

Commercial real estate

Singapore, Japan, Hong Kong and China

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Foreword

Real estate has always been an attractive investment class, not only to institutional investors but also to family offices and High Net Worth Individuals (**HNWIs**). As part of an investment portfolio, real estate assets can yield high returns, offer diversification for the investment portfolio and hedge against inflation. However, investing in real estate, especially internationally in emerging countries, can be challenging due to differences in regulations, requirements and tax treatments across different jurisdictions.

At Withersworldwide, we have assisted clients for decades in structuring their real estate deals involving a wide range of asset classes from hotels and resorts, office and industrial buildings, malls, self-storage spaces to farms, heritage and residential properties. Whether you are acquiring, building, managing, leasing or divesting, we pride ourselves as trusted advisors who can assist you to achieve your investment goals in the most efficient way. As our client, you can expect tailored legal and tax solutions from due diligence, negotiations, financing, structuring joint-ventures to dispute resolution.

It is with this view which we have set out to create a practical guide for those looking to invest internationally in commercial real estate. In this edition, we focus on the hottest commercial real estate investment destinations in Asia, namely China, Hong Kong, Singapore and Japan.

We hope you will find the guides useful for understanding the requirements and key considerations for investing into commercial real estate. To discuss further, please get in touch with your usual contact at Withersworldwide, or any of the authors featured.

Withersworldwide Real Estate Team

China

General market overview

For over a decade, the PRC's real estate market has made a profound impact on the country's economy. Although the Chinese government has introduced a number of real estate investment and financing regulations to cool the overheated market, some of the previously enacted market restriction regulations have been removed in part to stimulate economic growth. An extensive amount of inbound investment restriction policies have also been abolished, which significantly encourages foreign investment in real estate.

The year 2020 was a very challenging time for the global real estate market with a decrease in property transactions and investment volume because of the outbreak of Covid-19. However,

the PRC proved to be an exception and international institutional investors have shown increased interests in the Chinese real estate markets.

The legal framework regulating foreign investments into real estate has evolved over the years. Although the actual practice, requirements and attitudes of each local government on foreign participation in real estate transactions vary, and may change from time to time, the long-term trend that has been observed is a gradual relaxation of the regulatory restrictions on foreign investors' investment in the PRC, which will provide foreign investors with more opportunities.



Sale and purchase

1.1 Real estate ownership

Forms of real estate ownership

Land in the PRC is owned by either the state or the collectives, and there is no private ownership of land. However, private entities and individuals can have the land-use right of the state-owned land (土地使用权, "LUR") for a specific term. The following are the maximum terms for the respective purposes under the LUR:

- (a) 70 years for residential purposes;
- (b) 50 years for industrial purposes;
- (c) 50 years for educational, scientific and technological, cultural, health care and sports purposes;
- (d) 40 years for commercial, tourism and recreational purposes; and
- (e) 50 years for comprehensive utilization or any other purposes.

LURs are initially obtained through either allocation (划拨) by the government (with no land premium being required), or granted (出让) by the government upon payment of a land premium. LURs that are allocated by the government cannot be transferred, assigned or let, while LURs that are granted can be transferred, leased, mortgaged or otherwise commercially exploited, subject to certain land use conditions.

The LUR of land for operational purposes, such as industry, business, tourism, entertainment and commercial residential housing shall be granted by way of tender, auction or listing for sale at a land exchange administered by the local government. In the case where a land parcel is supplied for purposes other than the aforementioned and there is only one prospective purchaser after the public announcement of the supply plan for such land, the LUR can be granted by way of bilateral agreement with the local government.

Buildings erected on the land, not the land *per se*, can be owned by private entities and individuals (房屋所有权).

With implementation of the amended PRC Land Administration Law on January 1, 2020, the LUR relating to collectively-owned land for industrial and commercial development, rather than being first

converted into state-owned urban land by the government in the past, can be transferred or leased directly to enterprises or individuals subject to approval by more than two-thirds of the members of the collective economic organization or more than two-thirds of the villagers.

Renewal of LUR

The LUR related to land for residential construction will be automatically renewed upon expiry of the term subject to payment of renewal fee which might be reduced or exempted.

On the other hand, LURs of land for other purposes are terminated upon expiry of the term of years granted unless the term is renewed. The renewal of LUR shall be applied at least one year prior to the expiry and subject to the execution of a new contract for the grant of LURs and payment of the land premium. If the term of LUR is not renewed, the LURs will be reverted to the state and the ownership of any buildings erected on such land will be subject to the existing agreement, or in the absence of such an agreement, the applicable laws and regulations.

Major property legislation

Major property-related legislations in the PRC include:

- (a) The PRC Constitution (中华人民共和国宪法);
- (b) The PRC Civil Code (中华人民共和国民法典);
- (c) The PRC Land Administration Law (中华人民共和国土地管理法);
- (d) The Implementing Regulations for the PRC Land Administration Law (土地管理法实施条例);
- (e) Interim Regulations of the People's Republic of China Concerning the Assignment and Transfer of the Right to the Use of the State-owned Land in the Urban Areas (中华人民共和国城镇国有土地使用权出让和转让暂行条例);
- (f) The PRC Urban Real Estate Administration Law (中华人民共和国城市房地产管理法); and
- (g) Regulations on the Administration of the Development and Operation of Urban Real Estate of the PRC (城市房地产开发经营管理条例).

Title registration

LURs and titles to real estate are subject to registration and the registries are under the relevant

government authorities' control. The main information in the public register of titles include the following:

- (a) Term of the LUR;
- (b) Area of the building;
- (c) Location of the land;
- (d) Type of structure of the building;
- (e) Permitted usage;
- (f) Owner's name;
- (g) Completion date; and
- (h) Mortgage.

