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Commercial real estate investment guide

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China



Contents

Foreword	2	Commercial leases	15
Market overview	3	Lease agreements	15
Sale and purchase	4	Types of leasing arrangements	15
Real estate ownership	4	Common terms in commercial leases	15
Forms of real estate ownership	4	Managing leasing agreements	15
Renewal of LUR	4	Security of tenure	15
Major property legislation	4	Recovering real estate from a lessee	15
Title registration	5	Early termination	15
Transfer of real estate ownership	5	Termination by third party	15
Direct vs indirect transfer of real estate	5	Security for protecting against failure by lessee to meet obligations	15
Considerations for foreign ownership of real estate for investment purposes	6	Transfer of lease	16
Sale and purchase process	8	Right of first refusal	16
Typical process	8	Managing a leased real estate	16
Due Diligence	8	Restrictions on use	16
Consent and notification	8	Alterations	16
Sale and purchase contract	8	Rent	16
General components of a sale contract	8	Rent variation	16
Common rights, interests and encumbrances	9	Taxes for rental	16
Typical representations and warranties	9	Costs for tenants other than rent	16
Remedies against misrepresentations	9	Costs payable by tenants at start of lease	16
Costs relating to sale and purchase of real estate	9	Maintenance and repairs	16
Tax	9	Utilities and telecommunications	16
Estate agent's fees	9	Insurance	17
Legal fees	10	Taxes	17
Other fees	10	Tax liabilities of purchasers	17
Investment vehicles	11	Types of taxes	17
Types of investment vehicles	11	Recurring taxation	17
Legal forms of typical investment vehicles	11	Profits tax	17
Common structure used by foreign investors	11	Property tax	19
Setting up an investment vehicle	11	Other costs	19
Minimum capital requirements	11	Tax liabilities of sellers	20
Procedures for setting up an investment vehicle	12	Types of taxes	20
Governance, compliance and Taxation	12	Taxation of distributions	21
Real estate financing	14	Tax treaties	21
Common ways of financing commercial real estate acquisitions	14	Key contacts	22
Typical security created	14		
Restrictions on foreign loan	14		
Costs relating to the granting and enforcement of security	14		

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
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Market overview

China

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 restrict the overheated market, some of the previously enacted restrictions have been eliminated in part to stimulate economic growth. An extensive amount of inbound investment restriction policies has also been abolished, which significantly encourages foreign investment in real estate.

China's real estate industry experienced significant challenges in 2023, as the sector continued to reel from the impacts of debt crises among major developers, and a general slowdown in the country's economic growth. The government's crackdown on speculative investments and the 'three red lines' policy, which placed limits on the amount of debt property developers could take on, led to a liquidity crunch that sent shockwaves through the industry. High-profile defaults and the financial troubles of major developers such as Evergrande highlighted the vulnerabilities within the sector.



Housing sales and property investments dipped as consumer confidence waned, and the market faced a surplus of unsold homes, which further pressured prices and developers. The central government has stepped up with a series of measures designed to stabilize and reignite the troubled sector, including easing credit conditions for homebuyers (such as slashing requirements for down payments for first- and second-time homebuyers while lowering mortgage rates) and introducing measures to support developers' access to funds (such as launching a 'whitelist' mechanism allowing banks to boost lending to certain approved residential projects). Local policymakers have also intervened to shore up demand by lifting up the restrictions on purchases of real estate.

For 2024, the outlook for China's real estate industry appears cautiously optimistic, as the government may continue to balance the need for economic stability with the risks of reigniting speculative investment. Analysts project a gradual recovery as the market absorbs the excess inventory and as the government potentially introduces more supportive measures to ensure controlled growth. Urbanization and the rise of the middle class are likely to remain key drivers of long-term demand for housing, and there is an increasing focus on sustainable and smart city developments, with an emphasis on green building and energy efficiency.

