

## REFORM OF LAND SYSTEM IN CHINA

This article outlines the present land system in the People's Republic of China. It explains the difference between land ownership and land use rights. It also discusses problems related to land use rights over state-owned land.

AS China's economic reforms gather momentum, a new land system is also beginning to take shape. The aim of the most recent set of land reforms is to separate the land use right from ownership, while retaining the basic principle of public ownership of land. Since 1988, a new land use system has been emerging.<sup>1</sup> This article attempts to analyze and appraise these reforms and developments in China's land law with regard to state-owned land.

### I. LAND OWNERSHIP AND LAND USE RIGHTS

It is important at the outset to elucidate the difference between ownership of land and land use right under Chinese law. Land ownership refers to the right of the owner of the land to possess, use, or otherwise benefit from, as well as dispose of, the land.<sup>2</sup> The land users, on the other hand, have the exercise of their rights circumscribed by law.

#### *A. Land Ownership*

In the early stages after the establishment of the People's Republic of China, the land system was that of state ownership of land co-existing with private ownership by peasants. The state, in other words, owned all urban land and part of suburban land, while the peasants owned rural land as well as part of the land in suburban areas. Peasant-owned land could be leased or bought and sold by the peasants.<sup>3</sup>

<sup>1</sup> Wang Xianjin (former head of the States Administration Bureau), Internal Guidelines (1992) (unpublished).

<sup>2</sup> Zhang You Yu, Pan Nian Zhi, Wang Min Can, et al (eds), *Zhongguo Da Baike Quanshu* (China Encyclopaedia Volume on Law) (1984), at 572.

<sup>3</sup> Land Reform Law of the People's Republic of China (promulgated and implemented on 30 June 1950); Urban and Suburban Land Reform Regulations (promulgated and implemented on 21 November 1950).

From 1955, villages began to be organized into cooperatives and people's communes. Privately-owned rural land became converted, and thus subjected to collective ownership.<sup>4</sup> In 1960, the system was replaced when China adopted a land system comprising a co-existence of two types of ownership of land, namely, state-ownership and collective-ownership, respectively. This system still exists today. Hence, there are now two main categories of land: land owned by the state and land owned collectively by rural economic organizations. China's laws do not, at present, allow private ownership of land.

The various types of state-owned land include:

- a. urban land, portions of suburban land and rural land;<sup>5</sup>
- b. land requisitioned by the state and used and managed by industries, enterprises, the armed forces, schools, state organs and other institutions;
- c. state-owned land over which rights of use are granted by law to state-owned, collectively-owned working units and individuals;<sup>6</sup>
- d. undeveloped land, mountain ranges, seashores, forests, pastures, bodies of water, and unused land designated by law to be state-owned land;<sup>7</sup> and
- e. other land lawfully expropriated or requisitioned by the state.

The various types of collectively-owned land include:

<sup>4</sup> Revised Draft of Working Regulations for Rural People's Communes (also known as the "sixteen regulations") adopted at the tenth meeting of the Eighth Central Committee provided that "land within the premises of a production brigade shall be owned by the production brigade. Land owned by production brigades, including family or private plots, residential areas, *etc.*, of individual members of the team, may not be leased or traded....In addition, land owned by a production brigade may not be used or possessed by any unit or individual without the approval of the relevant committee of the people's government at county level and above."

<sup>5</sup> Constitution of the People's Republic of China (adopted in 1982, and amended in 1988 and 1993), Art 10. Hereinafter referred to as the "Constitution".

<sup>6</sup> Land Administration Law of the People's Republic of China (passed on 26 June 1986). Art 7 as amended in April 1988 provides that "State-owned land may be lawfully determined to be used by units under ownership by the whole people or units under collective ownership. State-owned land and collective-owned land may be lawfully determined to be used by individuals."

<sup>7</sup> *Supra*, note 5, Art 9.

- a. rural land and some suburban land (except the land owned by the state);
- b. residential areas; and
- c. plots of rural land belonging to peasants for family or personal use (family or private plots).<sup>8</sup>

Insofar as the land use rights regime was concerned, for thirty years (from 1949 to 1979), all land use was without charge in either urban or rural areas. This method of free land use created many problems.

Since 1979, China's economic reforms also included the area of land use. Where collectively-owned land was formerly put to collective use, such land is now utilized and managed by rural families as independent economic units. In some areas, fees are charged for the use of residential land. Nevertheless, land use rights of collectively-owned land are still not, in law, allowed to be the subject of grants (*ie*, sales), transfers or leases.<sup>9</sup> It should also be noted that collectively-owned land may not be directly used as the subject matter of land development projects by Sino-foreign joint ventures. Rural collective economic organizations also have no authority to grant for consideration or lease land owned by them to foreign or foreign-owned investment enterprises. ( This author has heard of cases where certain counties or villages have signed joint venture agreements with foreign enterprises for land development projects. If the land in question has not been requisitioned by the state and is owned by the state, such agreements will, in fact, not be valid).

The key point of the land reform is to separate the ownership and the land use right for state-owned land. The position of the state as the owner of land does not change, while the holders of land use rights enjoy such rights only for limited periods as provided by law. No organization or individual may own private land (*ie*, there is no freehold land as such).<sup>10</sup> Thus, the land reforms really address problems of the grant and transfer of land use rights. State-owned land, administratively allocated without price in the past, is now granted and transferred for consideration, thus creating a property market which is even now in the early stages of development. The issues relating to land use rights of state-owned land are recognized

<sup>8</sup> *Supra*, note 5, Art 10 and note 6, Art 6.

"Residential area" means village land that is not cultivated, whether or not built upon.

"Family or private plots" means small plots of collectively-owned land, including land in hilly areas, which are allocated to individual peasants for long-term use.

<sup>9</sup> *Supra*, note 6, Art 2.