Transfer of real estate ownership

The usual process for transfer of commercial real estate in the PRC includes:

- (a) The purchaser will carry out legal and technical due diligence, including title search at the land and/or real estate authorities, confirmation of relevant government approvals as to land use, review and confirmation of any unregistered interest and applicable tax payment receipts, inspection of the physical condition of the property, and due diligence on the target company if the property transaction is to be effected via a share transfer;
- (b) The parties should execute a written purchase agreement setting forth the terms of the transfer;
- (c) The parties will file an application to the local real estate authority for the registration of the title transfer from the seller to the purchaser and issuance of the new title certificate. The seller must first pay off any expenses that are on the property such as loans and taxes before proceeding to transfer the title. Applicable taxes related to sale and purchase of the commercial real estate shall also be paid up before issuance of the new title certificate.

Direct (i.e. asset transfer) vs indirect (i.e. share transfer) transfer of real estate

For a real estate transaction effected by way of an asset transfer, the purchaser in a direct property acquisition should be a PRC registered company or a PRC or qualified foreign individual.

In the current PRC regulatory environment, a foreign investor is required to establish onshore "commercial presence", i.e. to set up a foreign-invested enterprise ("FIE") to invest, develop, own, or operate real property in the PRC (with the exception of real estate

held for personal use). However, there are some commercial real estate in the PRC that are directly owned by offshore vehicles as they had been acquired by foreign investors prior to 2006, before the Chinese government authorities introduced restrictions on foreign investors' entry into the PRC real estate market.

In addition, for various business and tax reasons, it is common for foreign investors to use an offshore intermediate holding company to own their interest in a Chinese project company holding the underlying commercial real estate in the PRC.

In view of the above situations, the following discussions include the common types of transfer of commercial real estate used by foreign investors in the PRC:

- (a) Asset transfer by a PRC registered company (including an FIE) as the seller;
- (b) Asset transfer by an offshore entity as the seller;
- (c) Transfer of share in a PRC registered company (including an FIE) holding the underlying real estate ("**Onshore Share Transfer**"); and
- (d) Transfer of share in an offshore entity indirectly holding the underlying real estate ("**Offshore Share Transfer**").

The transfers of the real estate by the owner of the real estate (either the PRC registered company or the offshore entity) are governed by PRC law and will be subject to the relevant PRC registration requirements.

The foreign investor may transfer all or part of the equity interest in the FIE holding the real estate directly. Such an Onshore Share Transfer is conducted in the PRC and will be subject to full PRC filing and registration requirements, which may involve government discretion.

Alternatively, the foreign investor may transfer the underlying PRC commercial real estate by transferring all the shares of the FIE's foreign parent (i.e. the offshore company). Such an Offshore Share Transfer will be conducted in the jurisdiction of incorporation of the offshore company and is generally not subject to PRC jurisdiction and review, except for PRC reporting of the actual controller of the FIE and taxation on the indirect sale of PRC taxable assets. In addition, if the offshore company's ultimate shareholders are PRC nationals, certain PRC filings should have been made with the foreign exchange authorities in the PRC.



Considerations for foreign ownership of real estate not for self-use

Foreign Investment Restrictions

FIEs or representative offices established in the PRC by foreign entities or a foreign individual can purchase commercial property for self-use or self-accommodation, subject to several regulatory restrictions at national and local levels.

If a foreign investor (an entity or individual) intends to purchase real estate, not for self-use but to invest, develop, own or operate real property in the PRC, the foreign investor is required to establish an onshore "commercial presence", i.e. to set up an FIE. That being said, there are a number of foreign entities or individuals which/who have acquired commercial real estate in the PRC prior to 2006 and still directly own them.

Exchange Control Issues

China imposes foreign exchange control and categorizes foreign exchange transactions into current account and capital account items. Current account items include foreign exchange transactions related to the trading of goods or services, remunerations, dividends, interest, etc. Capital account items include foreign exchange transactions of a non-trade, non-recurring nature, such as direct investments, real estate purchase, borrowing, repayment of foreign loan, etc. Capital account items are subject to stricter control.

Foreign investment and FIEs involved in the PRC's real estate sector will be subject to the control over foreign capital flow, including restrictions on debt financing, foreign exchange settlement and other measures.

	Asset transfer	Onshore Share transfer	Offshore Share Transfer
Pros	<p>(a) The purchaser only needs to acquire the real estate without assuming the existing obligations, liabilities or restrictions of the company owning the real estate; and</p> <p>(b) It is relatively straightforward as asset transfers are generally not subject to the filing and registration with local authorities (except for the registration of ownership change in real property).</p>	<p>Generally, a share transfer is more tax efficient than an asset transfer for both the seller and buyer. (Please refer to Section 5 below)</p>	<p>(a) Generally, an Offshore Share Transfer can take place wholly offshore and is not subject to PRC filing and registration except for reporting of the actual controller of the FIE; and</p> <p>(b) Generally, an Offshore Share Transfer does not trigger any PRC tax liability. However, China may impose enterprise income tax on capital gain derived by a foreign entity from indirect transfer of the PRC taxable assets under certain circumstances. (Please refer to Section 5 below).</p>
Cons	<p>(a) Various contracts related to the commercial real estate (such as lease) might be assigned to, re-negotiated or resigned by the purchaser of the commercial real estate with the corresponding contracting parties to such contracts. This process could cause the purchaser to incur additional time/costs to complete the transaction;</p> <p>(b) The transfer of commercial real estate typically results in a much higher tax cost to the seller, which in turn may affect the transfer price. Such tax includes the land appreciation tax and value added tax. To the buyer, this includes the deed tax. (Please refer to Section 5 below); and</p> <p>(c) In the case where a new onshore acquisition vehicle is needed to be established, the incorporation of such new entity can take months.</p>	<p>(a) The buyer acquires the target company including all its assets, liabilities and employees. As such, the buyer may potentially assume hidden or unknown risks and liabilities of the target company;</p> <p>(b) Detailed and extensive due diligence (legal, financial, property etc.) is required; and</p> <p>(c) As opposed to indirect (offshore) acquisitions, direct acquisitions will be subject to filing (approval is needed in some cases) and registration by the relevant PRC authorities. Not only is this process time consuming, it also presents opportunities for PRC authorities to scrutinize, and possibly intrude on, the parties' contractual terms. Meanwhile, specific PRC legal requirements, such as state-owned asset appraisal if the seller is a state-owned enterprise, may also apply to the transaction and may add further complications and variables to the process.</p>	<p>(a) This option will not be used for the acquisition of purely domestic targets with no foreign shareholders.</p>

1.2 Sale and purchase process

Typical process

In the PRC, properties can be bought directly via developers, enterprises, individual sellers or an agent. To make a lawful and proper transfer of real estate, registration with relevant authorities is required. Although the processes of the commercial real estate transaction may vary, there are some common steps.

