

lands to rulers of sub-kingdoms, and, these sub-kingdom rulers sub-granted land to their military officers and public officials. The grantor could take the land and attached serfs back when necessary. The grant was inheritable, but not transferable.⁴ These rules changed gradually after the midpoint of Zhou Dynasty. The grantees became the *de facto* owners of the granted land. They could not only rent their land out, but also could sell or transfer their land in exchange for other forms of wealth.⁵ There are recorded examples where land was used as consideration for jewels and horses. There were even cases where defendants were ordered by judges to compensate wronged persons with land.⁶

In 770 B.C., the emperor of Zhou moved the capital to an eastern city, which began the history of the Eastern Zhou Dynasty. The history of Eastern Zhou was divided into two parts: 770 B. C.–476 B.C., the Period of Spring and Autumn; 475 B.C.–221 B.C., the Warring States Period.

Early in the Eastern Zhou, there developed a system of land management known as the “well” system,⁷ because the Chinese character for the word “well” is #. This was viewed as symbolic of the division of the land into nine sections. More than one person could own sections of an identical parcel, but overall there were always nine identical sections. The parties given the right to use the land had an obligation to care for and cultivate the center section of the nine sections for the benefit of the overlord, and pay over the proceeds or the product itself to the overlord. The obligation was to use at least the same level of irrigation and other management for the center parcel as for the other eight.

Due to the development and application by this time of new agricultural techniques and technology, it was no longer necessary to have many slaves work the land to produce a minimal return. At the same time, more and more arable land was developed. Thus, land was viewed as a less vital, and therefore a less valuable resource, and the Eastern Zhou emperors tolerated a system that did not view the newly developed land as belonging to or

⁴Pu Jian (Editor-in-Chief), *China's Legal History* (The Guangming Daily Publishing House 1987) 33 (hereafter cited as Pu Jian).

⁵*History Textbook* at 42.

⁶*Id.*

⁷This system is said to have been recognized first in the Lu Kingdom of Eastern Zhou, a sub-kingdom located roughly in what is now Shandong Province, in the year 594 B.C. Pu Jian at 44.

granted from the emperor, but saw it as more or less actually “owned” by private citizens. These citizens often were basically peasants — farmers who had little wealth other than that represented by the land they had been able to reclaim and work themselves.

In response to the new concepts of private ownership, rulers of sub-kingdoms began to reform their land tax system from the “well” system, which was primarily viewed as a method of capturing feudal revenues, to a different taxation system that would also reach the privately owned land. The tax was based upon the size of the land, rather than income. The tax could be, and often was, paid in products of the land, rather than cash.⁸

The Warring States Period ended in 221 B.C. when Qin Shi Huang unified China. The Qin Dynasty is viewed as China's first true centralized government, and the foundation of modern China. It lasted barely beyond the lifetime of the Emperor Qin Shi Huang himself, but nevertheless brought about many important changes in government and society. Qin Shi Huang confirmed the private ownership on the basis of the land ownership developed through sub-kingdoms during the Eastern Zhou. In 216 B.C., he issued an order requiring all the peasants to report their private land and recognized their ownership.⁹

Following a brief period of unrest, the Qin Dynasty was succeeded by the Han Dynasty, which ruled China basically from 206 B.C. until 220 A.D. Historical reports on land ownership during the Han Dynasty¹⁰ indicate that the Han emperors continued the practice of differentiating between state land (owned by the Emperor) and private land. Transactions in state land were strictly prohibited. Violators were executed. Owners of private land, however, could transact freely in such land, including transferring ownership to others.

The next available report on ancient rules of land ownership is from the Northern Wei kingdom, during a period known as the “North and South Kingdoms,” a time when the empire had fractionated into at least six separate kingdoms. In 485 A.D., the King of North Wei issued an order redistributing land to the peasants. There were two types of interests created — one type was not inheritable; it was basically a life estate. The

⁸*History Textbook* at 45.

⁹*Id.* at 96.

¹⁰The material on Han is based upon Ye Xiao Xin (editor-in-chief) *Textbook of China's Legal History*, (Peking University Press 1989) 103. (Cited as Ye Xiao Xin).

but then subsidized workers so that they could pay the rent. It was hoped that eventually the workers would be stimulated to make an election to use their housing subsidy to acquire their own housing units either by creating a market for private rental housing or by actually buying housing.

In cities such as Shanghai and Tianjin, the rent was raised only slightly but nevertheless housing subsidies were provided.

From 1988 through the early 90's, however, there was less than expected development of private housing. This was due in part to the continued existence of the welfare housing system in most of China. Few Chinese saw much incentive to invest in housing. Although the housing in which they dwelled was cramped and substandard, it was very cheap, and the Chinese who earned enough to establish a market for owner-occupied housing used their growing incomes to fill their cheap dwellings with consumer electronics, to invest in stocks, and to save for the future. Thus few granted land use rights for housing were issued. The ratio of allocated land use rights to granted land use rights by 1991 was 99:1.⁸⁰

China is now on its way to reforming its housing welfare system.⁸¹ Zhu Rongji, China's new Premier, promised an end to the housing welfare system. He said China would "reform the current policy of welfare housing so that people can purchase their homes."⁸² Under the new system, working units will no longer distribute public housing. In principle, newly built houses will only be sold to city dwellers. Public housing that has previously been distributed as welfare will be sold or rented to residents, but rents will rise considerably. State employees will have the chance to buy their own homes with the aid of subsidies (often tied to their years of service), public

⁸⁰Zhang & Cheng at 13.

⁸¹Under the current system, the majority of urban housing is owned or was built by State work units, and distributed to their employees according to their rank and seniority. State work units spent heavily to build housing they would then assign to their employees. Under such a housing distribution system, apartments were essentially welfare for State officials and employees. Operating since the founding of New China in 1949, the system has been called "the last icon of the planned economy".