<sup>10</sup> *Ibid*.

to be an important subject of analysis in this article and shall thus receive further treatment below.

### *B. Land Use Rights over State-Owned Land*

Presently, there are two ways of obtaining land use rights over state-owned land: first, by administrative allocation, and second, by grant for consideration. The land use rights obtained by these two methods are very different in terms of the rights and obligations of land users.

Allocated land use rights (the more established form of land use right) are obtained without consideration.<sup>11</sup> Land in cities and towns has been administered under the allocation system since 1949. Under this system, the prospective land user applies for land use rights according to a prescribed procedure. If the application is successful, the land use rights are allocated, without consideration from the land user, for an indefinite period. Once allocated, the land use rights are non-transferable. After 1988, legislation was introduced which required the land user to pay land use tax and land use fees. The land use tax is of nation-wide application and applies to all allocated land use rights except for land use exempted under Article 6 of the Interim Regulations of the People's Republic of China on Tax on Land Use in Cities and Towns.<sup>12</sup> Subject to local variations, land use by foreign investment enterprises is generally subject to land use fees. For example, according to the Measures of the City of Beijing on the Collection of Land Use Fees from Foreign Investment Enterprises promulgated by the Beijing People's Government in September 1992, land users setting up foreign investment enterprises within the precincts of Beijing city must pay land use fees to the local government. However, in comparison to sums usually paid for land use rights granted for consideration, land use fees for allocated land use rights are much cheaper.

Allocated land use rights are subject to state controls. Approval from the state is required for transfer, lease or mortgage of the land use rights.<sup>13</sup> Where it deems it necessary, the state may even withdraw the land use rights at any time.<sup>14</sup> Before allocated land use rights, buildings on the land

<sup>11</sup> Interim Regulations of the People's Republic of China on Granting and Transferring the Right to the Use of State-Owned Land in Cities and Towns (promulgated by the State Council on 19 May 1990), Art 43, para 1.

<sup>12</sup> Interim Regulations of the People's Republic of China on Tax on Land Use in Cities and Towns (promulgated by the State Council on 1 November 1988) which provides for a range of land use tax rates from 0.20 to 10 yuan per square meter, depending on the land use and other considerations relating to the particular circumstances in each city or town.

<sup>13</sup> Interim Measures for the Administration of Allocated Land Use Rights (promulgated by the State Land Administration Bureau on 8 March 1992), Art 5.

<sup>14</sup> *Supra*, note 11, Art 47.

and other fixtures on the land may be transferred, leased or mortgaged, four conditions as stipulated in Article 45 of the Interim Regulations of the People's Republic of China on Granting and Transferring the Right to the Use of State-owned land in Cities and Towns promulgated in 1990 (hereinafter "Interim Regulations") must be satisfied:

- a. the land user is a corporation, enterprise or other economic organization or individual (this implies that non-profit organizations, such as schools and state organs, do not enjoy such rights);
- b. the certificate for use of state-owned land has been obtained;
- c. legal title certificates for buildings and other fixtures on the land have been obtained; and
- d. the contract for granting the land use rights has been signed and land use fees for the granting of the land use rights have been retroactively paid to the people's governments of the relevant cities or counties or such payment has been made with proceeds from the transfer, lease or mortgage of the land use rights.<sup>15</sup>

It can be seen from the four conditions just set out above that in order for allocated land use rights to be transferred, leased or mortgaged, they must in effect be converted to land use rights granted for consideration (which is, in fact, the second mode of obtaining land use rights over state-owned land, a category analyzed below). The procedure for effecting such a conversion may be found in the Interim Methods for the Administration of Allocated Land Use Rights (8 March 1992) issued by the State Land Administration.

Land use rights granted for consideration refers to the land use rights obtained by the land user from the state in return for a one-time payment. This type of land use rights has a fixed duration stipulated by law. It is more autonomous and extensive than allocated land use rights. Land users may, with the sanction of the relevant laws, transfer, lease or mortgage the land use rights. This creates greater flexibility for the development, utilization and management of land. Particular issues regarding land use rights will be discussed later in this article.

In practice, foreign investors utilizing the wholly-owned foreign enterprise form in carrying out land development and management will only encounter issues relating to land use rights granted for consideration. Where the investment form is the equity or cooperative joint venture, the

<sup>15</sup> *Supra*, note 6, Arts 10 and 11.

foreign investor may have to deal with allocated land use rights. Thus, when negotiating a joint venture or a transfer of land use rights in China, a foreign investor must know two important facts: first, who the holder of the land use rights is; second, what kind of land use rights these are, *ie*, whether they are allocated land use rights or land use rights granted for consideration. Further, if the land use rights are to be contributed by the Chinese joint venture party as its capital contribution to the joint venture, it is important to ascertain if the land use fees for the granting or allocation (as the case may be) of the land use rights have been paid by that party. A concrete illustration of possible pitfalls facing the foreign investor in this regard concerns a Chinese joint venture party which purported to contribute land use rights as part of its capital contribution without either having paid the land use fees or obtaining the land use certificate. After the setting up of the joint venture, the Chinese party requested the joint venture enterprise to pay the land use fees. To avoid such problems, the nature of the land use rights should be thoroughly investigated at the negotiation stage, so as to clarify the mutual rights and obligations of the parties and thus ensure the smooth implementation of the joint venture.

## II. GRANT OF RIGHT TO USE STATE-OWNED LAND FOR CONSIDERATION

Rights to use state-owned land granted for consideration (hereinafter “granted land use rights”) were introduced in China only in the 1990s. It is a departure from the old system of administrative allocation of land use rights discussed above. This method of dealing with land use rights by contractual rather than administrative means allows for greater fluidity in allocation of land resources. It has also paved the way for the formation of a property market in China.