If the purchase is made directly from a real estate developer, sometimes the developer will enter into a Real Estate Irrevocable Purchase Order (房屋认购书) first with the purchaser who is required to pay a deposit. Depending on the construction status of the real estate, both parties shall subsequently enter into a Real Estate Pre-sale Agreement or a Real Estate Sale and Purchase Agreement, which is the master agreement of the transaction, and be submitted to the relevant real estate administrative and registration authority for registration. It shall be noted that the Property Title Certificate (房地产所有权证 or 不动产权证) will not be issued to the purchaser immediately if the construction has not yet been completed. In practice, it will often take no more than one year from the date of delivery for the developer to complete the formalities to apply for the Property Title Certificate. It shall also be noted that the developer shall first obtain sales approval from the competent local land resources and real estate authority before starting onshore strata-title sales for units within a project.

For purchases made from individuals, parties will enter into a Sale and Purchase Agreement based on a standard form provided by the local real estate administrative authority. Purchasers usually carry out due diligence prior to the execution of the agreement. A copy of the duly executed agreement shall be submitted to the relevant real estate administrative authority. In order to receive a legal and complete title of the property, parties should change the property title information at the immovable property registry (不动产登记机构) as the Record of Immovable Property (不动产登记簿) is the legal basis of ownership. In practice however, there are still a considerable amount of disputes arising from improper registration in such transactions.

The registration processes of the Immoveable Property Registry may vary between regions.

Due Diligence

In large real estate transactions, the purchasers will usually conduct extensive legal and financial due diligence. For a share acquisition deal, the legal due diligence typically includes an investigation into the target company's credit, debt, operation conditions, employee and management issues, as well as ongoing litigation and arbitration cases. The legal due diligence will also focus on the title of the property and restrictions on the usage rights. Lawyers may primarily focus on title issues and encumbrances for asset acquisitions. For second-hand real estate transactions in the PRC, the Record of Immoveable Property kept by the immovable property registry is an important source to consult.

Consent and Notification

Consent should be obtained for certain real estate transactions in the PRC. For example, except as otherwise agreed by the parties, the title transfer of real estate requires consent from all the co-owners. Unless otherwise agreed by the parties, if the property is owned by at least two parties by shares, the consent of co-owners holding two-thirds or more shares shall be obtained in order to transfer the property.

If the relevant property is subject to a mortgage, the seller shall notify the mortgagee of the sale promptly unless otherwise agreed by the parties.

1.3 Sale and purchase contract

General components of a sale contract

The contracts that real estate developers use in real estate transactions are often based on a template provided by the local governments. In practice, real estate developers are required to submit a copy of the real estate sale and purchase contract to the authority for registration. The terms are often non-negotiable for individual purchasers.

Article 16 of the Administrative Measures for the Sale of Commodity Houses (2001) (商品房销售管理办法(2001)) provides that a real estate sale and purchase agreement should contain the following terms:

- (a) Title or name and domicile of the parties;
- (b) Basic conditions of the commodity houses;
- (c) Sales pattern for the commodity houses;
- (d) Method of fixing the price, total price, manner and date of payment;

- (e) Conditions and date of delivery for use;
- (f) Decoration and facility standards requirements;
- (g) Requirements for the delivery of supplementary essential facilities, such as the supply of water, electricity, heating, gas, communication, roads and gardening, and of public facilities, as well as relevant rights, interests and obligations;
- (h) Ownership of property rights in relation to public ancillary constructions, such as hospitals and community centers built in accordance with state or local government requirements;
- (i) The method for dealing with any discrepancy between the floor area stipulated in the contract and the area actually delivered;
- (j) Relevant matters concerning the land use right registration;
- (k) Methods of dispute resolution;
- (l) Liabilities for breach of contract; and
- (m) Other items agreed upon by both parties.

Transfer of occupational leases and income

If the property transaction is effected by a share transfer and not an asset transfer, there will be no change of registered owner holding the property, and the benefit of any occupational leases and income remains the same.

If the property is sold as an asset transfer subject to a lease, the sale and purchase agreement normally will specify that the purchaser will assume all the rights, obligations and liabilities under the subsisting lease. A novation agreement shall also be entered into to replace the purchaser as the new lessor who shall continue to receive the rental income after the purchase of the property has been completed.

Common rights, interests and encumbrances

Property interests include:

- (a) Ownership rights;
- (b) Usufructuary rights, which include:
 - i. Land contracting rights;
 - ii. Construction land use rights;
 - iii. Homestead land use rights; and
 - iv. Easements.
- (c) Security interests.

Real estate rights are created by registering the relevant instruments at local registration authorities and title certificates serve as evidence of title.

Typical representations and warranties

Article 32 of the Administrative Measures for the Sale of Commodity Houses (2001) provides the warranties by the real estate development companies and shall be in accordance with the Rules for Warranty of Residential Building and the Manual for House Use (商品住宅实行质量保证书和住宅使用说明书制度的规定). Under Article 33, the real estate developers must warrant the repair of the sold house to the purchasers. The period of the warranty shall be specified in the agreement and be calculated from the day of delivery. The real estate development companies are not responsible for the damages caused by *force majeure* and/or improper use.

