

# Is this the end of the Japanese leasing?

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01/12/2004

The country's National Tax Agency has launched an attack on tax leases potentially threatens both domestic Japanese leveraged leases (JLL) and Japanese operating leases (JOL).

The move is partly in response to a court decision in October, which went against the agency's Nagoya office. The case involved a dispute with Nomura Babcock & Brown. Lawyers say the National Tax Agency had attempted to fine the arranger for selling JOL equity to individual investors. The agency claimed that only corporates could invest in JOLs. The court, however, ruled that there was nothing in the law that stated retail investors should be barred from JOL investments.

One month after losing the case, the agency shocked lease arrangers by proposing reforms for leases involving both institutional and individual investors.

"One month is very quick by the National Tax Agency's standards," says one banker.

One proposal the NTA has suggested is reducing the amount of benefit investors can claim to reflect the amount they invest. This would mean that investors could only save tax on the lease equity they invest (typically 25% of the aircraft's value) and not on the overall deal value.

The proposal would significantly reduce the benefit of investing in leases, making many deals unattractive to investors.

Whether such proposals would kill off the JOL and JLL completely is hard to assess. As one banker notes, this depends on what other investment alternatives Japanese investors have. "There would still be some benefit available in lease investments. At the moment, there aren't that many good investment opportunities available to Japanese investors, so some level of JOL or JLL activity could still continue," says the banker.

For the agency's proposals to become law, the organization first needs to get the ruling party, Japan's Liberal Democratic Party tax commission, to include the proposals in its budget recommendations for the next fiscal year. Although the party and the Japanese government are legally separate, lawyers say that whatever the Liberal Democratic Party recommends will be included in the government budget.

However, lease arrangers are not giving up and a lot of lobbying is taking place in Tokyo with Japanese leasing companies, other financial institutions, and the two Japanese major carriers involved. Lease market players are hopeful that this lobbying could reduce the effect of new legislation.

But despite this optimism even the most experienced Japanese leasing professionals are unsure of the outcome. Arrangers are speculating over a wide range of possible reforms including new legislation, which would make it a requirement that Japanese equity investors take real asset risk in onshore leases – this would effectively mean that JLLs would need to change into a product similar to offshore JOLs.

Other participants believe that the new style (post 1999) JOL structure that is now available to foreign airlines will disappear. "The government may decide that only Japanese airlines should be able to enjoy the tax benefit of a Japanese lease," says a banker. "It's worth noting that the government has been under pressure for several years to reform the Japanese Bank for International Cooperation's overseas loan programs which are also deemed to be over-generous to foreign entities," he adds.

Another arranger believes a clampdown could occur in the individual investor market alone. "This is logical, after all, the court case arose in this particular corner of the market," says the financier. The individual investor sector forms only a very small percentage of the overall Japanese lease market and would not have a significant impact on total JOL and JLL volumes. Indeed, during the last two years, Nomura Babcock & Brown has been one of the few arrangers to sell equity into the retail market.

"What the end result will be is very difficult to predict," concludes a foreign observer. "But what is clear is that at least some reform will occur. The tax agency's attack has been so strong that it is very hard to imagine it will be ignored."

Arrangers also believe that Japanese lawmakers will agree to grandfather transactions, which close before revisions to the law are introduced. The situation should be clearer in mid-December when the Liberal Democrat's tax commission announces its budget proposals.

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