The commercial real estate sector could see a diversification trend, with growing interest in logistics and warehousing driven by e-commerce, as well as in data centers due to the digital economy's expansion. Nonetheless, the trajectory of recovery will be closely tied to the broader economic context, including the global economic climate, China's trade relations, and ongoing reforms in the financial sector that aim to reduce systemic risks.

Sale and purchase

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:

- 70 years for residential purposes;
- 50 years for industrial purposes;
- 50 years for educational, scientific and technological, cultural, health care and sports purposes;
- 40 years for commercial, tourism and recreational purposes; and
- 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 the 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 the 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:

- The PRC Constitution (中华人民共和国宪法);
- The PRC Civil Code (中华人民共和国民法典);
- The PRC Land Administration Law (中华人民共和国土地管理法);
- The Implementing Regulations for the PRC Land Administration Law (土地管理法实施条例);
- 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);
- The PRC Urban Real Estate Administration Law (中华人民共和国城市房地产管理法); and
- 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 title to real estate are subject to registration. The registries are under the relevant government authorities' control. The main information in the public register of titles include the following:

- Term of the LUR;
- Area of the building;
- Location of the land;
- Type of structure of the building;
- Permitted usage;
- Owner's name;
- Completion date; and
- Mortgage.

Transfer of real estate ownership

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

- 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, due diligence on the target company if the property transaction is to be effected via a share transfer;
- The parties should execute a written purchase agreement setting forth the terms of the transfer; and
- The parties will file an application to the local real estate authority for the registration of transfer of the title from the seller to the purchaser and issuance of the new title certificate. The seller is allowed to transfer real estate with collateral without repaying the loan in advance. 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 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 on shore '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). Real estate directly acquired and owned by foreign companies and individuals for investment purposes prior to July 2006 (when the Chinese authorities introduced restrictions on foreign investors' entry into the PRC real estate market) are 'grandfathered'.

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:

- Asset transfer by a PRC registered company (including an FIE) as the seller;
- Asset transfer by an offshore entity as the seller;
- Transfer of share in a PRC registered company (including an FIE) holding the underlying real estate ('onshore share transfer'); and
- 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 the 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 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 target company). Such offshore share transfer will be conducted outside of the PRC 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, in an offshore share transfer, for the offshore company's direct shareholder which is a PRC company or individual and the proposed buyer which is a PRC company or individual, certain PRC filings (such as overseas direct investment filings) should be made with the relevant Chinese authorities as applicable.