The grant of state-owned land involves the following characteristics:

- (1) The market for the grant of land use rights (referred to as the primary market) is monopolized by the state. The land to be granted, its use, the duration of the grant and other conditions of the grant are all subject to the overall plans of the governments of cities and counties for land utilization.
- (2) Only state-owned land may be the subject matter of grants of land use rights. Land which is collectively-owned must first be requisitioned by the relevant land administration department, *ie*, converted into state-owned land, in accordance with the relevant

laws before land use rights can be granted. This change in the nature of the land use rights must be registered.<sup>16</sup>

- (3) The grant of land use rights does not include the rights to underground resources, buried articles or public utilities.<sup>17</sup> The Constitution of China provides that ownership of mineral resources and land are different subject matters. Thus the ownership of underground resources, buried articles and public utilities is separate and independent from the ownership of land<sup>18</sup> and is not transferred together with the grant of land use rights.
- (4) The state exercises control over the entire process involving the grant and transfer of land use rights through various measures. First, the overall plans for the land use rights to be granted must be examined and approved by the relevant government department. Second, during the development of the land, the land administration department has the right to inspect and supervise the performance of the contract under which the land development is being carried out. If the land is not developed and put to use in accordance with the contract schedule, the land administration department may issue warnings, impose fines and even withdraw the land use rights without compensation. Where land use rights are transferred for prices which are “unreasonable”, the government may also take steps to control prices.

#### A. *Methods of Granting Land Use Rights*

Three methods of granting land use rights are provided by law: by agreement, by tender or by auction. The State Council has yet to make regulations governing the use of these three methods but has delegated this task to the local governments.<sup>19</sup> There are thus regional differences in the procedures for each of the three methods just mentioned. Research into local regulations is therefore required for a full understanding of the applicable procedures.

Generally, the procedure for the agreement method is as follows: the prospective land user applies to the land administration department for the grant of land use rights; the land administration then negotiates with the prospective land user and a contract for the grant of land use rights is signed. This method is very flexible, especially in the negotiation of the price. Its

<sup>16</sup> *Ibid.*

<sup>17</sup> *Supra*, note 11, Art 2.

<sup>18</sup> *Supra*, note 5, Arts 9 and 10.

<sup>19</sup> *Supra*, note 11, Art 13.

disadvantage is its lack of openness. For this reason, the subjective perceptions of the land administration officers may exert inordinate influences. Furthermore, this method is not conducive to fair competition, and is susceptible to corrupt practices.

Tender and auction procedures are roughly similar: the city or county land administration department publishes a public notice of the tender or auction; at the end of the process, the land user and the land administrative department sign a contract for the grant of land use right.

Regardless of the method used, however, the land administration department should provide the following information:

- a. the location, area, boundaries and other physical features of the land to be granted;
- b. the proposed use of the land, building requirements and the condition of public utilities;
- c. method of grant of the land use rights and the period;
- d. the price and method of payment; and
- e. provisions for the sale and management of buildings upon the land.<sup>20</sup>

#### B. *Period of Grant of Land Use Rights*

The maximum periods of land use rights are governed by statute. Maximum periods are fixed by national legislation and local governments may stipulate more detailed rules according to the type of land use concerned. The general principle adopted is that local regulations may not exceed national limits set by the central government. Residential land use rights are granted for longer periods compared to other types of land use.

Article 12 of the Interim Regulations of 1990 sets out the following maximum periods: 70 years for residential use; 50 years for industrial, educational, scientific and technology, culture, health, sports as well as combined uses; and 40 years for commercial tourism and recreational activities. These are, however, merely broad divisions of the different kinds of land use. In practice, the problem is more complex. For example, a building may be built that has a basement car park, two stories of department stores, with the third and higher floors comprising residential units. What should

<sup>20</sup> Nan Luming & Xiao Zhiyue, "Land Law of the People's Republic of China" (1990), at 54.



be the period of land use rights for such a building? If the lowest limit is applied, *ie*, 40 years for commercial use, or if the limit of 50 years for combined use is applied, this would seem unfair to the purchasers of the residential units. If the highest limit of 70 years for residential use is applied, this would exceed the statutory limit for commercial use of land. This ambiguity is the result of a lack of details in the law. Supplementary legislation is required to resolve this problem.

### *C. Liability for Breach of the Contract for Grant of Land Use Rights*

Article 14 of the Interim Regulations provides: "Land users shall, within 60 days after signing the contract for grant of land use rights, pay the full amount of the fees for the grant of land use rights. In the event that the fees are not paid within the time limit, the granting party shall have the right to rescind the contract and may demand compensation for breach of contract." This requirement is the land user's most important obligation.

It must be pointed out that the act of granting the land use right may not occur at the same time as the vesting of the land use right in the land user. Very often, what happens is that the land use rights vest in the land user only after the performance of the land user's obligation under the contract, *ie*, full payment of the fees owed. During the interim period, the contract serves to set out each party's obligations, the breach of which will result in liability to pay damages or a fine. However, the Regulations have not, as yet, set out detailed provisions concerning the obligations and liabilities for breach. In addition, Article 17, paragraph 2 of the Interim Regulations provides as follows: "In case of failure to develop or utilize the land in accordance with the duration and conditions prescribed by contract, the land administration departments of the people's governments of cities or counties shall correct it and may, according to the seriousness of the case, impose such penalties as warning, fine or even revocation of the land use rights without compensation." It can be seen that the dates for performance and other conditions of the contract are mandatory and land users will be held strictly to them. Failure to comply will result in varying degrees of administrative penalties.<sup>21</sup> The flaw in this provision is that it allows too much discretion to the authorities enforcing the contract. First, insofar as the phrase "according to the seriousness of the case" is concerned, the article does not specify any guidelines for determining the

<sup>21</sup> There are three types of administrative penalties:

- (i) Warning: this is a relatively light penalty serving both as a reprimand and a caution to offenders. It is meant to have educative and coercive functions;
- (ii) Fine; and
- (iii) Revocation of land use rights.

degree of “seriousness” which should result in the commensurate penalty. Different interpretations can arise, and this creates problems in enforcing the article. Second, the range of penalties from a mere warning to rescission of the land use rights<sup>22</sup> does not leave much middle ground for taking into account varying degrees of default as well as extenuating circumstances. This is compounded by the first problem, *ie*, the lack of guidance as to the correspondence between varying degrees of default and commensurate penalties. The article also does not provide for guidance to be sought in other statutory provisions. This state of affairs does not contribute to the objective of deterring non-compliance with the law, to say the least, and creates a loophole for evading heavy penalties commensurate with serious breaches of the law. This may result in unfairness in the prosecution of the law, and thereby weaken its authority.