Remedies against misrepresentations

The purchaser of the real estate may make claims against the real estate development company for misrepresentation on the basis of the developer's representations and warranties, as well as the statutory requirements.

Under Article 35 of the Administrative Measures for the Sale of Commodity Houses (2001), the purchaser may return the property if the quality test shows that the main part of the property is indeed in a poor state of repair. The real estate developer will also be liable for any loss incurred by the purchaser as a result of such purchase.

1.4 Costs relating to sale and purchase of real estate

Tax

In an asset transfer, the purchaser is subject to deed tax and stamp duty, while the seller is subject to stamp duty, land appreciation tax, value added tax and related surcharges, and enterprise income tax (or individual income tax, as applicable). For a share transfer, the purchaser is subject to stamp duty, while the seller is subject to enterprise income tax (or individual income tax, as applicable) in addition to stamp duty.

For specific tax rates, please refer to [Section 5](#) below.

Estate agent's fees

The brokers / estate agents will arrange for the listing and viewing of the property, and will help the sellers and purchasers negotiate key terms for the sale and purchase. In addition, they assist the purchasers in matters such as passing of keys and arranging for inspection of the property if a vacant possession is to be delivered on completion. Brokers' / estate agents'



fees are charged at a rate of 1.5% to 2.5% of the purchase price, but this is open to negotiation.

Legal fees

Lawyers are appointed to negotiate, prepare and execute the documents necessary for the conveyance of property (e.g. sale and purchase agreement, assignment; and for share transfer, contract notes, instrument of transfer and the necessary shareholders' resolutions or board of directors' resolutions). In practice, lawyers are generally not involved in real estate transactions between individuals.

The purchaser's lawyer will conduct title review and investigation of the property. The seller's lawyer will answer title requisitions raised by the purchaser's lawyer (if any) and arrange to remedy any title defect(s).

For share transfer, the legal due diligence will be carried out by the lawyers.

The seller's lawyers are also typically involved in discharging the existing mortgage (if any) for the seller, while the purchaser's lawyers will help the purchaser with the legal documentation for the financing of the purchase.

The seller's lawyers will typically arrange for stamping and registration of the relevant instruments.

There is no fixed scale of legal fees. Parties will negotiate the applicable fees with their respective lawyers.

Other fees

Stamp duty (see more in [Section 5](#) below) as well as certain registration fee, are applicable.

Investment vehicles

1.5 Types of investment vehicles

Legal forms of typical investment vehicles

The following are major types of vehicles for inbound investments and funds into the PRC that are commonly used by foreign investors:

- (a) **Limited liability company ("LLC")**, which is incorporated by one or more foreign investors solely or together with one or more Chinese investor(s);
- (b) **Foreign-invested holding company**, which is usually set up by foreign investors to carry out investment activities in the PRC, and the requirements for establishing such holding company is relatively high;
- (c) **Foreign-invested partnership**;
- (d) **Qualified Foreign Limited Partner ("QFLP")**, which is only available in a number of trial areas such as Shanghai, Beijing, Tianjin, Chongqing, Shenzhen, Qingdao, Guizhou and Pingtan. QFLP enables qualified foreign investors (acting as the limited partners) to set up a private equity fund (in the form of a limited partnership or a limited liability company) with qualified domestic investors (acting as the general partner). Establishment of QFLP is subject to the local requirements, which are relatively stringent, and with additional pre-approval processes.

Opening a representative office is also an option, which is the most cost-effective method providing basic entry. However, restrictions on direct business activities make representative offices unattractive as an investment vehicle for investment in the PRC real estate market.



Common structure used by foreign investors

LLCs are the most popular vehicle under the PRC foreign investment regulatory framework.

In certain industry, LLCs that are jointly invested by foreign investors and Chinese investors are required. In addition to the regulatory requirements, there are also commercial considerations which encourage foreign investors to engage a local Chinese partner, for example access to the local Chinese partner's network, local market knowledge, workforce and facilities.

A LLC wholly owned by foreign investors ("**WFOE**") is an investment vehicle of choice for most foreign investors in industries where there are neither restrictions on foreign investment nor strategic reasons for engaging a Chinese partner. With the Chinese government easing foreign investment restrictions, WFOE has become the most frequently used foreign investment vehicle nowadays. WFOEs give foreign investors full autonomy over the entities and allow control of its governance through its articles of association without the involvement of local Chinese partners. However, WFOEs are not allowed to enter into certain industries.

1.6 Setting up an investment vehicle

Minimum capital requirements

There is no minimum registered capital requirement for most of the companies registered in the PRC except for those in special industries such as the financial or telecommunication industry.

Notwithstanding the above, the registered capital of a company should be sufficient to satisfy its contemplated operation and business scale.

There is another concept for foreign-invested enterprises ("**FIEs**") called "total investment", which is the projected amount of funds necessary for a FIE to attain the production or operational capacity. Under the PRC law, the level of foreign exchange loans/debts that a FIE is allowed to borrow is subject to the difference between its total investment and registered capital. Such difference, which is referred to as the "statutory minimum debt-equity ratios", is the maximum amount of foreign exchange loan the FIE can legally borrow. The statutory minimum debt-equity ratios are set out in the table below:



Total Investment

Minimum Registered Capital (% of Total Investment)

US\$3,000,000 or less	70%
US\$3,000,001 to US\$10,000,000	50% or US\$2,100,000 (whichever is higher)
US\$10,000,001 to US\$30,000,000	40% or US\$5,000,000 (whichever is higher)
US\$30,000,001 or more	33.3% or US\$12,000,000 (whichever is higher)

Notwithstanding the above, the concept of total investment will phase out with implementation of the PRC Foreign Investment Law.