Considerations for foreign ownership of real estate for investment purposes

Foreign investment restrictions

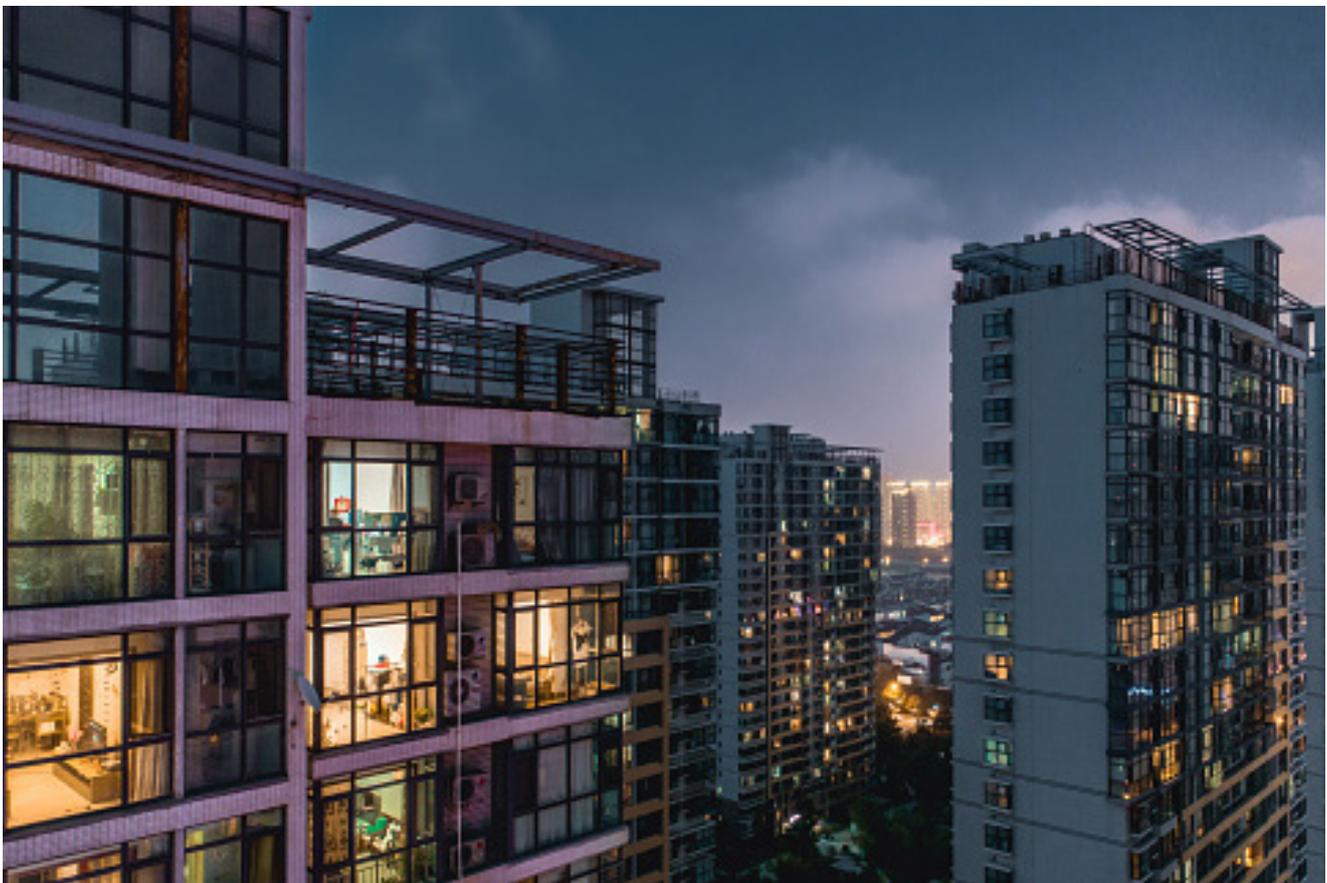
Foreign-invested enterprises ('FIEs') or representative offices established in China, by foreign entities or a foreign individual, can purchase commercial property for self-use or self-accommodation, subject to several regulatory restrictions at national and local levels.

If a foreign investor (an entity or individual) intends to purchase real estate in China, not for self-use but for investment purposes (e.g., greenfield development projects and acquisition of real estate for investment holding and/or leasing), the foreign investor is required to establish onshore 'commercial presence', i.e. to set up an FIE. That being said, there are a number of foreign entities or individuals which/who had acquired commercial real estate in China prior to 2006 and still directly owns 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 China'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.



	Pros	Cons
Asset transfer	<ul style="list-style-type: none"> 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 It is relatively straightforward as asset transfers are generally not subject to the filing and registration with the local authorities (except for the registration of ownership change in real property). 	<ul style="list-style-type: none"> 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; 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 Taxes (page 17); and In the case where a new onshore acquisition vehicle is needed to be established, the incorporation of such new entity can take weeks.
Onshore share transfer	<p>Generally, a share transfer is more tax efficient than an asset transfer for both seller and buyer. Please refer to Taxes (page 17).</p>	<ul style="list-style-type: none"> 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; Detailed and extensive due diligence (legal, financial, property etc.) is required; and 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, various 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.
Offshore share transfer	<ul style="list-style-type: none"> 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 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 Taxes (page 17). 	<ul style="list-style-type: none"> This option cannot be used for acquisition of purely domestic targets with no foreign shareholders.