### III. TRANSFER OF THE STATE-OWNED LAND USE RIGHT

A transfer of land use rights is distinct from a grant of land use rights: “The transfer of land use rights refers to the act through which a land user transfers his land use rights...”<sup>23</sup> In simple terms, a “grant” is the act of the state selling the land use rights to a land user, whereas a “transfer” is a private transaction between land users. One of the aims of China’s land reform is to establish a complete property market with two levels: a primary market for grant of land use rights, and a secondary market for transfers. These two levels of market have been recognized by both national and local legislation. Specific issues regarding transfers are discussed below.

#### A. *Forms and Principles*

Three forms of transfers are recognized by law: sale, exchange, and gift.<sup>24</sup> This form of sale is different from other forms of sale in that it does not pass ownership of the subject matter to the purchaser. Rather, it merely transfers the rights of use, with the rights of ownership remaining vested in the state.<sup>25</sup> This follows, of course, from the basic principle of the separation of ownership from the land use right. The second mode, exchange, is simply the transfer of the land use rights between two land users or one party exchanging land use rights for something other than money. In a transfer by gift, the donor transfers his land use rights without consideration

<sup>22</sup> *Ibid.*

<sup>23</sup> *Supra*, note 11, Art 19.

<sup>24</sup> *Ibid.*

<sup>25</sup> *Supra*, note 20, at 136.

to the donee, who accepts and becomes the holder of the land use rights.<sup>26</sup>

A transfer of land use rights is a civil legal act and a civil legal relationship between the parties is created. Thus, civil law principles of equality between the parties, free will in entering into the transaction, adequacy of consideration, bona fides and the national and public interest, apply to the above three forms of transfers of land use rights.<sup>27</sup>

### B. *Special Characteristics*

The special characteristics pertaining to the transfer of land use rights can be summarized as follows: prerequisite for transfer, legal restrictions and allowed government intervention.

#### 1. *Prerequisite for Transfer*

The prerequisite for transfer is as follows: the land use right can be transferred only when the land development terms had been fulfilled within the time stipulated in the contract.<sup>28</sup> The legislative intent is to prevent speculation and encourage the performance of the land development objectives by the investor. However, the Interim Regulations only provide general, as opposed to detailed, provisions. This means that detailed requirements are left to local governments. In some regions, *eg*, Shenzhen, Shanghai, Guangzhou, Qingdao, Fuzhou, Xiamen and Haikou,<sup>29</sup> detailed regulations have in fact been laid down. Although these regulations vary from place to place, they have exerted a positive effect in checking property speculation. However, legislation has not been specific and perfect in some cases, so some flaws have been revealed in practice. For example, some “developers”, after obtaining the grant of land use rights over a piece of land, do not develop nor make any further investments in the land for long periods of time. They wait for the land to appreciate in value, and hope to profit without lifting a finger. The Chinese government has become aware of the seriousness of the problem of land investment “overheating”, and has, recently, enacted the Law of the People’s Republic of China for the

<sup>26</sup> The law does not make clear whether inheritance is a mode of transfer. It is submitted that it should be a mode of transfer, but one with special characteristics. By and large, a transfer by inheritance would not be subject to the terms and conditions governing a contract of grant of land use rights. As a transfer by inheritance arises out of unforeseeable circumstances, the only condition precedent to such a transfer is the sudden death of the grantee of the land use rights.

<sup>27</sup> Tang Shuhua and Xie Weidong (Eds), *Zhongguo Fangdichan Shiwu Quanshu* (1992, Xinshidai Publishers), at 151.

<sup>28</sup> *Supra*, note 11, Art 19.

<sup>29</sup> *Supra*, note 24, at 140-141.

Administration of Real Estate in Cities.<sup>30</sup> Among other things, the Law provides in Article 11 that where a land user has delayed commencing development of the land according to the land use and within the time stipulated in the contract for grant of land use rights, a fine of up to 20% of the fee for the grant of land use rights will be imposed where the delay is for a year. Where the delay exceeds two years, the land use rights may be withdrawn without compensation. This Law will be effective on 1 January 1995, thus adding greater detail to the prerequisites for the transfer of land use rights.

## 2. *Legal Restrictions*

The transfer of land use rights is subject to certain legal restrictions. As explained above, land in China is largely state-owned. The state is the principal landowner. Land use rights can be transferred an indefinite number of times, but the state remains the owner of the land, no matter who the land user is. There therefore exist rights and obligations between the state as landowner and each land user, which do not change even on transfer of the land use rights concerned. The Interim Regulations provide: "When land use rights are transferred, the rights and obligations set forth in the contract and registration document for granting land use rights shall be transferred therewith."<sup>31</sup> In addition, it provides that the remaining years in the period of the original grant after deducting the period of use already elapsed would be the land use period for the new land user.<sup>32</sup> Upon transfer of the land use rights, the ownership of ground buildings and attachments on the land shall be transferred therewith. The owners or co-owners of ground buildings and other attachments on the land shall enjoy the right to the use of land area occupied by such buildings and attachment.<sup>33</sup>

## 3. *Allowed Government Intervention*

The state has power to intervene in the transfer market. This intervention can take one of two forms: first, the state may control prices of transfers and, second, the government examines and approves all registrations of transfers and partitions of land use rights before transfer.