⁸²See, Housing Reform: Q & A, China Daily, June 18, 1998. A national housing reform conference was held in Beijing in mid-June 1998, which resulted in a detailed housing reform plan. See, "Adieu to Welfare Housing- Reform Project Revealed." China Daily June 18, 1998. In the first quarter of 1999, China invested almost \$5 billion in "workers housing" development. Xu Dashan, "Developers Set to Face Low-Cost Challenge." China Daily (Business Weekly, 6/5/99.

housing reserve funds, bank loans⁸³ and their own savings. All commercial banks are allowed to provide mortgage loans to potential buyers with no limit on the amount of loan. The on-going housing reform will certainly be a stimulus to China's real estate industry. To reach its target of 8 per cent economic growth in 1998 and years ahead, the Chinese government listed the housing sector as a new growth area of the national economy. Banks are required to channel more money into the housing industry.⁸⁴

To stimulate the housing industry and housing reform, the Ministry of Construction has issued Interim Measures⁸⁵ authorizing the resale of housing purchased from work units, and of other housing purchased at subsidized prices (described in the Measures as "economic appropriate housing"). These Measures provide the preconditions and procedures for the resale of such houses.

The housing reforms, however, are combined with a social safety net. The 1999 Measures Governing Low-Rent Housing⁸⁶ state that low-rent housing should be provided at government-fixed rent to low-income families.

The powers toward the goal of a private housing economy is slower than some hope.⁸⁷ Despite bold pronouncements beginning as early as

⁸³Although there have been reports that the Bank of China is prepared to offer long term, low interest rate mortgage loans, the authors' conversations with Beijing housing developers indicate that the Bank privately is insisting upon guarantees from the developers and an agreement that the developer buy at any foreclosure in order for the Bank to offer such loans on new housing. Similarly, at a major new housing project for Beida and Tsinghua faculty, the universities will be required to guarantee the mortgage loans for faculty who wish to borrow to acquire their units.

⁸⁴See, "Banks Poised for Residential Mortgage Loans," by Xu Dashan, China Daily, June 15, 1998.

⁸⁵Interim Measures Governing the Resale of Housing Purchased from Working Units, and the Resale of Economic, Appropriate Housing, adopted by the Ministry of Construction on April 19, 1999 and effective as May 1, 1999. There are local provisions preceding the national rules. See, e.g., Provisions of Guangzhou City Governing the Resale of Housing Purchased from Working Units, effective as of February 1, 1999.

⁸⁶Measures Governing the Low-Rent Housing, adopted by the Ministry of Construction on April 19, 1999 and effective as of May 1, 1999.

⁸⁷See "Government Pushing Housing Sales But Sets No Clear Buying Guidelines," China Online, 4/22/99, at http://www.chinaonline.com/top/stories/breakingnews_b9042006.html. Also see "China's Real Estate Vacancies at Record Levels." China Online 11/04/99, at <http://www.chinaonline.com/topstories/<9110202.asp>. The government, of course,

tangible, like a parcel of land or a building, but such a right can exist in moveable as well as immovable property.⁵⁸ The holder of an “*in rem*” right has a right to protect the thing in which the right inheres,⁵⁹ and has a claim for damages if that thing is damaged or injured.⁶⁰ An “*in rem*” right may not be taken or transferred away from an owner without the owner’s consent. If another individual deprives one of something in which one has an “*in rem*” right, the State will restore possession.⁶¹ (Note that an “*in rem*” right in a land use right arises only upon registration.) An *in rem* right is mortgageable or pledgeable,⁶² and the mortgage interest⁶³ or pledge interests⁶⁴ themselves are *in rem* rights.

Scholarly opinion is that an “*in rem*” right can exist in a tangible embodiment of an intangible right, such as a bond or a share of stock.⁶⁵ For instance, a share interest in a joint stock company embodied in a formal publicly tradeable share probably can form the basis for an “*in rem*” right. A

cial public interest.) Compensation will be based upon the time of usage and the user’s investment.

⁵⁸Li Youyi (editor-in-chief), *Textbook of Civil Law (min fa xue)* (Peking University Press 1988) 253–254.

⁵⁹In accordance with the General Principles of Civil Law, Section 134, which lists the main methods of bearing civil liability, the holder can protect the things which the right inheres by claiming for “cessation of infringements,” “removal of obstacles,” “elimination of dangers,” “return of property” or “restoration of original condition.”

⁶⁰This is also provided in Section 134 as “compensation for losses”.

⁶¹Provided in Section 134 as “return of property”.

⁶²The 1995 Security Law distinguishes the pledge from the mortgage. A pledge is on moveable property (Section 63) a negotiable instrument or property rights provided in the Security Law, Section 75. Under a pledge, the pledgee will possess the property (Section 63), negotiable instruments (Section 76). For a pledge on other property rights, the pledge will mostly evidenced by registration (Section 78: registration of pledge on stocks; Section 79: registration of pledge on intellectual property rights). A mortgage can only be set on the property listed in the Security Law, Section 34, mostly on real estate (including land use right) or other fixed assets. The possession of the property will not be transferred under a mortgage (Section 33).

⁶³Liu Xingwen (editor-in-chief), *Comments on Studies of Chinese Civil Law (zhong guo min fa xue yan jiu shu ping)* (Publishing House of China University of Politics and Legal Science 1996) 415.

⁶⁴*Id.*, 426–28.

⁶⁵Further, Section 75 of the Security Law provides that a money orders, checks, cashier’s checks, securities, deposit receipts, warehouse receipts, bills of lading, shares and share of certificates that are transferable according to law can be used in hypothecation.

lease right, however, is a mere contract right, and is not “*in rem*.”⁶⁶ The same is true of a Chinese “judgment lien” the right to have a debtor’s property applied in satisfaction of a debt. The contract right of a purchaser under a land sale contract also is not an “*in rem*” right. China does not indulge in the “equitable conversion” concept that is sometimes applied in the Common Law.