Sale and purchase process

Typical process

In the PRC, properties can be bought directly from developers, enterprise or individual sellers. 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 it shall be submitted to the relevant real estate administrative and registration authority for registration. It shall be noted that the Property Title Certificate (不动产权证书) 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 finish 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 immovable property registry (不动产登记机构). In order to receive a legal and complete title of the property, parties should change the property title information at the immovable property registry 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 Immovable 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, ongoing litigation and arbitration cases. The legal due diligence would 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 Immovable 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 the consent of all the co-owners. Save as 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 should notify the mortgagee of the sale promptly unless otherwise agreed by the parties.

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 unnegotiable 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:

- Title or name and domicile of the parties;
- Basic conditions of the commodity houses;
- Sales pattern for the commodity houses;
- Method of fixing the price, total price, manner and date of payment;
- Conditions and date of delivery for use;

- Decoration and facility standards requirements;
- 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;
- 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;
- The method for dealing with any discrepancy between the floor area stipulated in the contract and the area actually delivered;
- Relevant matters concerning the land use right registration;
- Methods of dispute resolution;
- Liabilities for breach of contract; and
- 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 should also be entered into to make 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:

- Ownership rights;
- Usufructuary rights, which include:
 - Land contracting rights;
 - Construction land use rights;
 - Homestead land use rights;
 - Easements; and
 - Security interest.

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 provided 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 should 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 would also be liable for any loss incurred by the purchaser as a result of such purchase.

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 Taxes (page 17).

Estate agent's fees

Brokers / real estate agents are not a must for real estate transactions, but in practice, they are often engaged to arrange for listing and viewing of property. They also 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). But 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.

Seller's lawyers are also typically involved in discharging the existing mortgage (if any) for the seller, while the purchaser's lawyers would help the purchaser in 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 Taxes, page 17) as well as certain registration fee, are applicable.

Investment vehicles

Types of investment vehicles

Legal forms of typical investment vehicles

The followings are major types of vehicles for inbound investments and funds into China that are commonly used by foreign investors:

- **Limited liability company** ('LLC'), which is incorporated by one or more foreign investors solely or together with one or more Chinese investor(s). Each of the shareholders bear limited liability to the LLC within the limit of its subscribed capital contribution.
- **Foreign-invested investment company**, which is usually set up by foreign investors either in the legal form of LLC or joint stock company to carry out investment activities in the PRC, and the requirements for establishing such investment company is relatively high.
- **Qualified Foreign Limited Partner** ('QFLP'), which is a pilot program available in a number of trial areas such as Shanghai, Beijing, Tianjin, Chongqing, Shenzhen, Zhuhai, Qingdao, Guizhou, Pingtan, Hainan and etc. QFLP enables qualified foreign investors to set up a private equity fund (in the form of a limited partnership or a limited liability company) with or without qualified domestic investors to make equity investment in China. Establishment of QFLP is subject to the local requirements, which are relatively high, and additional pre-approval process.

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 estates.

Common structure used by foreign investors

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

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.

Joint ventures established by foreign investors and Chinese investors in the form of LLC then are required for foreign investment in such industries restricted for foreign investment. In addition to the regulatory requirements, there are also commercial considerations which encourage foreign investors to take on a local Chinese partner, for example access to the local Chinese partner's network, local market knowledge, workforce and facilities.

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 either the difference between its total investment and registered capital or the limit determined by the FIE's net asset value (as of the date of this guide, 3 times net asset value). If the aforementioned difference, which is referred to as the 'statutory minimum debt-equity ratios', is selected to determine the foreign debt quota, it will be the maximum amount of foreign exchange loan the FIE can legally borrow.

