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Notice Regarding Reassessment Receipt of Written Notice from the Kantoshinetsu Regional Taxation Bureau and Revision of Earnings Forecasts

KATITAS Co., Ltd. (the “Company”) hereby provides notice that it has been subject to a tax inspection by the Kantoshinetsu Regional Taxation Bureau (the “Regional Taxation Bureau”) since August 2019, and that today it received a Written Notice of Reassessment of Consumption Tax and Local Consumption Tax and a Written Notice of Assessment and Determination Regarding Additional Tax (the “Reassessment Penalty, etc.”).

In accordance with the receipt of the Reassessment Penalty, etc., the Company hereby provides notice that it has decided to take action set forth below that includes recording consumption tax, etc. difference of ¥2,014 million as extraordinary losses in its financial results for the fiscal year ended March 31, 2020.

In accordance with recording this extraordinary losses, etc., the Company also advises that the consolidated earnings forecasts announced on May 10, 2019 have been revised as follows.

In addition, the Company’s accounting and tax treatment that were subject to recent guidance from the Regional Taxation Bureau have been carried out without special guidance from the Regional Taxation Bureau in recent tax inspections conducted in October 2007, October 2011, and November 2015, and the Company plans to continue with its existing accounting and tax treatment.

Since the Company is completely unable to agree with the Reassessment Penalty, etc. from the Regional Taxation Bureau, it intends to promptly undertake the necessary procedures, such as filing an appeal.

1. Circumstances and details regarding the Reassessment Penalty, etc.

Since August 2019, the Company has been subject to a tax inspection by the Regional Taxation Bureau covering the period from the fiscal year ended March 31, 2016 to the fiscal year ended March 31, 2019. As a result of the inspection, the Regional Taxation Bureau claimed that in the following method used by the Company for calculating consumption tax amounts, the separation of the amount of consideration for transfer of the taxable asset and the amount of consideration for transfer of the non-taxable asset corresponds to a “case where the value is not rationally separated” under Article 45, paragraph 3 of the Order for Enforcement of the Consumption Tax Act, and the Reassessment Penalty, etc. was carried out.

(1) Method adopted by the Company for calculating the amount of consumption tax

The Company concluded sales agreements with buyers that covered the land and buildings together. The

Company calculated the amount of consumption tax applicable to the buildings by multiplying the total amount of the sale payment by a past-data-based ratio calculated by multiplying the consumption tax rate by the average value of the proportion of the assessed value of fixed assets tax for the building within the total amount of the assessed value of fixed assets tax for the land and buildings of properties traded in the past (the “Company’s Proportional Division Method”).

The Company had adopted the Company’s Proportional Division Method mainly because it deemed this approach to be a rational method for separating the land and building portions based on the method of “proportional division based on the assessed value of inheritance tax and the assessed value of fixed assets tax” for transfer payments in the National Tax Agency Tax Answer “No. 6301 Tax Base Q&A: Building payment in the case where buildings and land are transferred together.”

(2) Reason for the Reassessment Penalty, etc. from the Regional Taxation Bureau

The Regional Taxation Bureau claims that “the amount of the transfer consideration of the taxable asset and the amount of the transfer consideration for the non-taxable asset” are “not rationally separated” in the Company’s accounting and tax treatment for the following reasons.

- i. It is not rational to calculate the amount corresponding to the consumption tax amount using a uniform ratio to the total sale amount.
- ii. When the uniform ratio used by the Company is applied, the price of buildings that have added value from renovations is not reflected.

(3) Location of the problem

In principle, the amount that the Consumption Tax Act treats as the tax base is the amount of consideration that passes between the parties involved in the transfer, etc., of a taxable asset. Where a taxable asset and a non-taxable asset are transferred together, the amount of consideration for transfer of the taxable asset and the amount of consideration for transfer of the non-taxable asset need to be rationally separated. If they are not separated rationally, the tax base for consumption tax pertaining to the transfer, etc. of the taxable asset is an exceptional provision (Article 45, paragraph 3 of the Order for Enforcement of the Consumption Tax Act) of multiplying the amount of consideration for transfer of the assets by the ratio of the value of the taxable asset to the total amount of the value of the taxable asset and the value of the non-taxable asset at the time of their transfer.

