to the

payment of rent, the security deposit to secure the obligations of the tenant will be reduced accordingly. It is necessary to confirm whether there is a provision that allows the lessee to request an addition of a reduced security deposit in the lease agreement, and if there is no such provision, it is necessary to separately consider drawing up an agreement that allows the lessee to request an addition to the security deposit.

Lease Agreement (From the Standpoint of the Lessor) – X

A tenant has asked for a partial refund of the security deposit. Does a lessor have an obligation to accept such request? Also, if we decide to do so, what issues should we consider?

Since the right to claim a refund of the security deposit arises when the lessee vacates the building, the owner has no obligation to comply with the claim for the refunding of the security deposit during the lease term.

However, it is possible to return part of the security deposit, at the lessor's discretion, and in such a case, the parties will consider measures against the decrease in the security deposit, such as stipulating in a written agreement that the tenant shall pay an additional amount toward the reduced security deposit.

Lease Agreement (From the Standpoint of the Lessor) – XI

With the spread of COVID-19, can an entire building be closed at the owner's discretion regardless of the tenants' wishes?

If the entire building were to be closed at the discretion of the owner, it would constitute a breach of the lease agreement by the lessor, which may result in the lessor being liable to compensate the lessees for damages. In addition, in the case where the use of the premises can no longer generate operating revenues due to reasons not attributable to tenants, the owner may be requested to reduce the amount of rent in proportion to the extent that use of the premises has become unprofitable (Article 611, Paragraph 1 of the Revised Civil Code applies to lease agreements entered into or renewed on or after April 1, 2020, and there is a possibility that the amount of rent will be reduced as a matter of course in proportion to the extent that use of the premises has become unprofitable.)

In the event that the entire building is to be closed, it is necessary to consult with the tenants and agree in advance on the amount of rent, etc., while the building is closed.

Lease Agreement (From the Standpoint of the Lessor) - XII

The tenant requested that the rent be reduced in accordance with Article 32 of the Act on Land and Building Leases due to a decline in sales. Is the decrease in the tenant's sales a justifiable reason for reduction of rent?

The decrease in a tenant's sales due to the spread of COVID-19 will neither be an objective change in circumstances nor a change in circumstances between the parties, and therefore, could not be considered a justifiable reason for reduction of rent under such statute.

However, a decline in land prices or fluctuations in economic conditions resulting from the spread of COVID-19 may provide a basis for reduction of rent.

Lease Agreement (From the Standpoint of the Lessor) - XIII

The tenant informed me that they were considering filing for bankruptcy. What should we do as the owner?

In the event that a tenant becomes bankrupt, claims that occur after the commencement of the bankruptcy order may be considered as claims on the estate. This means that claims on the estate shall be paid in preference to bankruptcy claims.

However, claims that occur before the commencement of the bankruptcy order may become bankruptcy claims and may be difficult to collect.

For this reason, if there is a real possibility of the tenant going bankrupt, a measure may be taken to exempt the tenant from rent for a certain period and to record the amount as deductible expenses.

Lease Agreement (From the Standpoint of the Lessor) - XIV

How can we keep up-to-date regarding the latest trends in the real estate industry in response to the spread of COVID-19?

We regularly update such information on our homepage. For more information, please contact us directly.

Please refer to the following link for information on lease contracts announced by public agencies due to the spread of COVID-19.

https://www.mlit.go.jp/totikensangyo/const/sosei_const_tk3_00166.html (Japanese)

Lease Agreement (From the Standpoint of the Lessee) - I

As a result of the spread of COVID-19, sales declined substantially, making it difficult to pay rent. Are there any grounds for asking the owner for a reduction, exemption or payment deferral of the rent?

Firstly, please confirm if there are any provisions concerning the reduction of rent, etc., in your lease agreement. Generally, there are many lease agreements which provide for rent increases or decreases, and this will be the first step for tenants to consider regarding whether they can request a reduction of rent or seek consultation with the lessor pursuant to such provisions.

If no such provisions are stipulated in the lease agreement, then consideration will be given to whether it is possible under the relevant laws to request the owner for a reduction, exemption, or payment deferral of the rent. However, there is no legal basis for requesting the owner to reduce, exempt, or defer the rent solely on the basis of a decrease in sales, and the owner has no obligation to accept such request.

Even though there might not be a legal obligation, as of March 31, 2020, the Ministry of Land, Infrastructure, Transport and Tourism (MLIT), through real estate-related organizations, has made a request to business operators that lease real estate to tenants, including commercial tenants, to consider flexible measures, such as allowing tenants who have difficulty in paying rent due to the effects of COVID-19 to postpone the payment of such rent. However, such requests are not legally enforceable, and it is up to the owner to accept any reduction, exemption or deferral of payment of the rent.