Procedures for setting up an investment vehicle

The general procedures for the establishment of LLCs, which are not subject to special operating permit/license, are stated below:

- (a) Name pre-reservation with the competent local company registration authority ("AMR");
- (b) For investments not falling into the Negative List for Foreign Investment, online foreign investment information filing with the Ministry of Commerce is required. For investments falling

into the Negative List for Foreign Investment, approval by the competent local counterpart of the Ministry of Commerce ("MOFCOM") is required. Currently, foreign investment in the real estate sector falls within the "permitted" industries, and consequent foreign investment information filing will apply;

- (c) Registration with AMR for establishment of the LLC and issuance of the business license. The issuance of the business license signifies the official incorporation of the LLC;
- (d) Post-registration formalities, including:
 - i. Arranging for chop carving by a qualified chop carving agent;
 - ii. Foreign exchange registration and opening various bank accounts, including the foreign exchange capital account to receive capital injection, RMB basic account, special tax payment account (as required by the local tax authority in charge of the LLC) and other accounts necessary for business operation of the LLC;
 - iii. Verification of the types of taxes applicable to the LLC with the local tax authority in charge of the LLC;
 - iv. If the LLC intends to conduct import and/or export business, it is a requirement to



additionally apply for the foreign trade operator record filing, customs registration, and inspection and quarantine license registration; and

- v. Social insurance registration and registration for contribution of housing provident fund
- (e) Applying for the status of ordinary VAT taxpayer if applicable.

If the application documents are complete and in good order, steps (a) to (c) would normally take around 2 to 3 weeks, and the post registration formalities will roughly take around 1 to 2 months.

Depending on the location and particulars (such as the proposed business activities, amount of the proposed total investment and registered capital) of the LLC and on the local authorities involved, the procedures may vary in one detail or the other.

Governance, compliance and taxation

Governance requirements

The highest authority of a LLC is the sole shareholder or shareholders' committee as applicable. LLCs can have either a board of directors or in the case of a LLC with a relatively small number of shareholders or small scale, an executive director. The board of directors shall consist of 3 to 13 directors and one of them has to be the chairman. Small and medium sized companies, or companies with only a few shareholders, often opt for an executive director. The mandate for the directors or the executive director shall not exceed three years. However, they can be re-appointed.

In addition to the board of directors or executive director, the LLC shall also have a board of supervisors. In the case where the LLC is small scaled or has a small number of shareholders, at least one supervisor shall be in place to oversee performance of the duties by the directors and senior management personnel of the LLC. To ensure that

there is no conflict of interest, the LLC's directors and/or senior management personnel cannot concurrently serve as the supervisor of that LLC.

The management personnel of a LLC also consists of a general manager in addition to other board-appointed officers, such as the chief financial officer or deputy general manager.

Compliance costs

There are no set compliance costs as they depend on the actual situation of the companies. Generally, LLCs in China are subject to the following on-going compliance requirements:

- (a) Annual audit on the financial accounts by a qualified CPA firm in the PRC;
- (b) Joint annual reporting between April 1 to June 30 every year;
- (c) Annual enterprise income tax reconciliation by May 31 every year;
- (d) Annual report of equity-related data related to inbound and outbound direct investment by 30 September every year;
- (e) Filing of periodic tax returns; and
- (f) Periodic extension of the working permits and residence permits for the expatriate personnel if applicable.

Tax

The major taxes relevant to the daily operation of a LLC in the real estate sector are set out below:

- (a) **Enterprise Income Tax (企业所得税, "EIT"):** 25% on profits and reduced rate is available for small and low-profit enterprise, qualified high-tech enterprise and some special areas;
- (b) **Value Added Tax ("VAT"):** For small-scale VAT taxpayers, 5% on sales and leasing of real property (reduced at 1.5% for individual lessors

letting residential property); for general VAT taxpayers, 6% (most of the services), 9% (sales and leasing of real property) and 13% (most of the goods) on VAT payable which equal to the output VAT in the current period minus input VAT in the current period;

- (c) **Surcharges** (including urban construction and maintenance tax, education surcharges, and local education surcharges where applicable): around 12% of the paid VAT;
- (d) **Deed tax**: Levied when acquiring the land or property. Typically 3-5% but a reduced rate may be available depending on the size, holding period, location and other conditions of the land/property;
- (e) **Stamp duty**: Levied on contracts with respect to purchase and sales, processing, construction and engineering projects, lease, loan, technology contracts, property transfer, accounting ledgers, etc. The tax rate is in the range of 0.05% to 0.1%;
- (f) **Land Value Appreciation Tax ("Land VAT")**: Progressive rates ranging from 30% to 60% on the appreciation amount;
- (g) **Property tax**: Owners and users of buildings for commercial use are subject to property tax. For properties held by lease, a rate of 12% of the annual rental income is imposed. For self-used properties (excluding residential property), a rate of 1.2% of the property's adjusted cost (with a 10 to 30% deduction from the original cost) is imposed. Exemption might be available in certain circumstances;
- (h) **Urban and township land use tax**: Individuals and entities that use land in cities and towns are subject to the urban and township land use tax, which is in the range of RMB0.6 to RMB30 per square meter depending on the location. Exemption might be available in certain circumstances; and
- (i) **Import customs duty**: The rate of which vary from the HS code of the imported products.

Real estate financing

1.7 Common ways of financing commercial real estate acquisitions

Mortgage is the most commonly used financing tool to purchase property in the PRC, especially for small and medium transactions. Residential real estate purchasers will often be required to pay about 30% of

the purchasing price initially, while the requirement for purchasing commercial real estate is generally higher.

For large commercial real estate acquisitions, off-shore and on-shore bank loans and corporate bonds are the main sources of funding. IPOs, trusts and private investment funds are also used by investors.