A “credit right” is a right against a specific party.⁶⁷ It states a relationship of a given party with certain other specific parties, and does not enjoy protection against all the world.⁶⁸ A simple contract right, for instance, is a credit right. If the party who owes the credit right is somehow disabled from performing it by actions of a third party, the holder of the right has no action against the third party. The only claim is against the obligor.⁶⁹

2.4. Concepts of Co-Ownership:

Co-ownership is a recognized part of Chinese law. Partnership, marriage, or other special relationships will give rise to co-ownership concepts.⁷⁰ Modern private ownership of apartment units in multi-tenant buildings includes, as a matter of law, co-ownership of the building structure and the land use right supporting the building.⁷¹ Where there are multiple buildings in one housing development, all of the owners in the

⁶⁶See, for example, Wang Liming, Guomingrui & Wu Handong, *Min fa xin lun* (the Publishing House of China University of Politics and Legal Science 1988) 15. In the chapter on leases, the authors speculate as to whether a lease contract can be hypothecated. See *infra*, pp. 218–219.

⁶⁷*Id.*, 4.

⁶⁸The General Principles of Civil Law, Section 84, defines a debt as a “special relationship of rights and obligations established between the parties concerned” “according to the agreed terms of contract or legal provisions.” In a debt relationship, the creditor has the right to demand that the debtor fulfil his obligations as specified by the contract or according to legal provisions. Thus, a debt relationship is only limited within the parties concerned.

⁶⁹For a more detailed discussion of rights *in rem* and credit rights, see Qian Mingxing, *Principles of Rights In Rem*, at 9–38.

⁷⁰Editorial Board of Faxueyanjiu, *Summary of Civil Law Studies in PRC (xin zhong guo min fa xue yan jiu zong shu)* (Legal Science Press 1990) 311–12, 314.

⁷¹There has been huge amount of publications on this issue in recent years. See, Liu Xingwen (editor-in-chief), *Comments on Studies of Chinese Civil Law (zhong guo min fa xue*

The Ownership of Land

3.1.1.1. Urban Land:

The State owns all "urban land in cities."¹⁰ There is, however, no specific Constitutional definition of what constitutes a "city" for the purpose of defining such ownership. Under Section 3 of the Law on Urban Zoning,¹¹ "cities" include municipalities subject directly to the Central Government,¹² cities and towns.¹³

3.1.1.2. Expansion of Urban Land into Agricultural Collective Areas:

The amount of urban land in China is growing. The State Council has the power to approve the establishment of new cities, and does so. Further, old cities expand. As a consequence of these events, more and more Agri-

shiyongquan de ruogan guiding issued by the Ministry of Land and Resources on March 11, 1995. Chapter 2, dealing with State Land Ownership, provides in Section 3 that urban land belongs to the State, and in Section 3 that all land that has not been allocated to peasants or to People's Communes should belong to the State. Agricultural land originally was allocated to peasants in the 1950 land reform. See section 3.2. In 1962, the Communist Party issued a Revised Draft of the Working Regulations on Rural People's Communes *renmin gongshe gongzuo tiaoli* (popularly known as the "Sixty Articles.") The Sixty Articles established the scope of land ownership by communes. These articles basically reversed what was left of the original individual ownership of land by peasants dating from 1950 and identified other agricultural land to be provided to communes.

¹⁰ Chinese Constitution, Article 10.

¹¹ *zhong hua ren min gong he guo cheng shi gui hua fa*, adopted by the 11th Session of the Standing Committee of the 7th National People's Congress in 1990.

¹² Beijing, Tianjin, Shanghai, and Chongqing. They are equivalent to provinces and autonomous ethnic regions as a level of administrative division.

¹³ In accordance with the Constitution, Article 89, the State Council is in charge of the approval of the establishment and geographic division of cities at different level. In China, cities can be divided by their positions at the administrative division system. Thus, there are cities at prefecture level, such as the capital cities of provinces, cities at county level, cities and towns subject to county government. Municipal government of a city at prefecture level functions as a prefecture government, with counties or cities at county level subject to it. The municipal government of a city at county level functions as a county government. There has been a recent tendency to convert a prefecture or a county into a city at prefecture level or county level.

Note, the land in urban areas of cities is definitely owned by State, but not all the land within the jurisdiction of a city necessary belongs to the State. In February of 1998, the People's Daily overseas edition reported that there were 666 cities in China, citing an announcement by the Ministry of Construction.

cultural Collective-owned land inevitably will be converted into State-owned land. Because urban land necessarily is owned by the State, when new urban land is created, theoretically the State should own it.

Often, the State will requisition all the Agricultural Collective-owned land within the urban areas of new cities or expanded old cities. As indicated below, it can do this without compensating for the land itself, although it may pay for improvements.

There are circumstances, however, where the State has not requisitioned Agricultural Collective-owned land within urban areas, especially in rapidly expanding old cities.¹⁴ This land is viewed as still being owned by Agricultural Collectives. This is inconsistent with Article 10 of the Constitution, and with the relevant provisions in Land Administration Law and its implementing Regulations. This co-existence of the State-owned land and Agricultural Collective-owned land in the urban area of cities is more common in organic towns,¹⁵ where most of the land is owned by Agricultural Collectives except a few parcels that have been requisitioned by the State.¹⁶

¹⁴ See Qian Mingxing, *Principles of in Rem Rights (wu quan fa yuan li)*, Peking University Press, 1994 (hereinafter recited as Qian), at 187-188. Professor Qian has found that some land within the urban area of expanded old cities has never been requisitioned by the State, and is still used by Agricultural Collectives for non-agricultural purposes themselves or as their contribution to joint ventures with their foreign or domestic partners.

¹⁵ An organic town is usually established with the development of new industrial or mineral areas. In order to establish a new industrial or mineral area, the state usually requisitions almost all the land owned by an Agricultural Collective or several Agricultural Collectives, then the government has to set up an organic town near the industrial or mineral area to settle down the abundant agricultural laborers, and at the same time to resident the workers and their family members. It is not always necessary for the state to requisition the land planned for the organic town since most of the residents in the organic town are the members of the former Agricultural Collective. With the development of the township enterprises, in some areas, especially in south China, the Agricultural Collective members has begun to establish towns themselves, the most famous one might be the Longgang Town in Wenzhou City, Zhejiang Province. Longgang was firstly set up by an Agricultural Collective. The Agricultural Collective designated a certain area and finished the infrastructure and public utilities, then invite its members and other people to construct buildings within the area. People who wanted to invest or reside in this area must pay a certain amount of money for the use the land and the public utilities there. Longgang was later regarded by the government to be an organic town. Its residents are granted the status of city residents.

