

Client Alert

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China Real Estate Update

By Gregory Tan and Paul McKenzie

China property prices have continued to trend upward despite the government's previous efforts to cool the real estate market. Such efforts include, among others, limiting the number of residential properties that a household may purchase and raising the down payment requirement. On February 26, 2013, the General Office of the State Council promulgated the Circular of the General Office of the State Council on Continuing Regulation of the Real Estate Market (in Chinese, 国务院办公厅关于继续做好房地产市场调控工作的通知, the "Circular"). This Circular is the latest effort by the PRC government to stabilize property prices, restrain speculation in the property market, and encourage the supply of affordable housing.

20% IIT ON PROPERTY SALES

The Circular reaffirms strict enforcement of the 20% individual income tax on profits derived from property sale. Profits from property sale have long been subject to the 20% individual income tax since 1993, but few property owners have actually had to pay the tax. Currently, such tax is waived for a property owner if the owner's family has only one residential property for self-use and has owned such property for five or more years. The property owner may also pay an alternative tax of between 1% to 3% of the total sales price, if the owner does not possess or fails to submit property records that evidence the owner's original purchase price.

The new tax on property sales has stirred heated discussions among commentators and the general public. Absent any implementing guidance from the State Administration of Taxation, certain commentators have broadly interpreted the Circular to do away with both the tax waiver and the alternative tax. If these commentators were correct, the property owners with more than one property could face significantly higher tax burdens and make far less profits than before, which could result in reduced transaction volume and could arguably have a cooling effect on the China real estate market. Other commentators voiced concerns, however, that the tax can be easily shifted from sellers to buyers, resulting in another round of property price increase.

It is also worth noting that according to the Circular, the down payment requirement (currently, no less than 60% of the total sales price) and the lending interest rate (currently, no less than 1.1 times of the benchmark interest rate) for mortgage loans applicable to second-property buyers may be further increased in cities with rapid rise in property prices.

EXPANSION OF PROPERTY TAX

In addition, the Circular expands the reach of the pilot property tax program for individual home owners to beyond Shanghai and Chongqing. Properties¹ in China have been subject to property tax since 1986. Prior to 2011,

¹ Includes only properties located in cities, county towns, State-designated townships and industrial and mining areas, according to the Interim Regulations of the People's Republic of China on Property Tax, September 15, 1986.

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however, individual property owners were exempt from such property tax, so long as the property was for personal use. In 2011, Shanghai and Chongqing began testing a pilot tax program where individual property owners that meet the program's requirements are required to pay a property tax of between 0.4% to 1.2% of the property purchase price. The Circular notes that the State Council may expand the pilot tax program to other cities and provinces. The Chinese government hopes the expansion of the property tax program will help further dent the enthusiasm of speculators by increasing the cost of holding properties.

2012 FIREE APPROVALS

Despite the tough measures undertaken by the authorities, opportunities remain in the China real estate market. Between January and December 2012, about 760 foreign invested real estate enterprises ("FIREEs") were filed with the Ministry of Commerce or its provincial counterparts, through new setups and acquisitions, among others. Of these, approximately 2% of the filings were made in Beijing, 8% in Shanghai and 90% in other cities.

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