<sup>30</sup> Law of the PRC on Administration of Real Estate in Cities (adopted on 5 July 1994).

<sup>31</sup> *Supra*, note 11, Art 21.

<sup>32</sup> *Supra*, note 11, Art 22.

<sup>33</sup> *Supra*, note 11, Arts 23 and 24. In addition, Art 64 of Category 7 of "Opinion on Various Questions on the Implementation of Policies in Civil Law" of the Supreme People's Court, provides that when citizens lawfully buy or sell residential property in cities and towns, the land use rights of the property in question should pass with the ownership of the building to the new owner.

The city and county governments are authorized by statute to have a prior right to purchase land use rights where they are being transferred for consideration significantly below market value. The government is also authorized to take necessary actions to curb prices,<sup>34</sup> *eg*, by granting more land use rights, should the land use rights transfer market rise too sharply. Government intervention in the land use rights transfer market can have positive as well as negative effects. The positive effects include protecting an infant property market by restraining speculation; preventing profiteering; and directing investment towards actual development and use of the land, thus enhancing its value. However, the possible negative effects of government intervention should not be ignored. As the Chinese economy is in transition from a planned economy to a market economy, legitimate government powers of intervention may be abused by officials for private gain. Moreover, in a situation where the supply of and demand for land are in serious imbalance, it would be difficult to assess whether the rise or fall of transfer prices of land use rights is reasonable or whether government intervention is appropriate.

To give legal effect to a transfer of land use rights, examination and approval of the transfer by relevant government departments are necessary, over and above the documentary formalities. In addition, the transfer must be registered. Likewise, if the land use rights, buildings and other attachments on the land are to be partitioned and transferred separately, the approvals of the land administration department and the real estate administration department have to be obtained.<sup>35</sup> The partition referred to is not between the land use rights and the buildings and fixtures so that these are transferred separately. Neither does it refer to partition of a vacant plot of land. It refers to a situation where, for example, several residential blocks are built on a piece of land and are separately transferred. At the same time therefore, the land use rights have to be partitioned and transferred together with the respective blocks transferred. The examination and approval process for partitioning is intended to prevent loss of the utility of the land as a whole by excessive partitioning or non-compliance with municipal planning requirements.

### C. Lease of Land Use Rights

The lease of land use rights refers to the act by which a land user as lessor leases his land use rights together with buildings and fixtures on the land to a lessee for a rent. Before the land use rights can be leased, the land must be developed and utilized in accordance with the conditions stipulated

<sup>34</sup> *Supra*, note 14, Art 26.

<sup>35</sup> *Supra*, note 14, Art 25.

in the contract for grant of land use rights.<sup>36</sup>

Leasing is distinct from transferring of land use rights and there are specific legislative provisions governing it.<sup>37</sup> The main difference between the two is that a transfer effects a complete shifting of rights and obligations *vis-à-vis* the state as land owner from one land user to another, whereas in a lease, the land user continues to enjoy, and remains bound by, his rights and obligations under the grant of land use rights, and on that basis lets out the property for the lessee's use in return for rent.<sup>38</sup> In a lease, no transfer of land user rights is effected.

The procedure for a lease is relatively simple, involving only a contract for lease and registration. Every lease must be in the form of a written contract signed by both the lessor and lessee. The contract for lease must be registered with the local land administration department as well as the real estate administration department. The lease has legal effect only upon registration.<sup>39</sup> The law has not expressly provided whether the lessee may sublet the land use rights. One view is that subletting is permitted but should be subject to certain restrictions: first, the sublease should be based on actual business requirements and not as an improper means of making a profit or for other illegitimate reasons. Second, the consent of the head lessor must be obtained as the lessor-land user should have the right to determine whether the lessee can sublet the land use rights. If a sublease is given without these two requirements being met, the lessee subletting the land use rights will be liable for breach of contract.<sup>40</sup>

Should the lessor decide to transfer the land use rights, the land owner (*ie*, the state) has a prior right to the transfer of the land use rights on the same terms. The lessee is second in priority. The transfer of the land use rights does not affect any existing lease contract.<sup>41</sup>

#### D. Mortgage of Land Use Rights

After the establishment of the People's Republic of China, private ownership of land was totally abolished. Thus, the mortgage of land also ceased to exist in Chinese law. During the 1950s and early 1960s, due to the influence of Soviet jurisprudence, the concept of rights in rem was also abrogated, again severely limiting the effect of the mortgage, even if it had been possible under Chinese law. It was only in 1986 when China promulgated its General

<sup>36</sup> *Supra*, note 14, Art 28.

<sup>37</sup> *Supra*, note 11, Arts 28 to 31.

<sup>38</sup> *Supra*, note 24, at 155.

<sup>39</sup> *Supra*, note 11, Arts 29 and 31.

<sup>40</sup> *Supra*, note 26, at 155.

<sup>41</sup> *Supra*, note 25, at 159.

Provisions of Civil Law that the “mortgage” was recognized as a basic concept of law. However, the provisions on mortgages in the General Provisions of Civil Law are too rudimentary and brief. A number of important issues, *eg*, how a mortgage is created, when a contract for a mortgage becomes effective and various questions relating to the mortgage of land use rights, were not provided for in detail. Subsequently, the Supreme People’s Court issued a judicial interpretation of the provisions in the General Provisions of Civil Law regarding mortgages, which dealt with the subject in greater detail.<sup>42</sup> Following this, the major Chinese banks successively announced administrative procedures for loans secured by mortgages. When the State Council promulgated the Interim Regulations, there was a specific chapter dealing with the mortgage of land use rights. Some provinces and cities also established corresponding regulations.