The issue lay in a difference of interpretation between the Company and the Regional Taxation Bureau as to whether or not the Company’s Proportional Division Method corresponds to a “case where the value is not rationally separated” under Article 45, paragraph 3 of the Order for Enforcement of the Consumption Tax Act.

(4) Summary of the Company’s main assertions

- i. The Company’s Proportional Division Method is a separation method based on an objective standard of the assessed value of fixed assets tax, and proportionally dividing the total sale payment amount by the assessed value of fixed assets tax is accepted by the National Tax Agency as being generally rational.
- ii. The past-data-based ratio used by the Company to calculate the consumption tax amount is an average value calculated mechanically from assessed value of fixed assets tax for properties that the Company has traded in the past. It is therefore an objective number that does not include any arbitrary influence from the Company. Moreover, the Company regularly monitors the past-data-based ratio to make sure that it does not diverge from actual conditions.
- iii. The Company handles a large number of properties, and its sales activities start immediately after procurement by posting the property information and the total amount of the sale payment on the Company’s

website and real estate portal websites. For this reason, it is necessary to calculate the consumption tax amount for numerous properties immediately after procuring them. In addition, on the sales front line, there are price negotiations and in some cases the sale agreement is concluded for an amount that differs from the initially anticipated sales amount. Therefore, the Company's Proportional Division Method based on a past-data-based ratio is a rational method that suits the Company's business flow.

- iv. With regard to Regional Taxation Bureau's assertion that added value due to renovations is not reflected in the building price, the consumption tax base is originally the amount of consideration that passes between the parties involved, and added value due to renovations is not considered in calculation of the amount of consideration that constitutes the tax base.
- v. The "case where the value is not rationally separated" in the Order for Enforcement of the Consumption Tax Act is interpreted as referring to a relatively limited case where the parties have decided the consideration arbitrarily between themselves, such as when the content of the agreement document and the facts do not agree, for example where the parties have colluded in a misrepresentation. When the Company concludes a sales agreement for land and buildings with the buyer, all of the agreement documents created by the Company with the buyer bear the consumption tax amount and are signed or stamped with registered seals of the seller (the Company) and the buyer based on the parties' intention, showing clearly that the documents are genuinely agreed in accordance with the free will of the parties. Since there was no condition of collusion in a misrepresentation between the Company and the buyer, the transfer payment for the buildings stated in the agreement document should be treated as the tax base under the Consumption Tax Act.

(5) Future plan

The Company has been in consultation with external experts from within the tax examination period, and as described above, it believes that there is no error in its existing accounting and tax treatment. Since the Company is unable to completely agree with the Reassessment Penalty, etc. from the Regional Taxation Bureau, it intends to promptly undertake the necessary procedures, such as filing an appeal.

2. Revision of earnings forecasts

(1) Revision of the consolidated earnings forecasts for the fiscal year ended March 31, 2020 (April 1, 2019 to March 31, 2020)

	Net sales	Operating profit	Ordinary profit	Profit attributable to owners of parent	Basic earnings per share
	Millions of yen	Millions of yen	Millions of yen	Millions of yen	Yen
Previously announced forecast (A)	89,872	10,356	10,094	6,805	89.39
Revised forecast (B)	89,978	10,121	9,895	5,190	67.98
Change in amount (B-A)	106	(234)	(199)	(1,614)	
Change (%)	0.1	(2.3)	(2.0)	(23.7)	
(Reference) Results for the previous fiscal year (Fiscal year ended March 31, 2019)	81,356	9,104	8,740	5,926	78.81

* The Company conducted a 2-for-1 share split of common shares on April 1, 2020. "Basic earnings per share" has been calculated under the assumption that this share split was conducted at the beginning of the previous fiscal year.

(2) Reason for revision

As described in 1. above, the Company has recorded extraordinary losses following the Reassessment Penalty, etc. for the fiscal year ended March 31, 2016 to the fiscal year ended March 31, 2019. The Reassessment Penalty, etc. is not a penalty that the Company can be in agreement on, and it plans to continue to adopt the Company's Proportional Division Method.

This revision of the earnings forecasts has not caused a revision in the dividend forecast.

(Note) The earnings forecasts are prepared based on information available as of the date of announcement of this notice, and actual results may differ from the forecasts due to various factors going forward.

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