¹⁶ Qian, at 188.

Collective-owned land, and the authors will discuss these two types of interests separately. Except as indicated, however, the general characteristics of allocated land use rights described in the section on rights on State-owned land will apply as well to allocated land use rights on Agricultural Collective-owned land. Also, because of special issues unique to certain forms of land users, we will include in the discussion of rights on State-owned land separate discussions of various specialized users, such as military units and foreign investment enterprises.

4.1. Allocated Land Use Rights Defined:

The land use rights created prior to 1986 generally were provided for no consideration and were of indefinite term. The term "allocated land use rights" became part of the vocabulary of Chinese legal scholars when China began a policy of creating a different species of land use rights — rights for which the State demanded compensation and which did have a definite term. To differentiate these new types of land use rights from the more older forms, legal scholars began denominating the old form of right an "allocated land use right" and the newer form a "granted land use right."

Although the differentiation began relatively early in the 1980's, even before the 1986 Land Administration Law provided national validation for granted land use rights, the term did not become part of the "official vocabulary" of Chinese legal provisions until 1990, when the 1990 Interim Provisions for the Granting and Transfer of Land Use Rights on State Owned Urban Land⁶ specifically defined a land use right obtained free of any charge as an "allocated land use right."⁷ The 1994 Law on Urban Real Estate Administration⁸, however, changed the definition to include rights conferred upon users who were required to pay compensation fees and settlement fees — fees designed to compensate parties who already were making use of the land allocated and would be displaced by the new use. Such fees had been a common, but not universal practice, in earlier times. Even prior to

⁶*Zhong hua ren min gong he guo cheng zhen guo you tu di chu rang zhuan rang zan xing tiao li*, promulgated by Decree No.55 of the State Council on May 19, 1990 and effective as of the date of promulgation.

⁷Section 43.

⁸Section 22.

1994, it was generally accepted that the term "allocated land use right" included such rights.

4.2 Allocated Land Use Rights on State-Owned Land:

We can categorize existing allocated land use rights into two groups — those allocated with no charge at all, and those for which a charge is levied for settlement fees and compensation fees for persons currently on the land, even though there is no charge for the land itself. Those rights in the first group can be further subdivided as follows:

- (1) Land requisitioned and allocated in accordance with Section 10, Paragraph 2 of the 1958 Measures for the Acquisition of Land for State Construction. This measure provided that if the land use rights were on empty urban land that had not been producing any income prior to its acquisition, no compensation would be required.
- (2) Land allocated in accordance with Section 31 of the 1982 Regulations for Acquiring Land for State Construction. Article 31 provided that if the land use rights were on state-owned wasteland, barren mountains, or beaches, or state-owned land there would be no compensation, even if other entities had been using the land.
- (3) Land allocated in accordance with Section 34 of the 1986 Land Administration Law. Section 34 provides that if the land use rights are on state-owned wasteland, barren mountains or beaches, no compensation fee will be required.

Those allocated land use rights for which a charge is levied for the land use right itself include:

- (1) Land acquired and allocated by the People's Government at or above county level in accordance with the 1953 Measures for the Acquisition of Land for State Construction. In accordance with these Measures, the land users are required pay compensation and settlement fees for allocated land use rights.
- (2) Land acquired and allocated by the People's Government at or above county level in accordance with the 1958 Measures for the

financial support from the State. Consequently, it has become quite common for them to devote their property to revenue producing purposes. Schoolyards in Shanghai have become parking lots. The street frontage of Peking University in the area closest to the Haidian District "Silicon Street" has become a shopping mall.

Local officials have condoned and even licensed these practices, although they have occurred on land allocated for different purposes. Like commercial activities on land allocated to the military, such activities are theoretically inconsistent with the allocated land use right, and should occur only when such rights have been "converted" to granted land use rights. As a practical matter, however, the practice is so widespread and well established that at some point government officials will have to find some way to "make room" for the development within the legal hierarchy of permitted real estate activities.

To mitigate the housing difficulties for employees of these institutions. The General Office of State Council in 1998 approved proposals by the Ministry of Construction and other relevant ministries and commissions to encourage these institutions to build subsidized housing for their workers in their respective assigned land.⁸⁷ According to the proposals, these organizations or institutions can build such housing for their own employees on their allocated land use rights. If they would like to convert the land use rights into granted land use rights, the land use rights can be converted without paying the granting prices.

4.6. Interim Rights:

It is possible for a party to obtain an "interim right" for the use of land that has not yet been made available for permanent land use rights. The holder of such a right runs the risk of losing the entire investment if and when the government chooses to put the land to a different use or to invite new bidders for a regular land use right. Parties obtaining such a right, nev-

⁸⁷Circular of the General Office of the State Council on Proposals of the Ministry of Construction and other Ministries on Encouraging Scientific Research Institutes, Universities and Colleges, Cultural Organizations and Health Institutions to Build Economic Houses on Their Respective Assigned Land, issued on September 18, 1998.

ertheless, probably will have to pay for it. But the price will reflect the reduced market value of this right.

Another form of interim right can be obtained during the period of development or construction in anticipation of the obtaining of an allocated or granted land use right. The user will be required to execute an "interim use contract" with the applicable owner of the land (State or Agricultural Collective) and will pay a temporary use fee.⁸⁸ The term for the temporary use right shall not exceed two years and the user may not build any permanent structures inconsistent with the contract purpose.⁸⁹

Also, if arable land has been used by a party or entity in the past for agricultural purposes, and a new user has been identified, but will not initiate its use of the land within the next following twelve month period, the old user is given an interim right to continue the existing use.⁹⁰ The concepts expressed in this subsection might also apply to allocated land use rights on Agricultural Collective-owned land, described below.