Mortgage of land use rights is a means whereby a land user secures a debt owing from him with his land use rights. When the mortgagor (*ie*, the land user) fails to repay the debt on the date of repayment, the mortgagee may recover the debt from proceeds realized by transferring the land use rights.<sup>43</sup> It can be said that this is a form of “quasi-mortgage”, a mortgage of immovable proprietary rights. The mortgage of land use rights has two main characteristics. First, there is no transfer of the mortgaged property, *ie*, the land use rights are still exercised by the mortgagor. Also, the land use rights and the buildings and other fixtures on the land cannot be separately mortgaged.<sup>44</sup> Second, the mortgage must be registered. Where land use rights and/or ground buildings and other attachments on the land are acquired through the exercise of the mortgagee’s right to dispose of the mortgaged property or where the mortgage is discharged by the repayment of the debt or other reasons, registration procedures must be followed.<sup>45</sup>

#### *E. Developing and Operating Large Tracts of Land with Foreign Investment*

The development and management of large tracts of land with foreign investment refers to large-scale land development projects whereby foreign investment enterprises, after obtaining land use rights over state-owned land, undertake comprehensive development and construction upon the land. This includes developing the land for industrial use by levelling the land, building

<sup>42</sup> Arts 112 to 116 of the “Opinion of Supreme People’s Court on Various Questions Regarding the Trial Implementation of the General Principles of Civil Law of the People’s Republic of China”.

<sup>43</sup> *Supra*, note 24, at 173.

<sup>44</sup> *Supra*, note 11, Art 33.

<sup>45</sup> *Supra*, note 11, Arts 35, 36 and 38.

public utilities such as water supply, drainage, power supply, heat supply, road transport and communications, so as to create conditions of land for industrial use, as well as other construction. The developer may then transfer the land use rights and engage in operating the public utilities. Alternatively, the developer may construct industrial factory buildings for general use and other necessary ground structures for production as well as some structures such as living quarters and other service buildings; he may then transfer or lease these buildings and structures.<sup>46</sup> We can see from this statutory definition of such large-scale development activity that the aim is to attract foreign investment to rapidly develop hitherto undeveloped and low-utility land into high-value-added land with all the necessary facilities<sup>47</sup> for industrial, commercial and/or residential use. This is one of China's most effective strategies for development. It is a reversal of the old strategy of developing the land first in order to attract foreign investment. In view of the special character of this large-scale land development strategy, the State Council and local governments have enacted specific legislation regulating this form of investment activity. The following points should be noted.

First, large tract land development can be carried out only in certain regions. Article 18 of the Interim Administrative Methods for Developing and Operating Vast Tracts of Land with Foreign Investment (hereinafter "Interim Administrative Methods") provides that developing vast tracts of land shall only be effective in "special economic zones, open coastal cities and open coastal economic areas."<sup>48</sup>

Second, large tract land development must be carried out by a "development enterprise" (corporation), which must be a Chinese-foreign joint Sino venture, a Chinese-foreign cooperative enterprise or a wholly foreign-owned enterprise, established according to the relevant laws.<sup>49</sup> Such a

<sup>46</sup> Art 2 of the Interim Administrative Methods for Developing and Operating Vast Tracts of Land with Foreign Investment (promulgated by the State Council on 19 May 1990).

<sup>47</sup> The Chinese term *wutong yiping* is used of land which possesses five types of utilities: *ie*, water, electricity, gas, roads and telecommunication lines, and levelled land.

<sup>48</sup> The five special economic zones are: Shenzhen, Zhuhai, Shantou, Xiamen and Hainan Province. The fourteen open coastal cities are: Dalian, Qinhuangdao, Tianjin, Yantai, Qingdao, Lianyungang, Shanghai, Nantong, Ningbo, Wenzhou, Fuzhou, Guangzhou, Zhanjiang and Beihai. Open coastal economic areas include the Yangtze River Delta, Pearl River Delta, Minnan Triangle (Xiamen, Zhangzhou, Quanzhou) and the northeastern, northern and eastern coastal regions of China.

<sup>49</sup> These are:-

- (i) Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures (adopted at the Second Session of the Fifth National People's Congress on 1 July 1979, and revised on 4 April 1990);
- (ii) Law of the People's Republic of China on Chinese- Foreign Contractual Joint Ventures (adopted at the First Session of the Seventh National People's Congress on 13 April 1988, and effective as of the date of promulgation);



development enterprise is a Chinese legal person and is subject to the jurisdiction and protection of Chinese law.<sup>50</sup>

Third, land use rights over state-owned land must of course be obtained before carrying out large tract land development. When, then, is the most appropriate time and method for obtaining land use rights for large tract land development? To answer this question we must look to the relevant provisions of the law. The Interim Regulations provide that all corporations, enterprises, other organizations and individuals, whether operating within or outside China, may obtain the land use rights to develop land. This has been discussed in Parts I and II of this article, and it is sufficient to briefly recapitulate the various points here. In terms of the procedural order of obtaining land use right and establishment of a corporation, there are two ways: one is to establish a development corporation first, then obtain the land use rights and decide the development project accordingly. The other is to obtain the land use rights first, draft proposals for the development project and then apply to establish a corporation to carry out the development. Both methods have advantages and disadvantages and there are, at present, no detailed regulations governing either. This writer is of the opinion that obtaining both the land use rights and establishing the enterprise entity can be undertaken simultaneously. Under an overall plan, activities such as planning the development project, obtaining the land use rights and setting up the corporation can take place side by side, thus saving time. What is most important is that the investor must understand and follow the relevant national and local laws and regulations.

When undertaking large tract land development, the foreign investor will be affected by legal considerations as diverse as, *eg*, land administration, city planning, raising finance, industrial and commercial registration, tax, audits. This article can only examine and discuss some of the more important issues.