Under the current PRC foreign exchange control regime, companies (both domestic companies and FIEs) in China are required to register all foreign loans or debt in either foreign currency or RMB borrowed from non-PRC residents or entities. Failure to register will result in the unenforceability of the loan agreement and an inability to repay and remit the principal and interest to the offshore lender. FIEs may choose to be subject to the debt-equity ratio as discussed in [Section 2.2](#) or a new regime introduced in 2016. Under this new regime, a Chinese non-financial enterprise (being a FIE or a purely domestic company) may borrow foreign debt within a quota which, under the current rules, is essentially equivalent to two times of its net assets value. However, SAFE will not process any foreign loan, registered debt or settle foreign loans for foreign-invested real estate enterprises that are approved by or filed with MOFCOM on or after 1 June 2007. Such policy constitutes a critical barrier to financing foreign-invested real estate enterprises. This effectively restricts foreign parent companies from extending shareholder loans or intercompany loans to such enterprises, and leaves capital injection as the main source of offshore funding for such enterprises.

1.8 Typical security created

Typical security interests include:

- (a) Mortgage over the land use right and/or real property;
- (b) Guarantee provided by the borrower or its parent company; and
- (c) Pledge over the shares of the borrower or the company holding the title to the property.

The security documents should be in writing in order to create a valid security interest.

In addition, registration is mandatory in certain circumstances in the PRC to create security interest, such as mortgage over the land use right and/or real property and pledge over shares of a PRC-registered companies.

If a security interest is of a cross-border nature which falls within the scope of onshore security for offshore

indebtedness (where a security interest is provided by an onshore guarantor for a debt owed by an offshore debtor to an offshore creditor) or offshore security for onshore indebtedness (where a security interest is provided by an offshore guarantor for debt owned by an onshore debtor to an onshore creditor), such security is subject to registration with the competent local counterpart of SAFE within 15 working days upon execution of the security documents. If not, performance of the security agreement in question may not be achieved due to the potential failure of fund remittance.

1.9 Restrictions for foreign lenders

Please refer to the debt-equity-ratio requirements under [Section 2.2](#) and restrictions on foreign loan to the foreign-invested real estate enterprises under [Section 3.1](#).

1.10 Costs relating to the granting and enforcement of security

In the PRC, stamp duty is payable on loan agreements with financial institutions.

A registration fee for the registration of real estate mortgages and share pledge will also be payable. If the party to a financing or security documents is a non-PRC party, notarization by a notary public and authentication by a competent Chinese embassy/consulate may be required and relevant fees will be incurred correspondingly.

Commercial leases

1.11 Lease agreements

Types of leasing arrangements

Generally, the law recognizes contractual agreements under which occupation and use of real property is let for a certain period of time. Written lease contracts are required if the intended lease term exceeds six months.

All residential, commercial and industrial letting are principally governed by the PRC Civil Code and the Administrative Measures for Commercial Real Estate Leasing. Local leasing policies and decrees may also apply.

Common terms in commercial leases

Unless provided by law, parties will be free to negotiate and agree on the terms of commercial leases. The lease agreement generally contains the following:

- (a) Details of the parties;
- (b) Location, area, structure, ancillary facilities, furniture and fixtures status of the property;
- (c) Rental, deposit and payment term;
- (d) Usage;
- (e) Lease term;
- (f) Repair and maintenance liabilities;
- (g) Payment of the property management fee and applicable utility fees;
- (h) Dispute settlement; and
- (i) Liabilities of breach.

In certain cities, a prescribed form lease must be adopted when submitting the lease for registration. However, the parties can amend its provisions.

Commercial leases typically last 3 to 5 years, while residential leases generally last 12 months with an option to renew. The lease term for all types of leases cannot exceed more than 20 years. Tenants are not guaranteed to a right of renewal at the end of the term unless otherwise provided in the lease, and any renewals cannot exceed 20 years from the date of renewal.

1.12 Managing leasing agreements

Security of tenure

Tenants are not guaranteed to a right of renewal at the end of the term. However, fixed-term leases may be renewed automatically under the same terms if the lessee continues to occupy the property after the expiry of the lease and there is no objection from the lessor. Nevertheless, such renewed lease may still be terminated at any time if the lessor gives reasonable notice.

Recovering real estate from a lessee

The lessor may include a term in the lease contract penalizing the late return of premises. Alternatively, if the lessee does not vacate the premises after termination of the lease or expiration of the lease term, the lessor can demand rent for the period in which the lessee remains in the premises.

Early termination

Many leases provide the lessor with a right to terminate and re-enter the premises in the event that the lessee breaches the lease agreement and fails to remedy a remediable breach within a stipulated notice period. Development clauses are also included in



many leases, which give the lessor the right to redevelop the building.

Termination by third party

The government may expropriate land and pay compensation if it is in the public interest. Examples of public interest may include national defence and foreign affairs; construction of infrastructure and rebuilding of old urban areas under the Urban and Rural Planning law.

The lease typically provides for the above situations or is covered by the *force majeure* clause.

Security for protecting against failure by lessee to meet obligations

The lessor typically would do the following to protect against a failure by the lessee to meet its obligations:

- (a) Require the lessee to provide a security deposit consisting of certain months' rent and/or certain months' management fee; and
- (b) Require the lessee to provide a down payment of one month's rent.

Transfer of lease

Unless otherwise provided by the lease, the lessee can only sublet or assign the lease to third parties with the lessor's written consent.

Right of first refusal

If the lessor intends to sell the leased premises, it shall notify the lessee within a reasonable time before the sale, and the lessee shall have the right of first refusal under the same conditions except for in situations where the co-owner of the premises exercises the right of first refusal or the lessor sells the premises to immediate family members.

If the lessee fails to explicitly indicate the intention of purchase within fifteen days upon receipt of the lessor's notice, the lessee shall be deemed to have given up the right of first refusal.

1.13 Managing a leased real estate

Restrictions on use

Lessees are only entitled to use the premises for the purposes specified in the lease. If the lease does not provide for a specified purpose, the premises can only be used for the purposes aligning with that specified in the Property Title Certificate.