4.7. Homestead Rights:

Since Liberation, China has recognized a continued, inheritable⁹¹ right in homesteads. Such rights originated almost exclusively in free standing houses used as homes. In 1982, when the Constitution was adopted to declare that all land in cities was owned by the State and all agricultural land by Agricultural Collectives,⁹² these homestead rights continued to be recognized.⁹³

⁸⁸Land Administration Law, Section 57.

⁸⁹*Id.* at 82.

⁹⁰*Id.* at Section 37.

⁹¹The 1985 Inheritance Law does not list homestead as an inheritable estate. But it does provide that building ownership is inheritable. (Section 3). As a practical matter, inheritance of the building would carry with it the right to continue to have the building located on the property where it exists. As the ensuing discussion demonstrates, the Chinese have some discomfort legislating about homestead rights, because they are not formal land use rights and thus they are inconsistent with the overall pattern of land rights created under modern Chinese statutes.

⁹²See *supra* note 1, 2 in p. 59 and accompanying texts.

⁹³In fact, the Constitution, Article 10, provides that the land that is subject to homestead in agricultural property belongs to Agricultural Collectives. This reference to the exis-

ing a granted land use right today should be to carry out their defined institutional purposes.⁴⁰

Although public welfare institutions and the military might also use allocated land use rights both for their own purposes, there is no restriction on their acquisition and use of granted land use rights as well. They may have acquired the right as part of the acquisition of the building on it in order to use it for the purpose for which it was originally granted — such as an office building. They may have acquired the land use right in connection with a change of use or other conversion of an allocated land use right from some other holder.

Occasionally military or public welfare entities will be involved in the use of granted land use rights for commercial purposes. If the property is to be used for purposes unrelated to the military or public welfare purpose, most likely the unit will transfer the land use right to a company formed for the purpose of a commercial enterprise.⁴¹

5.3. Creation of Granted Land Use Rights:

5.3.1. Authority to Grant:

5.3.1.1. Agricultural Collectives:

As indicated above, Chinese lawmakers have not conferred upon Agricultural Collectives the right to create granted land use rights on Collective-owned land. This restriction is stated to be for the reason that Collective property is supposed to be used for agricultural purposes.⁴² But Agricultural Collectives may “convert” land that they own into granted land use rights, which are then transferrable, by the process of State requisition of

⁴⁰Any real estate companies formed prior to the 1990 ruling were required to be made independent of their parent public entities or liquidated. *Id.*, referring to a 1985 Circular on Strengthening the Supervision of Companies (*guo wu yuan guan yu jin yi bu qing li he zheng dun gong si de tong zhi*) issued by the State Council on August 20, 1985.

⁴¹For a discussion of the recent divestiture of military property interests used for non-military purposes, see *supra* text accompanying note 84, p. 104.

⁴²But, as described below, Agricultural Collectives can enter into leases of buildings located on Collective owned lands (as opposed to granted land use rights held by the Collective), which leases are in effect leases of the land itself.

the Collective land and then the State granting of granted land use rights in the same land back to the Collective. The Collective then can retransfer these granted land use rights just as could any other holder of a land use right.

5.3.1.2. Bureaus of Land Administration:

5.3.1.2.1. Approval System for Granted Land Use Rights Prior to 1999:

The 1998 amendments to the Land Administration Law adopted a new system by which proposed land use rights are to be approved. Because the changes are quite recent as of the time of publication of this work, the authors have included here the system which the amendments replace. The next subsection of this work will detail the new system, which applies to both allocated and granted land use rights. Aside from the methods of approval by the Land Administration authorities, the system for creating granted land use rights remains relatively unchanged, and the authors simply have entered changes where appropriate in their further discussion of the system beyond the next following subsection.

Prior to 1999, local organs of the People's Government, either the city or county governments, had the right to create use rights. The actual contract was between city or county and the grantee, but the agent to facilitate the granting of the right would be the Bureau of Land Administration in the city or county.⁴³

The local governments had authority to grant land use rights in parcels of land of certain maximum size (consistent with zoning and planning preconditions). If the proposed land use right was for a parcel larger than that authorized to be contracted for by a given city or county, then such agency had to seek the authority of a higher state organ to approve the grant.

In the 1989 Circular Concerning Authority of Approval for the Granting of Land Use Rights on State Owned Land,⁴⁴ issued by the State Council, the State Council provided specifically for authority to approve granted land use rights to the same extent as had existed for allocated land use rights. The limits were as follows:⁴⁵

⁴³Urban Real Estate Administration Law, Sections 11, 14.

⁴⁴*Guan yu chu rang guo you tu di shi yong quan pi zhun quan xian de tong zhi*, promulgated by the State Council on July 22, 1986.

⁴⁵Land Administration Law, Section 25 (prior to 1998 amendments).

of the property in which they are offered an opportunity. In most cases, the Basic Land Price system will not limit the parties in setting a market price. Under local regulation in some areas, however, the government has declared that it has a right of first refusal as to properties that are contracted to be sold for a price that is below that established by the system.¹²⁷

5.3.6.3. Infrastructure Contribution:

As part of the payment process for granted land use rights, the purchaser may be expected to make a payment for extension of utility services and other necessary infrastructure alterations that will be made necessary by the proposed construction.¹²⁸

5.3.7. Limit on Government Expenditure of Proceeds of Granted Land Use Rights:

As part of the thrust of the 1998 Land Administration Law to protect and reclaim China's arable land, the law commits all net proceeds from the creation of granted land use rights, both at the State and lower governmental levels, to projects to preserve or reclaim arable land.¹²⁹ The authors read this provision to apply only to land use grants of land that are currently being used for agricultural purposes, and not to all granted land use rights. This provision may dramatically alter the economics of creating granted land use rights for local governments, who in the past had seen the creation of land use rights as a "cash cow"¹³⁰ and perhaps may have been guilty of overdevelopment of such rights in order to address other economic objectives, even at the cost of good planning.