### 1. Authority to examine and approve large tract land development projects

As mentioned above, land for development by foreign investors in China is state-owned. It is not surprising, therefore, that the state exerts a measure of control over the foreign investment in large tract land development. The development enterprise must sign a contract with the state land administration department for the grant of land use rights and apply for approval of the project. Where the grant is of up to 1,000 *mu* (approximately 66.7 hectares)

(iii) Law of the PRC on Foreign-Capital Enterprises (adopted at the Fourth Session of the Sixth National People's Congress and effective as of 12 April 1986).

<sup>50</sup> *Supra*, note 45, Art 4.

of cultivated land and 2,000 *mu* (approximately 133.4 hectares) of other types of land, and the total investment of the project is within a certain amount, the local governments of the relevant province, special autonomous region, centrally-governed cities (Beijing, Shanghai and Tianjin), special economic zone are the competent authorities to approve the project proposal. For projects exceeding those limits, the project proposal is to be referred by the local government at those levels to the State Planning Committee for verification and the State Council for approval.<sup>51</sup> The reason for this requirement is the state's desire to monopolize the granting of land use rights so as to exercise overall supervision of the supply of land and direct foreign investment. Nevertheless, despite repeated directions by the central government to local administrations to follow proper procedures provided by laws and regulations, some practical problems have arisen.

In order to avoid the inconvenience of going through the various levels of approving authorities, some foreign investors adopt a strategy of dividing a large project into smaller parts and applying for the grants of land use rights over the various smaller plots of land from the local authorities piecemeal. There are presently no laws or regulations prohibiting this practice. The law in this area is clearly inadequate, leaving a loophole which can thus be exploited.

Another problem is where local governments, in their eagerness to attract foreign investment, grant land use rights over large pieces of land for low prices, thus overstepping the bounds of their authority. This often appears advantageous to both the local administration as well as to the foreign investor. But once discovered, such activities will result in penal consequences for the approving "authority" as well as economic loss to the foreign investor who may find that the land use rights so obtained are invalid. This kind of mistake should not be made since it is in blatant breach of an express provision of the law, whatever assurances to the contrary one may receive from local authorities.

## 2. *Land Value Added Tax*

At the beginning of 1994, China unveiled a new tax system, arousing great interest within and outside China. The basic principles of this series of tax reforms are as follows: unification of tax laws, equitable sharing of tax burdens, simplification of the tax structure and reasonable apportionment of revenue between central and local governments.<sup>52</sup> The purpose of the reforms is to do away with the confusion and complexity of the

<sup>51</sup> *Supra*, note 45, Art 3.

<sup>52</sup> Art 50 of the "Decision of the Third Plenary of the 14th Central Committee of the Communist Party of China".

old tax regime, to set up some basic standards and norms of taxation, administer the tax system according to law, standardize tax rates, expand the base of basic taxes, and to make for a more adequate and complete tax system. Among the taxes directly affecting land is the Land Value Added tax. The Interim Regulations for Land Value Added Tax<sup>53</sup> have drawn sharp responses, positive and otherwise, from land investors. However, as the detailed implementing regulations have yet to be enacted, this article can only offer a brief introduction to, and analysis of, the issue.

Since the 1990s, China has increasingly opened up its property market in line with the speedy development of its economy. Real estate prices have also risen explosively over this period. Moreover, the property market has been plagued by imperfections in its laws and regulations as well as inexperience in management. These created opportunities for speculators, some of whom were hoarding land in anticipation of better prices as well as engaging in purely speculative sales or in disguised forms of such sales, with a view to making a windfall. Statistics reveal that in 1993, exploited land in China amounted to 15,300 square kilometers, of which only 307 square kilometers actually underwent development, (constituting 2% of the total exploited land area). The remainder is the subject of an endless cycle of speculative buying and selling.<sup>54</sup> Land in some areas of Shenzhen have changed hands at an average of seven times before being developed. In the process, the prices of such land have been inflated to as much as ten times the original grant price.<sup>55</sup> In addition, there is also a grave phenomenon of speculative buying transacted through the purchase of transferable pre-sale houses. In the province of Hainan, prices for landed properties from January 1992 to April 1992 soared by an average of 40%, twice the rate for the whole of the preceding year. Part of this increase could be attributed to natural appreciation, but the main reasons were the speculative buying and transfer of land. The upshot is that genuine land users were unable to procure the land in time and at reasonable prices, while speculators could easily reap handsome profits.<sup>56</sup> Genuine land users thus find it difficult to obtain land at reasonable prices while speculators make unjustifiable profits.

In order to re-establish order in the real estate market and curb speculation, the Chinese government has decided to impose a Land Value Added Tax.

<sup>53</sup> PRC, Land Value Added Tax Tentative Regulation (adopted at the 12th Routine Meeting of the State Council on 26 November 1993, promulgated by the State Council on 13 December 1993 and effective from 1 January 1994) in *Gazette of the State Council of the PRC*, Issue No 29 (1993), at 1393-1396.

<sup>54</sup> Dai Wenliang and Zhu Guofa, "Fangdichan Touji Xingwei Ji Qi Falu Zhiyue" (Speculation and Legal Restrictions) in *Faxue* (Chinese Legal Science) (1993), No 11 at 33.

<sup>55</sup> "Xinwen Texie" (News Report) in *Lianhe Zaobao* (21 January 1994), at 21.

<sup>56</sup> *Supra*, note 51.