The outcome is likely to be the same even if the tenant voluntarily refrains from operating without receiving a request or instruction to suspend the use of the facility from the prefectural governor pursuant to the Act on Special Measures for Pandemic Influenza and New Infectious Diseases Preparedness and Response.

[Reference]

“Measures Against Novel Coronavirus Disease (Request)” by the Ministry of Land, Infrastructure, Transport and Tourism
<http://www.mlit.go.jp/report/press/content/001339166.pdf>
(Japanese)

Lease Agreement (From the Standpoint of the Lessee)

- II

Are there any grounds for requesting the owner to reduce, exempt or defer payment of the rent when the prefectural governor requests or instructs a tenant to suspend the use of the facilities pursuant to the Act on Special Measures for Pandemic Influenza and New Infectious Diseases Preparedness and Response?

If the request or instruction has come from the prefectural governor to suspend use of a facility under the Act on Special Measures for Pandemic Influenza and New Infectious Diseases Preparedness and Response, there is a possibility that the tenant may claim a reduction of rent in proportion to the extent that use of the premises has become unprofitable for reasons not attributable to the tenant (Article 611, Paragraph 1 of the Revised Civil Code applies to lease agreements entered into or renewed on or after April 1, 2020, and there is a possibility that the amount of rent will be reduced as a matter of course in proportion to the extent that use of the premises has become unprofitable).

Please consult with us directly for more specific advice.

Lease Agreement (From the Standpoint of the Lessee)

- III

Is it possible to request the owner to reduce the rent based on Article 32 of the Act of Land and Building Leases due to the spread of COVID-19, and the decrease in sales and our customer base due to the travel constraints imposed by the declaration of a state of emergency?

Article 32 of the Act on Land and Building Leases has a provision regarding requests from tenants for a reduction of rent. Even if there is a provision in the lease agreement to the effect that the rent shall not be reduced during the term of the lease, it is understood that the exercise of the right to claim a reduction of rent under Article 32 of the shall not be prevented.

However, we believe that it would be difficult to successfully file a claim for a reduction of rent under Article 32 of the Act based on the spread of COVID-19, or the decrease in sales and customer base caused by travel constraints imposed by a declaration of a state of emergency by the Japanese government.

This is because, a claim for a reduction of rent under Article 32 of the Act may be made only when the rent becomes unreasonable due to the increase or decrease in tax and other burden relating to the land or the buildings, as a result of the rise or fall of land or building prices or fluctuations in other economic circumstances, or in comparison to the rents on similar buildings in the vicinity, or a change in circumstances between the parties.

The decrease in a tenant’s sales represents neither change in the above economic circumstances nor a change in circumstances between the parties. Furthermore, the spread of COVID-19 has not immediately caused a decline in real estate prices, and therefore, it would be difficult for tenants to seek a reduction of rent under Article 32 of the Act.

However, if such circumstances continue, leading to a situation where economic conditions, including price indexes and national incomes, have fluctuated and real estate prices have fallen, there may be a possibility that such circumstances will provide a basis for reduction of rent.

Lease Agreement (From the Standpoint of the Lessee)

- IV

We were told by the lessor that we would be prohibited from operating our business in the premises because the entire building will be closed. In such case, can we have the rent reduced or exempted?

If the entire building is closed at the owner’s discretion, the owner would be in violation of its obligation to make a rental property profitable and may be liable for damages incurred by

the tenants. However, if the building is closed in response to requests from prefectural governors for restrictions on the use of the facility, etc., in connection with the issuance of a declaration of a state of emergency, a claim for compensation for damages against the owner will not be successful, since the building would not be closed for reasons attributable to the owner. If the owner has informed you that the building will be closed, you should thoroughly discuss and negotiate with the owner how to handle the rent in the future.

Furthermore, in the case where the use of the premises can no longer generate operating revenues due to reasons not attributable to tenants, the tenant may claim a reduction of rent in proportion to the extent that use of the premises has become unprofitable (Article 611, Paragraph 1 of the Revised Civil Code applies to lease agreements entered into or renewed on or after April 1, 2020, and there is a possibility that the amount of rent will be reduced as a matter of course in proportion to the extent that use of the premises has become unprofitable).

Lease Agreement (From the Standpoint of the Lessee) - V

Are there any benefits or loan programs available to tenants to offset the financial burden of paying rent?

The below links outline the amounts tenants may be eligible for regarding rent assistance benefits.