The statutory minimum debt-equity ratios are set out in the table:

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 as stated below:

- Name pre-reservation with the competent local company registration authority ('AMR');
- For investment not falling into the Negative List for Foreign Investment, online foreign investment information filing with the Ministry of Commerce, but for investment falling into the Negative List for Foreign Investment, approval by the competent local counterpart of the Ministry of Commerce ('MOFCOM'). Currently, foreign investment in the real estate section falls within the 'permitted' industries, and consequently foreign investment information filing will apply;
- 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;
- Post-registration formalities, including:
 - Arranging for chop carving by a qualified chop carving agent;
 - 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;

- Verification of the types of taxes applicable to the LLC with the local tax authority in charge of the LLC; and
- 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;
- Social insurance registration and registration for contribution of housing provident fund; and
- Applying for the status of ordinary VAT taxpayer if applicable.

If the application documents are complete and in good order, the first three steps 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 the local authorities involved, the procedures may vary in one detail or the other.

Governance, compliance and taxation

Governance requirements

The highest authority of an 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 instead of a board of directors. 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 to oversee performance of the duties by the directors and senior management personnel of the LLC. In the case where the LLC is small scaled or has a small number of shareholders, the LLC can have one supervisor in lieu of the board of supervisors; and if consented by all the shareholders, the LLC is allowed not to have a supervisor. 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 an 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:

- Annual audit on the financial accounts by a qualified CPA firm in the PRC;
- Joint annual reporting between April 1 to June 30 every year;
- Annual enterprise income tax reconciliation by May 31 every year;
- Annual report of equity-related data related to inbound and outbound direct investment by 30 September every year;
- Periodic filing of tax returns; and
- 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 an LLC in the real estate sector are set out below:

- **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;
- **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;
- **Surcharges** (including urban construction and maintenance tax, education surcharges, and local education surcharges where applicable): around 12% of the paid VAT;
- **Deed tax:** Levied when acquiring the land or property. Typically 3-5% but reduced rate may be available depending on the size, holding period, location and other conditions of the land/property;
- **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% and exempted in transfer of residential property by individuals;

- **Land Value Appreciation Tax ('Land VAT'):** Progressive rates ranging from 30% to 60% on the appreciation amount;
- **Property tax:** Owners and users of building 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;
- **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 30 per square meter depending on the location. Exemption might be available in certain circumstances; and
- **Import customs duty:** The rate of which vary from the HS code of the imported products.



Real estate financing

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 quota determined by the debt-equity ratio or by the limit determined by the FIE's net asset value as discussed in *Setting up an investment vehicle* (page 11). 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 3 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 (except for some with grandfathering right) 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.

Typical security created

Typical security interests include:

- Mortgage over the land use right and/or real property;

- Guarantee provided by the borrower or its parent company; and
- 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.

Restrictions on foreign loan

Please refer to the debt-equity-ratio requirements under *Setting up an investment vehicle* (page 11) and restrictions on foreign loan to the foreign-invested real estate enterprises under *Common ways of financing commercial real estate acquisitions* (page 14).

Costs relating to the granting and enforcement of security

In the PRC, stamp duty is payable on loan agreements with financial institutions. 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, notarisation by a notary public and authentication by a competent Chinese embassy/consulate may be required and relevant fees will be incurred correspondingly.

Commercial leases

Lease agreements

Types of leasing arrangements

Generally, the law recognises 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:

- Details of the parties;
- Location, area, structure, ancillary facilities, furniture and fixtures status of the property;
- Rental, deposit and payment term;
- Usage;
- Lease term;
- Repair and maintenance liabilities;
- Payment of the property management fee and applicable utility fees;
- Dispute settlement; and
- Liabilities of breach.

In certain cities, a prescribed form lease must be adopted when submitting the lease for registration. However, the parties can incorporate the supplementary provisions to amend and/or supplement the standard clauses.

Commercial leases typically last 3 to 5 years, while residential leases generally last 12 to 24 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.