¹²⁷*Id.*, 80.

¹²⁸The Shenzhen regulations, discussed above, require that such payment be made in a lump sum at the time of the awarding of the contract, even in situations in which the land use fee itself can be paid over time. The requirement applies both to auction situations and to invitations for bid. Sections 26, 33.

¹²⁹Land Administration Law, Section 55. 1998 Implementing Regulations, Section 30.

¹³⁰In a recent announcement of a land use right auction in Lanzhou in the northwestern Province of Gansu, the City government proclaimed that it would use the proceeds of the sale of a former woolen mill property to "upgrade production lines and assist poor former employees of the former mill." China Daily "Briefs" (Business Weekly) 6/13/19.

5.4. Remedies for Breach of Granting Contract:

5.4.1. Enforcement of Price Obligation:

If the proposed grantee of a land use right¹³¹ fails to pay the agreed price in accordance with the contract, the Bureau of Land Administration can rescind the contract and make a claim for damages. The national law does not discuss forfeiture of deposits, but under the Shenzhen rules, if the successful bidder fails to perform, he will forfeit his deposit as well as pay any damages.¹³²

Note that the Bureau of Land Administration might elect not to terminate the contract, but rather to seek specific performance.¹³³

5.4.2. Enforcement by Buyer:

The Law on Urban Real Estate Administration¹³⁴ does not provide for specific performance, but states only that when there has been a failure by the government to deliver the land use right as contracted, the disappointed buyer has a claim for rescission and damages. The fact that a statute is silent on the point, however, does not preclude the awarding of specific performance in a contract, even a contract with a government agency.

Although Chinese authorities ten years ago generally favored the granting of specific performance, even against the State, now there is less certainty. Some continue to argue that parties should be entitled the specific performance whenever possible, but another group of commentators takes

¹³¹ Law on Urban Real Estate Administration, Section 15.

¹³²Shenzhen Granting Regulations, Article 20. The rights of the Land Administration do not arise until default in payment has existed for 60 days.

¹³³The Law on Urban Real Estate Administration, Section 15, and the 1990 Interim Provisions for the Granting and Transfer of Land Use Rights on Urban State-owned Land, Section 14, both provide for damages remedies only, but Chinese Civil Law permits a suit for specific performance when such performance is vital to the interests of the injured party and performance remains possible. Li Youyi, general editor, Textbook of Civil Law (Peking University Press 1992) 629. Also see the discussion of specific performance remedies under China's 1999 Contract Law, *infra* p. 158 note 136.

¹³⁴Section 16.

tion to make the necessary change in the building registration indicating termination of rights.⁵⁵

The provision requires the registration of mortgages of buildings.⁵⁶ It also requires the registration of the *dian*.⁵⁷ To the extent that this somewhat unusual Chinese custom⁵⁸ applies to real estate, it applies only to housing. The borrower transfers possession of a house in exchange for a loan. The lender continues in possession for an identified period — sometimes as long as twenty years, and this possession is the return the lender gets for the loan. If, at the end of the period, the borrower pays the loan, the house is restored to the borrower, but if the borrower does not pay, the holder of the *dian* obtains the ownership of the building. Modernly, the courts may require the *dian* holder to pay some extra money in this situation.

The provision also requires that any other rights in the building must be registered,⁵⁹ although it does not mention what these might be. Presumably, this would cover co-ownership interests and various kinds of servitudes.

The registration may cover only a portion of a building, such as an individual apartment unit or a floor.⁶⁰

A problem can arise where an owner registers ownership of a building but fails to register concurrently an ownership interest in the land use right pertaining to the land under and around the building. Section 6 of the 1998 Building Registration Measures provides that the applicant for the registration of building ownership must also be the owner of the pertinent land use right. In Shanghai, Shenzhen, Beijing, Chongqing and other business centers, the registration records for buildings and land use rights are maintained together. But in other areas they are not, leading to some difficulty and delay in establishing the right to register ownership of a building if the land use certificate is not produced. The measures do provide an excuse from the rather short registration requirements where there are good reasons for delay in the production of necessary documentation.⁶¹

⁵⁵1998 Registration Measures, Section 24.

⁵⁶1998 Registration Measures, Section 19. Again, registration must occur within thirty days.

⁵⁷*Id.*

⁵⁸Prior to Liberation, this custom included transfer of all kinds of property — including wives.

⁵⁹1998 Registration Measures, Section 19.

⁶⁰1998 Registration Measures, Section 20.

⁶¹1998 Registration Measures, Section 22.

The Measures also state two circumstances in which the Building Administration may register a building even without an application.⁶² The first instance is where the building is managed by the Building Administration itself. The second instance is where no one claims ownership of the building. Circumstances might arise, for instance, where records have been lost or destroyed and no entity wishes to accept the responsibility of ownership — such as an apartment building. In other cases, there simply is no record of ownership, and ownership may escheat to the State.

6.1.5.1. Liability of the Registration Office for Erroneous Registration of Buildings:

Section 38 of the 1998 Registration Measures establishes financial responsibility in the registry office in the event of an erroneous registration of a building caused by the negligence of that office. The Section provides that the office will be liable for the “direct economic consequences” of any such error. Note, however, that Chinese law defines “direct economic consequences” rather narrowly.⁶³ These do not include expectation damages, even those that might be regarded as “reasonably foreseeable” under the Common Law.

6.1.6. Registration of Leases:

Although a lease of a building and land use right supporting the building creates a credit right, and not a right *in rem*, the law nevertheless requires registration of such leases.⁶⁴ Registration of a lease, however, is not a condition of validity, it is only a kind of recordation⁶⁵ for the convenience of government administration and tax collection.

Until very recently, there had been some doubt as to whether leases of land use rights should be registered independently of the registration of the leases of the buildings on those rights. It should be noted that a lease of land

⁶²1998 Registration Measures, Section 21.

⁶³Zhang Bu Hong, State Compensation Law, Cases and Applications (*guo jia pei chang fa pan jie yu ying yong*) 241–245 (China Legal Press 2000).