Alterations

Structural repairs by a lessee which involve alteration of the building's form and framework are usually not allowed.

The lessor's consent should be sought when undertaking non-structural alterations. If such consent is not sought, the lessee must pay the full cost and reinstate the premises to their original condition, or compensate for damages, upon the expiration of the lease.

1.14 Rent

Rent variation

Rent payable remains the same during the term, but is typically subject to an annual increase, which is specified in the lease. For retail leases, it is common for the lessee to pay either the turnover rent or fixed rent, whichever is higher.

Taxes for rental

There are a series of taxes that apply to the lessors. For full details, please refer to [Section 5](#).

1.15 Costs for tenants other than rent

Costs payable by tenants at start of lease

The lessor will usually require the lessee to pay a rent security deposit, which is refundable without interest upon termination of the lease unless the lessee breaches the lease. The lessor may also require deposits for utilities and/or management fees.

The lessee will need to pay stamp duty and in most cases, the lease registration fee as applicable.

Maintenance and repairs

The maintenance and repair costs of the common areas are generally covered by the management charges. The burden to pay such management charges is open for negotiation between the parties.

The lessor shall perform the duty of maintaining and repairing the leased premises, unless the parties stipulate otherwise in the lease. If the lessor fails to do so, the lessee may maintain and repair the premises at the lessor's expense. If the maintenance and repair of the leased premises affects the lessee's use of the premises, the rent shall be reduced or the lease term extended accordingly.

Utilities and telecommunications

Such services are usually subscribed and paid by lessees directly to third-party suppliers. If separate metering is not possible for the leased premises, the landlord can arrange for the supply of utilities and apportion the charges to the respective lessee accordingly or cover such charges in the management fees payable by the lessee.

Insurance

The laws do not set out which party is responsible for insuring the premises. However, the lessor usually pays for the cost of insurance and the insurance policy is taken out under the lessor's name.

Furthermore, leases typically contain clauses which:

- (a) Require the lessee to purchase insurance covering damages caused to the leased property or third parties because of the lessee's activities on the leased premises; and
- (b) Require the lessee to purchase third-party and fire insurance to cover damages to common areas of the leased property and premises of other lessees (caused by the lessee's fitting out of the leased premises during the rent-free fitting out period, if any).

Taxes

1.16 Tax liabilities of purchasers

Types of taxes

Asset transfer

In an asset transfer, the purchaser is subject to the taxes set out in the following table:

Type of Tax	Rate
Deed Tax	3-5%, but reduced rate may be available depending on the size, holding period, location and other conditions of the property
Stamp Duty	0.05% of the transfer price but exemption is available in the case of purchase of the residential property by an individual

Purchasers may enjoy tax reduction or exemption upon satisfaction of certain requirements.

Onshore Share Transfer

In an onshore share transfer, the purchaser is subject to stamp duty, which is payable at 0.05% of the share transfer price.

In the context of an intra-group restructuring, subject to certain criteria, such transactions may be considered as special reorganization and the recognition of the gain or loss on the transfer of the shares or assets will be deferred, resulting in deferral of EIT liability.

1.17 Recurring Taxation

Profits tax

Income arising from an investment in real estate generally includes the following:

- (a) Rental income; and
- (b) Sales income.

Please refer to [Section 5.3](#) for taxes applicable to sales income.

Taxes applicable to rental income is shown below:

Type of Tax	Rate
Value-added Tax ("VAT")	<p><u>For enterprise lessor:</u></p> <ul style="list-style-type: none"> ● Small-scale VAT taxpayers: 5% on rental income but exemption might be available depending on the amount of the VAT taxable income ● General VAT taxpayer: 9% <p><u>For individual lessor:</u></p> <ul style="list-style-type: none"> ● 1.5% for letting of residential property and 5% for letting of non-residential property. Exemption might be available depending on the amount of the rental income.
Urban Construction & Maintenance Tax ("UCMT")	1%, 5% and 7% on paid VAT depending on the location of the taxpayer
Education Surcharge ("ES")	3% on paid VAT
Local Education Surcharge ("LES")	1% or 2% on paid VAT, collected in some cities such as Shanghai
Stamp Duty ("SD")	0.1% payable by both the lessor and lessee, but exemption is available in the case of letting of the residential property by an individual
Real Estate Tax	12% of the annual rental income, but exemption or reduction might be available in the case where the lessor is an individual
Urban and Township Land Use Tax	In the range of RMB0.6 to 30 per square meter depending on the location of the property, but exemption is available in the case where the lessor is an individual
Individual Income Tax ("IIT")	<p><u>For individual lessor:</u></p> <p>20% on rental income after certain deduction, but reduction might be available in some cities</p>
Enterprise Income Tax ("EIT")	<p><u>For enterprise lessor:</u></p> <ul style="list-style-type: none"> ● Rental income forms part of taxable income for calculation of EIT if the enterprise lessor is a PRC registered entity. The statutory EIT rate is 25% of net profit and favorable tax treatment (such as reduced tax rate) may be available under certain circumstances ● 10% of the rental income if the enterprise lessor is a foreign entity

Property tax

Owners of property are subject to Real Estate Tax (房产税, "RET"). Depending on the use of the real property, the rate and the tax base for RET will differ. For properties held for lease, a rate of 12% of the annual rental income is imposed. For self-used properties, a rate of 1.2% of the property's adjusted cost (with a 10% to 30% deduction from the original cost) is imposed. The implementation practice might vary depending on location.

Individuals are normally exempted from RET on residential property. Shanghai and Chongqing have

released interim pilot measures relating to RET on residential property owned by individuals.

Other costs

Urban and Town Land Use Tax is imposed on the entity or individual which/who uses the land in cities, counties, administrative towns, industrial and mining areas. The amount payable depends on the size of the land (in square metre). This differs among different regions from about RMB0.6 to RMB30 per square metre, and is calculated on an annual basis and paid in installments pursuant to the local regulations.

