

## **New Regulations on Foreign Capital in the Chinese Real Estate Market**

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On July 11, 2006, the Chinese Government issued a joint regulation (six central government organisations are involved) called "*Opinions on Regulating Access to and Administration of Foreign Capital in Real Estate Market*", which aims at curbing the soaring real estate market in China and the speculation which is deemed to be caused by excessive foreign investment in this area.

The Opinion introduces a number of restrictions to the possibility for foreigners - companies or individuals - to invest in real estate. Some partial exceptions are made, however, in favor of Chinese overseas individuals and residents of Taiwan, Hong Kong and Macau.

A distinction is made between investment/purchase made for other purposes than personal use (such as letting out) and investment/purchase made only for personal use.

- *Investment/purchase made for other purpose than personal use*

The investment/purchase must be made via a real estate company to be set up in China. Capital requirements are strict: if the investment is higher than 10 MUS\$, the capital percentage must be at least 50 % of the total investment (instead of 40% or less for other types of companies). Below this limit, the normal percentage provided for foreign invested enterprises still applies. In case the company invests in several projects, it must ensure that the capital contribution in any specific project constitutes at least 35 % of the total investment of such project. In addition, no borrowing is permitted unless the registered capital is entirely paid out and the land use right has been obtained. If the investment is to be made via a Sino Foreign real estate joint venture, the parties are not allowed to agree on a fixed return on investment.

- *Investment/purchase made for personal use*

The principle is that foreign companies or individuals may not purchase real estate in China for their own use, unless they have already established a presence in China: a branch or a representative office for a company, or if the investor is an individual, an effective working or studying presence in China of more than one year.

There is an exception in favor of overseas Chinese individuals and residents from Taiwan, Hong Kong and Macau, who are allowed to purchase even if they have resided in China for less than one year. However, in a press interview, a representative of the six central government agencies made clear that they can only buy one unit for their own personal use. He added that foreign companies branches/representatives offices could only buy real estate for their own use in the city where they are registered.

The *Opinion* further stipulates that all purchases must be made in the real name of the purchaser, as indicated in their registration or working/studying permits.

Any preferential tax treatment is prohibited.

Chinese Authorities are obviously concerned with the general heating of the economy, where real estate plays a crucial role. Since 2002, investors aiming to capitalise on RMB appreciation had invested heavily in the Chinese real estate market and the flood of foreign capital into the Chinese real estate market had, to a certain extent, led to an ever-increasing demand in the property market and a boom in house prices.

Chinese officials worried that excessive spending on real estate could fuel inflation or cause problems for banks if deeply indebted borrowers were to default on loans. Since May 2006, the Chinese government promulgated a series of measures. For example, since June 1, 2006, a 5% business tax is levied on the selling price if the house has been purchased less than 5 years before, and since August 1, 2006, a 20% individual income tax is levied on the net capital gain arising from sale of a house.

However, this is the first time, since the elimination of the distinction between "buildings for Chinese" and "buildings for foreigners" in 2002 (following the accession of China to the WTO), that the Chinese Government promulgates such kind of discriminatory regulation. Many commentators have expressed doubts about the efficiency of such measures, as the share of foreigners in the global Chinese real estate market remains marginal.

In practice, the *Opinion* will be implemented in accordance with detailed rules to be issued by local governments. Indeed, a number of questions need to be clarified: for example how to control the long-term effectiveness of the "personal use" of a house by an individual? What is exactly the definition of personal use ? What documents are needed for the purchase, and of course, does the *Opinion* exclude houses already owned by foreign individuals?

Beijing has already started to apply the limit of one house only for overseas Chinese or residents of Taiwan, Hong Kong and Macau individual resident (*Urgent Circular on Several Questions Concerning Signature of Real Estate Purchase Contracts by Foreign Organizations and Individuals* issued by Beijing Construction Commission on July 20, 2006), but as of August 8, Shanghai had not yet started implementing or issuing detailed rules.

## **Circular of Beijing AIC suspending the Registration of New Businesses in Residential Buildings**

On June 16, 2006, Beijing Administration for Industry and Commerce issued a circular called "*Circular on Strictly Examining Premises Use Certificate* " (Jinggongshangfa [2006] No.14), which, as of 19 June 2006 (the effective date of the Circular), temporarily prohibits the registration of businesses in residential buildings.

Some background explanation is necessary.

The manner in which a building may be used is defined by the Construction Committee of the Municipality, when the developer of a building applies for the permission to build. The authorization may be granted for residential or commercial use. For large buildings, however, it is common to see a distinction between ground floor and above. The ground floor is often used for commercial purposes whereas the floors above are used for residence. The specific use of each unit is shown in the Purchase Agreement of a particular unit signed with the developer, and appears on the Ownership Certificate.

As early as 1999, in order to stimulate the development of high technology activities, the Beijing AIC issued a circular authorizing these types of businesses to be registered in residential premises, under the condition that they would not cause disturbances to the residents. (Jinggongshangfa [1999] No. 119)

In 2002, the Beijing AIC issued another circular (Jinggongshangfa [2002] No.109) authorizing other types of businesses to be registered in residential premises: technology development, consultation services, market investigation, enterprise image strategy, typewriting, photocopying, graphic design, animation production and advertising. However, this circular made it clear that restaurants and bars, music and dancing venues, Internet access services, production, processing and manufacturing activities could not be registered in residential buildings.

This circular was fully used by small entrepreneurs who found it convenient and cost effective. And of course, restaurants, bars etc. opened on the ground floors of residential buildings, when the ground floor benefited from a commercial qualification.

Actually, the distinction between residential or commercial units is sometimes difficult to make, when, for example, an ownership certificate contains expressions such as "commercial residence" or "comprehensive".

The trend of mixing residence and business had some negative consequences. Disturbances and security problems lead to complaints from residents of buildings where many businesses were operated.

The Circular No 14 puts a temporary stop to the previous "tolerance" by stipulating that:

- No new business, whatsoever, shall be registered in a unit of a building, where the ownership certificate or purchase agreement (where no certificate is available) of such unit states that it is for residential use.
- This prohibition also applies to units for which the right of use is not clear and indicates a mix of residential and commercial use, such as "commercial residence" or "comprehensive".

- And even where the ground floor of a residential building is fully qualified as "commercial", the Circular prohibits the registration in such ground floors of new restaurants, bars, music and dancing venues, internet access services, production, processing and manufacturing activities.
- The Circular entered into force on June 19. It does not apply to Businesses that were already registered, or for which the registration had been approved prior to this date.

This Circular is a temporary measure, but no indication of the length of its effectiveness has been given.

As for now, there seems to be no reason for lawfully registered businesses to be concerned with the new Circular No. 14, which is merely meant to suspend the registration of new businesses in residential premises.

Nevertheless, the concern exists because every year, all businesses are required to go through an inspection of their business licences by the AIC. Could the AIC decide not to renew a business licence because the relevant business is registered in a residential building? This seems unlikely: annual inspection does not mean granting a new registration, and it seems unlikely that a business could fail to "pass" the examination only because it was registered, in compliance with the regulations at that time, in a residential unit, in particular where the Circular states that it does not apply to already registered businesses.

The question has been put to the Beijing AIC whose comment was that "no decision has been made".

Certainly, this matter needs to be closely watched.