[Reference]

“System to Support Payment of Rent for Tenants” by the Ministry of Health, Labour and Welfare

https://www.meti.go.jp/covid-19/pdf/yachin_shien.pdf

(Japanese)

<https://www.meti.go.jp/covid-19/yachin-kyufu/index.html>

(Japanese)

Lease Agreement (From the Standpoint of the Lessee) - VI

Due to the effects of COVID-19, my income has decreased and paying the rent has become a heavy financial burden. May I request the owner to apply my security deposit to unpaid rent?

As a lessee, you may not demand that the security deposit be applied to the payment of rent, since the security deposit is to secure your monetary obligations to the lessor.

The lessor may apply the security deposit to the unpaid rent; however, this is at the discretion of the owner. It is necessary to discuss with the owner regarding the payment deferral, reduction or exemption of the rent, including the application of the security deposit to the rent.

Lease Agreement (From the Standpoint of the Lessee) - VII

I spoke with the owner and asked to apply my security deposit to the unpaid rent. Am I required to repay the amount applied to such rent in the future?

Even if the lessor applies a part of the security deposit to the unpaid rent during the term of the lease agreement, it is not automatically permitted for the lessor to request the lessee to repay such portion of the security deposit so applied.

Where the security deposit is applied to the unpaid rent during the term of the agreement, it is necessary to confirm that the lessee can request additional payment of the deposit and that the payment method and details are clearly stated.

Furthermore, in the event of such application, it may be required to prepare a written agreement regarding the addition of a security deposit, even if there is no provision for such addition.

Lease Agreement (From the Standpoint of the Lessee) - VIII

I spoke with the owner and they agreed to reduce the rent. What additional issues should I consider?

In order to avoid any disputes, it is highly beneficial to clearly define in writing the amount of rent to be reduced, the period of reduction, and the treatment of the rent after the lapse of such period.

In addition, there may be a provision in the lease agreement stating that if any new agreement which differs in terms and conditions from those set out in the original lease agreement is entered into, it will not become effective unless agreed upon in

writing, in which case the foregoing point must be agreed in writing.

Lease Agreement (From the Standpoint of the Lessee) – IX

The spread of COVID-19 has reduced our sales and thus made it difficult to pay the rent. If we do not pay the rent, will our lease agreement be terminated?

In some cases, the owner may terminate the lease agreement due to the non-payment of rent by the tenant.

However, if the non-payment of rent has not resulted in the total breakdown of the relationship of trust between the owner and tenant, it would not be permitted to terminate the lease agreement. We recommend that you take a sincere attitude, such as continuously paying a partial amount of the rent by the due date, while also explaining to the owner the circumstances and the difficulty in paying, so as not to damage the relationship of trust.

In determining whether a relationship of trust has been entirely diminished, the period and total amount of non-payment is generally considered important. However, the fact that the non-payment is temporary due to the Coronavirus pandemic may be considered a circumstance that has not led to the breakdown of the relationship of trust.

In this regard, the Civil Affairs Bureau of the Ministry of Justice has stated that, although the decision will be made on a case-by-case basis in the end, the non-payment of rent for about 3 months due to the effects of COVID-19 would not entirely diminish the relationship of trust based on the circumstances before and after the non-payment, and it is believed that termination of the lease agreement (request for eviction) would not be accepted in many cases.

[Reference]

“System to Support Payment of Rent for Tenants” by the Ministry of Health, Labour and Welfare

https://www.meti.go.jp/covid-19/pdf/yachin_shien.pdf

(Japanese)

Lease Agreement (From the Standpoint of the Lessee) – X

As a result of the spread of COVID-19, the sales of the building's tenants have declined, making it unprofitable for our business, so we wish to vacate the building as soon as possible. By when should our business inform the owner that we are leaving?

In the case of a fixed-term lease, the lease may not be terminated during such term unless the same is agreed with the owner. However, if the building lease agreement states that it may be terminated during the term, then the termination may be made in accordance with such provisions (if there is no provision regarding the period from the request to the effective date of termination, the period would be 3 months).

In the case of a building lease agreement without a fixed term, the lease would be considered as having terminated when 3 months have passed since the request to terminate the lease was made.

Lease Agreement (From the Standpoint of the Lessee) – XI

Is it possible for the lessee to be exempted from the obligation of restoring the premises to its original state when the lease is terminated and not renewed?

There is no legal basis for requesting that an owner exempt the tenant from its obligation to restore the premises to its original state, and it is up to the owner's discretion.

It is probably quite feasible to say that a tenant will be exempted from the obligation of restoring the premises to its original state if the owner assumes the fixtures and furnishings to be included. In addition, it might be possible to negotiate to cover the cost of restoration within the amount of the security deposit, thus exempting the cost of restoration. We recommend that you discuss this question thoroughly with the owner.

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