⁶⁴Interim Provisions for the Granting and Transfer of Land Use Rights on State-owned Land in Cities and Towns, Section 31, and Measures Governing Urban Building Leasings (*cheng shi fang wu zu lin guan li ban fa*), promulgated by the Ministry of Construction on May 9, 1995, Chapter 3 (Sections 13–19.)

⁶⁵Measures Governing Urban Building Leasings, Section 13.

7.2.3. Leasing of Buildings:

Buildings and free standing improvements²⁷ have a separate identity in Chinese law. A building on State-owned land, Agricultural Collective owned land²⁸ or on an allocated land use right, can be the subject of a lease, even though the underlying interest in the ground cannot. The question of how the lessee has the right to enter on the property without any interest in the ground is a question that is unanswered in available Chinese law. Obviously, there must be some implicit right transferred to the lessee. Chances are that the implied permission to use the ground would be recognized as a Civil Law “neighborhood right” — the basic privilege of the owner of a right in one parcel to make reasonable use of neighboring parcels to obtain access to his own parcel.²⁹ Thus, at present, parties to leases of buildings in China see little purpose in attempting to create access rights or other rights in the ground itself. A lease of the building is a sufficient and complete transfer of use of the ground on which the building exists.³⁰

Agricultural Collectives can lease buildings on their land. Often, such leases are in effect leases of the land. Because, however, the interest being

²⁷Improvements constituting infrastructure, such as roads, paved parking lots, etc., can in many cases be sufficient “buildings” to be the subject of a lease, even when the land or land use right itself cannot. There are examples of leases by Agricultural Collectives of a “site,” or of a “mine” or “quarry,” where there has been little more done on the land than moving or excavating dirt. But nevertheless, the parties to these leases, and government officials involved in reviewing them, concluded that there was a sufficient difference between the subject of these leases and raw land to warrant the conclusion that the land itself was not being leased.

²⁸“Collective land” in this context may include an allocated land use right that has been contributed to a joint venture. The joint venture controls the land pursuant to the transfer from the Collective, but cannot transfer the interest in the land, since the interest is a non-transferrable land use right. In theory, the actual ownership land must be viewed as remaining in the ownership of the Collective. Nevertheless, because the joint venture, as a separate entity, has control over the land, it will be viewed as necessarily the “owner” of the buildings, and can lease them. Possession and control of land, under the Civil Code principle of “inherent right” gives a right of ownership to improvements constructed on them.

²⁹See General Principles of Civil Law, Article 83. Also see *Interpretations*, Articles 99 and 100, *supra* p. 31, note 11.

³⁰It probably is possible to create easements or other “subordinate rights” in land that is the subject of a “non-transferrable” land use right such as an allocated land use right. But there is little experience of this type of transaction in China at present.

leased is only the building, a building must exist. There are examples of leases being entered into where the building is essentially “vestigial” — only a suggestion of the improvements actually planned for the property. In such cases, the lease may require the tenant to develop a more elaborate building. (The building, regardless of who pays for it, will belong to the landlord during and after the lease.) But the theory would not condone the creation of a lease where there was no building at all.

7.2.3.1. Buildings That Cannot be Leased:

A regulation³¹ of the Ministry of Construction places limits on the kinds of buildings that can be the subject of a lease³². Buildings that have been condemned or closed by government³³ or judicial decree³⁴ cannot be leased. Generally speaking, properties whose ownership is currently in dispute in a legal proceeding, such as proceedings to determine ownership following death of an owner, cannot be leased,³⁵ but one assumes that the court could approve leases that were in the best interests of all disputants. The regulation also requires that all co-owners of a building must concur in a lease. Another important provision is that the mortgagee of the building must approve the leasing. Note that this regulation appears to apply whether or not the mortgagee has reserved in the mortgage the right to approve the lease. Further, buildings that involve purposes that involve heavy public use — such as hotels and restaurants, and other buildings with special safety concerns, such as factories, may be subject to regulation and permit requirements by various special agencies. This regulation prohibits leases of such buildings if the necessary permits have not been secured.

³¹Measures Governing Urban Building Leases, Article 6.

³²The first rule, that the landlord must have a certificate of ownership for the building, virtually goes without saying. Credentials are everything in China.

³³Buildings may be closed because they are unsafe or built in violation of building or land use codes, as in Western countries. But Chinese prosecutors also have broad powers to close buildings that are known to harbor criminal activity.

³⁴Creditors with security interests in real property who are seeking to recover a debt in a legal proceeding may obtain court orders restricting further leasing or transferring of the property by the debtor.

³⁵A lease entered into prior to the death of the landlord would bind the landlord’s estate and those taking from it.

a new secondary market. In turn, we may see a mechanism for real estate financing in home mortgages that will provide a template for the commercial securitization of mortgages,¹³ as has happened in the West.¹⁴ Lenders may begin to look at real estate as a favored form of security as they do in some Western countries.

In addition to the new housing policies, a change in banking regulation at the beginning of 1998 also may have an impact on mortgage lending decisions in China.¹⁵ Prior to 1998, China's central bank, the People's Bank of China ("PBOC"), developed "credit ceiling controls" for each state-owned commercial bank. These controls set forth in detail expectations related to the amount of loans which banks could make in various categories

¹³There are discussions in China about the securitization of mortgaged housing loans. See, e.g., Min Xuesong, *Geren Zhufang Diya Zhengquanhua de Sikao* [Considerations on Securitization of Personnel Housing Mortgage Loans], 2 ZHONGGUO FANGDICHAN JINRONG [CHINA REAL EST. FINANCING] 24, 24-26 (1998). The success of this program depends upon the basic cash flow underlying it. One wonders whether Chinese workers will pay their mortgages in a timely fashion. It should be kept in mind that for several decades Chinese workers have enjoyed housing that cost them a pittance and provided them with extensive protection against eviction. This experience is likely to cause workers to believe that they will not lose their homes promptly if they miss a mortgage payment. If they do not fear the consequence of default, will there be other incentives to insure prompt payment? And who will take the risk that they will not? It is unlikely that international securities markets will do so. The securitization issue in China has floundered for two years while Chinese officials grapple with the reality that some "deep pocket," likely within China, will have to provide meaningful credit enhancement to make any securitized housing loan offerings marketable. See Wang Ying, *Insurers Shy away from Mortgages*, CHINA DAILY (Bus. Wkly. Edition), June 5, 1999, at 5. Of course, Chinese state-regulated and state-supported insurance companies may ultimately take the risk and buy the bonds. These are still Chinese entities, however, and they would take on the risk of default as a result of government pressure.