1.18 Tax liabilities of sellers

Types of taxes

Asset transfer

In an asset transfer, the seller is subject to the taxes set out in the following table:

Type of Tax	Rate
Value-added Tax ("VAT")	<p><u>For enterprise seller:</u></p> <ul style="list-style-type: none"> ● Small-scale VAT taxpayers: 5% ● General VAT taxpayer: 9% <p><u>For individual seller:</u> 5%, but exemption may be available under certain circumstances where the individual seller sells his/her ordinary residential property satisfying some qualifying conditions</p>
Urban Construction & Maintenance Tax ("UCMT")	1%, 5% and 7% on paid VAT depending on the location of the taxpayer
Education Surcharge ("ES")	3% on paid VAT
Local Education Surcharge ("LES")	1% or 2% on paid VAT, collected in some cities such as Shanghai
Stamp Duty ("SD")	0.05% of the transfer price but exemption is available in the case of sale of the residential property by an individual
Land Value Appreciation Tax ("Land VAT")	<p><u>For individual seller:</u></p> <ul style="list-style-type: none"> ● Residential property: exempted ● Non-residential property: progressive rates ranging from 30% to 60% on the appreciation amount <p><u>For enterprise seller:</u></p> <p>Non-residential property: progressive rates ranging from 30% to 60% on the appreciation amount.</p>
Individual Income Tax ("IIT")	<p><u>For individual seller:</u></p> <p>20% on net gain but tax exemption or reduction may be available depending on the nature, size, holding period, location and other conditions of the property</p>
Enterprise Income Tax ("EIT")	<p><u>For enterprise seller:</u></p> <ul style="list-style-type: none"> ● Gains arising from the property transfer form part of taxable income for calculation of EIT if the enterprise seller is a PRC registered entity. The statutory EIT rate is 25% of net profit and favorable tax treatment (such as reduced tax rate) may be available under certain circumstances ● 10% of the share transfer price if the enterprise seller is a foreign entity

Onshore Share Transfer

In an onshore share transfer, the seller is subject to:

- (a) **Stamp Duty:** 0.05% of the share transfer price;
- (b) **EIT** applicable to company seller:
 - i. 10% of the share transfer price if the seller is a foreign entity;
 - ii. Capital gains arising from the Onshore Share Transfer form part of taxable income for calculation of EIT if the seller is a PRC registered entity. The statutory EIT rate is 25% of net profit and favorable tax treatment (such as reduced tax rate) may be available under certain circumstances.
- (c) **IIT** applicable to individual seller: 20% of net gain and IIT may be reduced or exempted under certain circumstances; and
- (d) **Land VAT:** Technically speaking, pursuant to the PRC Land VAT regulations, the transfer of equity interest in a PRC tax-resident enterprise should not give rise to Land VAT as any underlying real estates are not directly transferred. However, the tax authorities may seek to impose Land VAT on the transfer of an equity interest in a PRC company that directly holds real estate if the transfer consideration is equivalent to the value of the real estate and/or the primary purpose of the equity transfer is to transfer the land use right and/or real property (rather than the company).

In the context of an intra-group restructuring, subject to certain criteria, such transactions may be considered as special reorganization and the recognition of the gain or loss on the transfer of the shares or assets will be deferred, resulting in deferral of EIT liability.

Offshore Share Transfer

Generally, for an Offshore Share Transfer under the PRC's existing offshore indirect transfer reporting and taxation rules, if an offshore indirect transfer of Chinese taxable assets (including shares, immovable assets, etc.) by a non-PRC-resident enterprise is considered without reasonable commercial purposes, the transaction would be re-characterized as a direct transfer of Chinese taxable assets and subject to PRC EIT at the rate of 10%.

The potential exposure of Land VAT discussed under the above onshore share transfer section might also apply.

Taxation of distributions

Withholding EIT of 10% is imposed when dividend distributions are transferred by the onshore vehicle to non-PRC tax resident enterprise shareholders, which may be reduced to as little as 5% under certain tax treaties. On the other hand, dividends distributed to PRC tax resident enterprise shareholders and non-PRC tax resident individual shareholders are currently tax exempt in the PRC.

1.19 Tax treaties

The PRC has 107 signed agreements on avoidance of double taxation ("**DTAs**") as of 30 April 2020, among which 101 DTAs have already taken effect, and more than 10 tax information exchange agreements and one multilateral convention of mutual administrative assistance in tax matters. The DTAs of China basically followed the Model Treaty Convention of the OECD. Mainland China has also entered into arrangements with Hong Kong, Macau and formed an agreement with Taiwan for avoidance of double taxation.

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Joyce is a senior legal and tax manager in the corporate team. She is a PRC legal and tax specialist based in Withers' corporate team in Hong Kong. She focuses on mergers and acquisitions, foreign direct investments, joint ventures, corporate, commercial and employment matters related to investment and operation in China. She has advised a number of MNEs on their retail and office leases in China. She also advises on a variety of PRC-related tax matters, including tax compliance and tax incentive application.

Joyce advises clients across a wide range of sectors, including retail, distribution, technology and pharmaceutical.

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Our real estate practice in Asia

Our real estate team represents a one-stop shop for all types of investors' real estate needs, covering the full life cycle of a property transaction. We have a great deal of experience on the sale and purchase of investment properties and our particular strength is structuring cross-border property transactions effectively.

Our clientele spans across the industry from developers, landowners, investors, lenders and borrowers, banks and fund managers. We aim to establish long-term relationships with our clients at all levels.

Our services include:

- Joint ventures and mergers and acquisitions
- Sale and acquisitions
- Tenancy agreements
- Leases and licenses for residential, commercial and industrial properties
- Development and real estate financing / re-financing

Working in collaboration with our global offices, we are able to coordinate the needs of our clients wherever their property holdings may be.

With... a wider range of services:

Banking and finance

Corporate

Hotels

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Tax

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Family

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