

Legal Updates & News

Legal Updates

China Real Estate Update, February 2007

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After 171: An Update on New Real Estate Regulations and Policies Since Issuance of Opinion 171

In an Update circulated last July ([New Policies Affecting Foreign Investment in Chinese Real Estate](#), July 2006), we reported on promulgation on July 12, 2006 of the *Opinions on Regulating the Entry into and the Administration of Foreign Investment in the Real Estate Market* (关于规范房地产市场外资准入和管理的意见) (“Opinion 171”) by the Ministry of Construction (“MOC”), the Ministry of Commerce (“MOFCOM”), the National Development and Reform Commission, The People’s Bank of China, the State Administration of Industry and Commerce, and the State Administration of Foreign Exchange (“SAFE”). Opinion 171 sets out far-reaching new policies governing foreign investment in real estate in China. As a policy document, Opinion 171 was short on specifics, leaving to the relevant regulators the job of implementing and clarifying these policies through legislation.

The seven months since promulgation of Opinion 171 have been a busy period for China’s legislators and policy makers. Not only have new regulations and policies been issued to implement Opinion 171, but the State Council and its various ministries have taken other steps to more tightly regulate the real estate sector. We discuss a number of these developments in this Update.

New Foreign Exchange Rules Issued

SAFE and the MOC jointly issued a *Notice on Relevant Issues on Regulating the Administration of Foreign Exchange in the Real Estate Market* (关于规范房地产市场外汇管理有关问题的通知) (“SAFE Implementation Rules”) on September 1, 2006, to provide for the implementation of foreign exchange control pursuant to Opinion 171.

Provisions of interest include:

- *Procedures for Inbound and Outbound Remittances in Connection with Purchase of “Self-Use” Premises Clarified.*

The SAFE Implementation Rules set out certain procedures for the remittance in and conversion of foreign exchange for purchase of “self-use” commodity premises by foreign individuals and foreign companies. The SAFE Implementation Rules provide that, when buying “self-use” commodity premises, a foreign purchaser must apply to an authorized bank to pay in foreign currency, providing documents such as the sale contract, business license, or identification certificate. The bank will convert the foreign currency into Renminbi (RMB) and pay the same directly into the RMB account of the seller after verifying the authenticity of the transaction.

In case the transaction fails and the purchase price needs to be repatriated, a similar procedure will be followed in reverse (i.e., the purchaser will need to apply to the original bank to repatriate funds by providing the necessary documents, and the bank will convert

and repatriate the RMB purchase price after verifying that the transaction has in fact failed).

- *Conditions to Be Satisfied by FIE Prior to Approval of Foreign Debt Reinforced.* Article 2(7) of Opinion 171 prohibits the borrowing of loans in foreign exchange (外汇借款) by a foreign invested enterprise (“FIE”) engaged in real estate investments before full payment of the registered capital, issuance of the “Land Use Certificate,” and payment of 35% project investment. This provision is reinforced by the SAFE Implementation Rules, which expressly state that no “foreign-debt” registration (外债登记) or foreign exchange conversion will be made or approved for the FIE before satisfaction of these conditions. Note that the term “foreign debt” for relevant purposes includes foreign bank debt as well as foreign shareholder loans.
- *Rules Requiring One-Time Payment of M&A Price and Prohibiting Fixed Returns Implemented: One-time Payment with Own Funds in M&A of Real Estate FIE.* The SAFE Implementation Rules reiterate Articles 1(5) and 2(8) of Opinion 171 by stating that no foreign exchange conversion will be allowed if a foreign investor who invests in a real estate FIE by merger and acquisition fails to pay the full price in a single payment with its own funds.

Further, no foreign exchange registration or re-registration will be permitted in relation to a real estate FIE if there is a clause in the joint venture contract, articles of association, or other relevant documents that contemplates the foreign investor enjoying a fixed return on its investment.

State Council Imposes Minimum Pricing Standards; Requires Bidding for Industrial Land

On August 31, 2006, the State Council promulgated a *Notice on the Relevant Issues on Further Strengthening the Land Control* (关于加强土地调控有关问题的通知) (“Notice”). Generally, the Notice is intended to regulate the improper conversion of agricultural land into construction land, grant of industrial land at unreasonably low prices, and other improper practices of governmental agencies in relation to land use. The Notice contemplates that the State will enact minimum land grant pricing standards applicable to different localities. The minimum land grant price must be no less than the costs of land acquisition and of early-stage development costs incurred by the State, together with fees charged according to relevant regulations.

