香港信託人公會
Hong Kong Trustees' Association

# China and Hong Kong Tax and Regulatory Update

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## Restrictions on Foreign Investment in Real Estate in China

Before 2000, it was relatively easy and convenient to invest in properties in China through a foreign company or a Hong Kong incorporated company. In 2002, in order to promote the development of the real estate business as a pillar of the national economy, the Chinese government encouraged foreign real estate investment, especially in coastal cities such as Shenzhen and Zhuhai, special economic zones created to attract foreign investment.

Since 2003, the real estate market in most cities in Mainland China has spiraled resulting in huge increases in housing prices across the board. The Chinese Government started to be concerned that the overheated property market, coupled with excess liquidity in the domestic money supply, would cause inflation, civil discontent and related governance problems. Control over real estate prices became an important issue requiring prompt policy actions. Foreign capital, considered the prime culprit for the excess liquidity and speculation, caught the attention of the Chinese government and gradually fell out of favour.

The Chinese government began restricting foreign capital from entering into the local property market. In July 2006, six Ministries and Commissions of the Central Government jointly issued a circular entitled "Opinions on Regulation of the Entry of Foreign Investment into the Real Property Market and the Administration Thereof (Circular 171)", which forbade foreign investors from investing directly in Chinese real estate.

According to the Circular, in order to make such an investment, a foreign organization (other than those that had already received approval to engage in the real estate business) must have established branches or representative offices in China.
Foreign organizations that do not have a branch, sub-branch or representative office in China and foreign individuals who are to work or study in China for less than one year may not purchase any Chinese real estate. Foreign nationals who are to work or study in China for more than one year may purchase properties for their own use or as their own residence. Residents of Hong Kong, Macao and Taiwan and overseas Chinese may only purchase properties in certain locations for their own residential use.

The Circular further provides that a foreign organization or individual ("the foreign investor") planning to invest in property in China *not for its own use* must comply with the requirement of having a commercial presence by applying to establish a foreign-invested enterprise in accordance with provisions on investment in real property by foreign business entities. The foreign investor may only engage in the relevant business within the approved scope of business after obtaining the approval of the relevant departments and carrying out the relevant registration procedures. Foreign investors with intention to invest in real property but do not have a Foreign-invested Enterprise Approval Certificate and Business Licence may not develop or deal in land or property.

In June 2007, the Ministry of Commerce and the State Administration of Foreign Exchange issued "Circular on Further Strengthening and Standardizing the Examination, Approval and Regulation of Direct Investment in Real Property by Foreign Investors (Circular 50)", which strictly controlled the investment in the domestic real estate industry by foreigners. From 1st December 2007 onward, foreign capital has been denied access to real estate intermediary or agency businesses. Up to this moment, we have not seen any sign of loosening of the tight grip on foreign investment in the domestic property market.

To reinforce existing Circular 171 restrictions, the Ministry of Housing and Urban-Rural Development and the State Administration of Foreign Exchange jointly issued Circular 186 in November 2010. Circular 186 reiterates several existing restrictions applicable to the acquisition of real estate by foreign investors, (i) each foreign individual may only purchase one residential property for self-use, and (ii) each foreign branch office or representative office may only purchase non-residential property in the city where it is registered for its own office use. In addition, Circular 186 strengthens the implementation of certain of these restrictions by including new verification procedures and requirement of supporting documents.

Apart from restrictions of foreign capital inflows into the Chinese real estate industry, governmental control and oversight over Chinese domestic investments in the real estate sector have also increased. The government has announced a series of control measures to restrain financial support by domestic banks to real estate investors and developers and has maintained strict controls over real property investment through various pronouncements.

A measure less noticed by the outside world is the policy tightly enforced by the Chinese Securities Regulatory Commission restricting domestic real estate enterprises accessing capital via listing on the A- Share market.

All such measures show the gravity of the issue of the overheated property market identified by the Chinese government.

Recent data released by the National Bureau of Statistics of China shows that, in October 2011, prices of newly-built houses in thirty-four medium sized cities have fallen. This was the first time that average housing prices have decreased as compared with the previous month since the Chinese government adopted their tight controls over the real estate market some years ago. Transaction volumes have also dropped significantly in the major cities. A long-anticipated adjustment of housing prices in China might be on the horizon.

However, so far we have not heard any news of relaxation of the policy restricting foreign capital and foreign nationals to acquire properties in China, and do not expect any loosening of the tight grip in the near future.

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