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 penalising 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:

- Require the lessee to provide a security deposit consisting of certain months' rent and/or certain months' management fee; and
- 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 the situation 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 give up the right of first refusal.

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 purpose 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 costs and reinstate the premises to their original condition, or compensate for damages, upon the expiration of the lease.

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 lessors. For full details, please refer to Taxes (page 17).

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 also needs to pay stamp duty and, in most cases, 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:

- 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
- 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

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.

Recurring taxation

Profits tax

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

- Rental income; and
- Sales income.

Please refer to Tax liabilities of sellers (page 20), for taxes applicable to sales income.

Taxes applicable to rental income is shown as in the table below:

Type of tax	Rate
Value-added Tax ('VAT')	<p>For enterprise lessor:</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>For individual lessor:</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 and 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, and 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>For individual lessor:</p> <p>20% on rental income after certain deduction, and reduction might be available in some cities</p>
Enterprise Income Tax ('EIT')	<p>For enterprise lessor:</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 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.



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>For enterprise seller:</p> <ul style="list-style-type: none"> • Small-scale VAT taxpayers: 5% • General VAT taxpayer: 9% (but 5% for transfer of real property which was acquired prior to 30 April 2016 if the simple tax calculation method is selected) <p>For individual seller: 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 and 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>For individual seller:</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>For enterprise seller: Progressive rates ranging from 30% to 60% on the appreciation amount.</p>
Individual Income Tax ('IIT')	<p>For individual seller:</p> <ol style="list-style-type: none"> 1) 20% on net gain or 2) 1% to 3% of the transfer price in the case where the proof of the original value of the property (such as the invoice) cannot be provided, but tax exemption or reduction may be available depending on the nature, size, holding period, location and other conditions of the property
Enterprise Income Tax ('EIT')	<p>For enterprise seller:</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% on the gains arising from the sales if the enterprise seller is a foreign entity

Onshore share transfer

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

- **Stamp Duty:** 0.05% of the share transfer price;
- **EIT** applicable to company seller:
 - 10% of the capital gains if the seller is a foreign entity;
 - 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.
- **IIT** applicable to individual seller: 20% of net gain and IIT may be reduced or exempted under certain circumstances; and
- **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-characterised as a direct transfer of Chinese taxable assets and subject to PRC EIT at the rate of 10% on capital gains.

The potential exposure of Land VAT discussed under the above onshore share transfer section might also apply, though the possibility is minor.

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 its PRC tax resident enterprise shareholders by a PRC company and those to non-PRC tax resident individual shareholders distributed by a foreign-invested enterprises are currently tax exempt in Mainland China.

Tax treaties

Mainland China 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 1 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.

Key contacts in APAC

Real Estate



**Mabel Lui | Head of Greater China Commercial
Hong Kong**
+852 3711 1638
mabel.lui@withersworldwide.com



Chau Hwei Lee | Partner | Singapore
+65 6922 4108
chauhwei.lee@withersworldwide.com



Toshihiko Tsuchiya | Partner | Tokyo
+81 3 6810 2562
toshihiko.tsuchiya@withersworldwide.com



Akinari Nakano | Partner | Tokyo
+81 3 6810 2569
akinari.nakano@withersworldwide.com



Ean Macpherson | Partner | Singapore, Tokyo
+81 3 6810 2341
ean.macpherson@withersworldwide.com

Tax



Eric Roose | Partner | Tokyo
+81 3 6810 2561
eric.roose@withersworldwide.com



Kohei Kobayashi | Japan Tax Partner | Tokyo
+81 3 6810 2573
kohei.kobayashi@withersworldwide.com



Yee Hong Chua | Partner | Singapore
+65 6238 3016
yeehoong.chua@withersworldwide.com



**Joyce He | Senior Legal and Tax Manager
Hong Kong**
+852 3711 1655
joyce.he@withersworldwide.com





withersworldwide.com



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