Significantly, the Notice also expressly states that industrial land must be granted through a process of competitive bidding, public auction, or public tender, and the land grant price may not be lower than the amount computed under the minimum land grant pricing standards. It may be noted that before promulgation of the Notice, such a public bidding requirement applied mainly to grants of land for residential and commercial use.

New Land Use Fee Standards for New Construction Land Announced; Sharing between Beijing and Local Governments Adjusted

On November 7, 2006, the Ministry of Finance (“MOF”), the Ministry of Land and Resources (“MOLAR”), and the People’s Bank of China jointly promulgated a *Notice on Adjusting the Policies on Land Use Fees for Newly Converted Construction Land and Related Issues* (关于调整新增建设用地土地有偿使用费政策等问题的通知) (“Land Use Fee Notice”). New land use fees apply to construction land newly converted from agricultural or unused land. The Land Use Fee Notice is part of the central government’s efforts to tighten land control and cool down investment in the real estate market.

- The fee rates for newly converted construction land will be increased to a range of RMB10 for “class 15” land to RMB140 for “class 1” land per square meter, i.e., twice the range put into effect on August 4, 1999.
- Thirty percent (30%) of the land use fees will be paid by the city/county governments to the central government and seventy percent (70%) will be paid to the provincial government treasury. The 30% will be kept by the central government, while local governments may be eligible to apply to the provincial governments for allocation back to the local level of the remaining 70%. Prior to the Land Use Fee Notice, 70% of the land use fees was retained by the city/county governments.
- Local governments are prohibited from transferring to future grantees of the relevant lands

the costs associated with conversion of land into State-owned land and must use their own funds to pay such costs.

Catalogues on Restricted and Prohibited Land Uses Updated

On December 12, 2006, MOLAR and the National Development and Reform Commission jointly issued the *Catalogue of Restricted Uses of Land (2006 Version)* ("Restricted Catalogue") and the *Catalogue of Prohibited Uses of Land (2006 Version)* ("Prohibited Catalogue") (关于发布实施《限制用地项目目录(2006年本)》和《禁止用地项目目录(2006年本)》的通知). Prior catalogues issued in 1999 are no longer valid.

One significant difference between the 1999 catalogues and the newly issued Restricted Catalogue and Prohibited Catalogue is that the Restricted Catalogue expressly bans the use of arable land for the construction of low-density and large-unit residential projects, which term refers to residential projects with a construction floor area ratio of less than 1.0 or with unit construction area exceeding 144 square meters. Other projects that may not be constructed using arable land are (i) automobile trade markets, furniture malls, construction materials malls, and other large commercial facilities; (ii) various categories of entertainment facilities such as theme parks; (iii) automobile racetracks; (iv) cemeteries; and (v) automobile training areas. Certain non-ferrous metal projects and gold mining projects also fall under the Restricted Catalogue.

The Prohibited Catalogue bans, among other things, (i) gold mining projects on forest land and arable land and in river beds; (ii) unlicensed mineral exploration and mining projects; and (iii) villa development, golf course projects, and horse tracks.

FIEs Now Required to Pay Land Use Tax; Tax Rates Adjusted

On December 31, 2006, the State Council amended the *Provisional Regulation on Urban Land Use Tax* (城镇土地使用税暂行条例) ("Amended Land Tax Regulation").

As a result of the amendment, FIEs are for the first time liable for land use tax. Previously, FIEs using land were allowed to pay land use fees as an alternative to land use taxes, and FIEs using land granted or transferred to their names were exempted from both land use fees and land use taxes. Imposition of land use tax on FIEs will increase the overall tax burden of FIEs and represents one further step of the PRC government towards unification of the tax system to apply to both domestic and foreign invested enterprises.

Land use tax rates have also been increased. For example, the rate of tax in large cities ranged from RMB 0.5 to RMB10 per square meter under the 1988 version and has been increased to RMB 1.5 to RMB 30 per square meter under the Amended Land Tax Regulation. Local governments are given discretion to determine the exact rates within the new ranges. In order to impose tax outside the new ranges, local governments must obtain approval from MOF.