One rationale for this tax is that the appreciation of land value in cities is at least partly attributable to state investment and therefore to levy a tax on land appreciation would appear justified. Further, the laws and regulations regarding the grant of land use rights are as yet imperfect, resulting in land use rights sometimes being granted at prices below their real values. Some land users have thus benefited by being able to buy low and sell high. The tax redresses this situation by allowing the state to recover some of this gain.<sup>57</sup>

The main provisions of the Interim Regulations for Land Value Added Tax include the following:

- a. *Taxpayers*: Taxpayers are work units and persons who transfer the right to use of land, buildings and attached fixtures and who thereby obtain revenue. This includes government organizations, armed forces, corporate units, independent entrepreneurs, other units and individuals, as well as foreign investment enterprises, foreign enterprises, foreign organizations, overseas Chinese, compatriots in Hong Kong, Macao and Taiwan, and foreign citizens, *etc.*<sup>58</sup>
- b. *Subject Matter of Taxation*: The subject matter of the tax is the quantum of the increase in value of land. This value is the income derived by the taxpayer from the transfer of the land (including fixtures) less the sums deductible according to the Regulations. Sums deductible include: expenses incurred to obtain the right to use of land; the principal sums and expenses involved in exploitation of the land; expenses of newly-constructed houses and serialized installations; tax revenues in relation to transfer of property; and any other sums stipulated to be deducted by the Ministry of Finance.<sup>59</sup>
- c. *Taxation Rate*: The Land Value Added Tax adopts a four-level cumulative tax rate, *viz.*, the tax rate is calculated on the basis of the ratio that the increase in the value of land bears to the sums deductible. The table of tax rates is as follows:

<sup>57</sup> Lu Xinshe, "Waishang Ying Zhuyi Zhongguo Tudi Zhengzhi Shui De Yingxiang" (Foreign investors should notice the impact of Chinese Land Value Added Tax) in *Lianhe Zaobao* (April 1994, at 21).

<sup>58</sup> Art 2 of the Interim Regulations of the People's Republic of China on Land Value Appreciation Tax.

<sup>59</sup> *Ibid*, Art 6.

Land Value Added Tax Rates<sup>60</sup>

<i>Proportional gain in land value</i>	<i>Tax rate</i>
Below 50%	30%
Above 50%, below 100%	40%
Above 100%, below 200%	50%
Above 200%	60%

d. *Tax Exempt Conditions*: The Regulations stipulate that the Land Value Added Tax will not be levied in two situations.

- (1) Where the taxpayer constructs ordinary standard residential buildings for sale, the Value Added not exceeding the deductible sums by 20%;
- (2) Property requisitioned in accordance with law for reasons of state construction.<sup>61</sup>

e. *Deadline for Tax Payment*: Within seven days from the day when the taxpayer executes the contract for the assignment of the real property, he should file a tax return with the tax authorities at the locality of the property in question. Thereafter, he is to pay the Land Value Added Tax within the deadline set by the authorities concerned.<sup>62</sup>

The tax authorities are responsible for the collection of the Land Value Added Tax. Land Administration and Real Property Administration authorities should supply the tax department with the required data, and assist the tax department in processing the relevant change of title procedures.<sup>63</sup> As we have seen, from the state's perspective, the Land Value Added Tax serves the following functions: curbing speculation in land; providing a new source of revenue for the state; and affording the state the opportunity to affect the flow of funds through the adjustment of the tax rate. What, then, is the impact of the levy of this new tax on the development of property and on developers?

First, property development is a long-term, high-investment venture. Many developments or sales of property contracts were signed before the end of 1993, and expected profits did not take into account the new tax

<sup>60</sup> *Supra*, note 54.

<sup>61</sup> *Supra*, note 55, Art 8.

<sup>62</sup> *Ibid*, Art 10.

<sup>63</sup> *Ibid*, Arts 11 and 12.

burden. If the new tax laws are implemented, this would inevitably reduce the profits rightly due to the developers.

Second, developers may try to increase the figure of construction costs and reduce the quantum of value added in an attempt to pay lower taxes. This may result in problems such as the method of assessment of construction costs.

Third, as the tax rate is preponderantly high, sellers may therefore attempt to transfer the tax burden to the buyers, resulting in an unreasonable increase in property prices.

Fourth, the levy of the Land Value Added Tax has the most direct impact on the property resale market. Large parcels of constructions are due for completion in various parts of China in 1994. The constructions that are already completed and those that are due for imminent completion will trigger off a sharp rise in the property resale market. Will the implementation of the Land Value Added Tax stop prospective buyers in their tracks? Will it dampen the interest that developers have in investments? Other problems may be created if there is a slump in the property market. If not resolved reasonably, questions like these will inevitably affect the enthusiasm with which overseas businessmen invest in property development in China.

#### IV. CONCLUSION

The different land systems in the world can be broadly divided into three categories, private ownership, public ownership and state-owned but with private rights to use the land. After the founding of the People's Republic of China, the system of land ownership moved from private ownership to public or the state ownership. In the early stages, state ownership of land in cities co-existed with private ownership of rural land which remained in the peasants. Subsequently, with the establishment of cooperatives and People's Communes, rural land became collectively-owned and private ownership of land ceased to exist in China. Urban land is owned by the State, and allocated administratively without cost to the land users.

Decades of experience have revealed the flaws of this system. Land resources were being wasted by this inefficient system. Moreover, as the Chinese economy underwent reform, enterprise structures also took on new forms. Foreign capital was being attracted. The old rigid land system became a shackle on the progress of China's economic reforms. This system had to change to adapt to the new economic realities in China.

China realized that compared with the systems of other countries the model of state ownership with private land use right has advantages and was more suitable for the situation in China. The separation of land ownership from land use rights is the cornerstone of the land reforms. New laws and regulations were enacted to change the relationship between state

and land user from that of a purely administrative relationship to a civil relationship on equal terms, while simultaneously preserving state powers of administration. In a short span of a few years, China has successively promulgated a series of laws and regulations relating to land. While these laws and regulations are still incomplete and many gaps in the law still exist (some of which have been indicated in the course of this article), they have exerted a definite positive effect in advancing the reform of the land system and the growth as well as maturation of the real estate market in China. As China continues to learn from its own as well as foreign experience, its legal framework for its land system will be improved, thus assuring the ultimate progress and success of its land reform.

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