National Minimum Land Grant Fee Pricing Standards For Industrial Lands Promulgated

On December 23, 2006, MOLAR issued national minimum pricing standards for grants of industrial land ("Pricing Standards") through a *Notice on the Promulgation and Implementation of the National Minimum Pricing Standards for Grant of Industrial Use Land* (关于发布实施《全国工业用地出让最低价标准》的通知) ("Notice on Pricing Standards").

Under the Notice on Pricing Standards, different minimum pricing rates are stipulated for different localities throughout the country, ranging from RMB840 per square meter for land in the urban areas of Shanghai to RMB60 for land in the remote western regions. The Notice on Pricing Standards reaffirms that the grant of land for industrial use must go through competitive bidding, public auction, or public tender, and further provides that, subject to express exceptions, the base price and final transaction price for land must not be lower than that provided in the Pricing Standards. Exceptions include:

- for land that is outside the planned city construction area and where the pre-development work is carried out by the land user, a discount of up to 40% of the applicable Pricing Standard may be granted; and

- for state-owned vacant land such as desert, barren land, gravel, and rock land without vegetation that has not been placed in the arable land reserve, the land grant fee may be as low as 30% of the applicable Pricing Standards.

The Notice on Pricing Standards also provides that any discounts in land grant fees offered by the provincial-level land and resources administration must be reported to MOLAR. It also authorizes provincial governments to raise the minimum pricing standards for grant of industrial land based on compensation payments made in the land acquisition process, and to adjust the Pricing Standards for land grants in different areas and/or different industries in the same district.

More Stringent Controls Imposed on Collection and Use of Land Grant Fees

On December 17, 2006, the General Office of the State Council (国务院办公厅) promulgated a *Notice on Standardizing Administration of the Collection and Expenditure Land Use Right Grant Fees for State-Owned Land* (关于规范国有土地使用权出让收支管理的通知).

The notice governs all payments to government for the grant of land use rights ("Land Payments"), including not only land grant fees under the land grant contract, but also other payments by the grantee in connection with land acquisition, early-stage land development costs, additional payments by the land user or grantee for changing the nature or use of the land or planning specification (for example, the gross floor area), and other conditions for the land use.

- The notice expressly stipulates that a land use right certificate will not be issued before the grantee pays all Land Payments in full, and states that land use right certificates issued in violation of laws may be invalidated by the government.
- Government agencies are prohibited from using various forms of subsidies, exemptions, or other methods to reduce Land Payments.
- Land Payments will be fully included in the state budget, and the system for collection will be separated from the system for expenditure of revenue from Land Payments. Revenue from Land Payments will be used for the development of "new rural villages" and for the benefit of farmers and other occupants relocated from the land in the acquisition process.
- The notice calls for improvement of the land reserve system, for establishment of a land reserve fund accounting verification system, and for improvement of the system for sharing information in regard to Land Payment collection and expenditure.
- Under the notice, failure to make any Land Payment on time will be subject to daily penalty interest of 0.1%.

Methods For Calculation of Land VAT Tax Changed

On December 28, 2006, the State Administration of Taxation promulgated a *Notice on Several Issues Relating to the Settlement of Land Value-Added Tax ("Land VAT") of Real Estate Development Enterprises* (国家税务总局关于房地产开发企业土地增值税清算管理有关问题的通知) (国税发[2006]187号) ("Settlement Notice"). Land VAT is not a new tax, being first introduced in 1993, but for various reasons it was not widely collected.

- The Settlement Notice aims to standardize the imposition of Land VAT and provides guidelines to the authorities on its collection. The Settlement Notice, for example, requires settlement of Land VAT upon (i) the completion and sale of all units of a real estate development project; (ii) the transfer of a real estate project whereby the final construction settlement has not been completed; and (iii) the transfer of land use rights.
- In addition, real estate developers who have obtained sale or pre-sale permits but have unsold units in a real estate project after three years are also required to settle Land VAT with the tax authorities.
- Land VAT, which is a progressive tax classified into four levels (ranging from 30% to 60%), is calculated on the difference between the sale price and the aggregate of deductible costs.