¹⁴Although the authors acknowledge the possibility that a large securitized home mortgage marketplace will emerge, one of them is skeptical as to whether this will occur absent government guarantees of mortgage debts. If government guarantees are necessary, this author suggests that there are more efficient ways than a free-laden securitization process for the government to subsidize housing loans. See Patrick Randolph, *Is Securitization the Answer for China's Housing Needs?*, WORLD SECURITIZATION NEWS & COMMENT, Dec. 1998, at 1.

¹⁵See Dai Xianglong, *Wei Jianli Xiandai Jinrong Tixi, Jinrong Zhidu he Lianghao de Jinrong Chixu er Nuli* [The Objectives of a New Round of Financial Reform and Development], ZHONGGUO JINRONG [CHINA FIN.], no. 2 (1998), at 6.

and for various terms.¹⁶ The plans significantly reduced the inclination of lenders to take advantage of special lending opportunities, such as relatively high-credit real estate loans, if these opportunities were not part of the plan.

An even more important feature of the credit plans that discouraged mortgage lending was the fact that the plans set forth an expectation of a cash return on existing loan portfolios.¹⁷ This seemingly common-sense provision had an impact on the inclination of Chinese lenders to make mortgage loans because it inhibited their ability to acquire the security property in the foreclosure process.¹⁸ Under the Chinese credit plans, if the choice was to accept an inadequate cash bid at a foreclosure auction or bid a credit on the debt in a higher amount, the lender might have elected to take the cash bid, as this would result in some return during the relevant pe-

¹⁶The credit planning system was established in accordance with the Zhongguo Renmin Yinhang Jindai Zijin Guanli Banfa [Interim Measures of the People's Bank of China on the Management of Credit Funds] (issued Oct. 8, 1984) [hereinafter Measures on the Management of Credit Funds] reprinted in JINRONGFA SHIWU YU GUIZE [PRACTICE AND RULES OF FINANCE LAW] 541-44 (1995). According to these measures, the People's Bank of China managed the Renminbi credit funds under an integrated credit plan and approved the credit plan of each state-owned bank. *Id.* Compliance with the credit plan had a significant impact on the government's attitude toward the bank and the banker. See Fernando Montes-Negret, *China's Credit Plan: An Overview*, 11 OXFORD REV. ECON. POL'Y, Winter 1995, 25, 31-32.

¹⁷The implementation of the credit plan depends on the uninterrupted cash flow between lenders and borrowers. Montes-Negret, *supra* note 16, at 32-33.

¹⁸The ability to acquire the property at foreclosure, and hold it until the market turns, makes it possible to recoup losses on the loan. It is also an important factor that makes mortgage loans in Western countries desirable to lenders. An important reason why mortgage lending is attractive to lenders in other countries is that the land given as security represents potential value that can provide the ultimate protection against loss. This potential value, however, cannot always be realized in the context of an emergency liquidation like a foreclosure sale. Consequently, it is common in America for lenders to "bid in the debt" or bid part of the debt, and outbid anyone else interested in purchasing at the foreclosure sale. The lenders make this decision because they believe that ultimately they will be able to dispose of the property after a holding period for an amount that is in excess of the relatively low "fire sale" prices that competing bidders might be willing to pay at the foreclosure auction. If a lender was penalized for acquiring and holding property at foreclosure as opposed to accepting low cash bids, the lender might be less inclined to see special value in real estate as security and would emphasize loans secured by more readily liquidated assets or project loans with lower returns but higher security protection.

to withhold approval under certain circumstances, such as when the mortgage debt is retired from proceeds or when adequate substitute security is provided.

8.8.3 Impact of Transfer on the Original Mortgagor

If there is a transfer of property subject to a mortgage and the mortgage debt is not retired — such as when the price is inadequate to pay off the debt — there is no reason to believe that such a transfer automatically releases the original debtor from the obligation. The original debt remains, and the transferee is required to register the mortgage in favor of the mortgagee as part of the transfer. Of course, the mortgagee's consent is necessary for such a transfer, and the right to transfer likely must be purchased. The transferee's assumption of the debt could be an appropriate "purchase price."

8.9 Leasing of Mortgaged Property

Article 49 of the Urban Mortgage Measures provides that a mortgagor can lease or transfer the mortgaged property with the consent of the mortgagee.²⁰⁰ Article 37 of the Urban Mortgage Measures states that the proceeds of such a lease or transfer shall be paid to the mortgagee as a prepayment.²⁰¹ To the extent this language covers only the transfer of a mortgagor's land use rights, it likely is consistent with Article 49 of the Security Law.²⁰² But the new impact here is on the lease of the mortgaged property. The language appears to require all lease revenues (the Measures do not clarify whether these are net or gross lease revenues) to be applied as a prepayment on the outstanding mortgage.

²⁰⁰*Id.* art. 49.

²⁰¹*Id.* art. 37.

²⁰²The Security Law does not list any consequences for a transfer without the mortgagee's permission. In contrast, the Urban Mortgage Measures expressly indicate that such transfers (including leases) are void. Urban Mortgage Measures, *supra* note 4, art. 49. To the extent that the Security Law is not read to void unapproved transfers, the Urban Mortgage Measures and the Security Law are inconsistent.

A central purpose of much real estate development is to transfer or to lease the property. The whole purpose of borrowing money is to permit the mortgagor to create an economic asset, often a rent-generating economic asset. As long as the mortgagor makes the payments required under the lease, the mortgagor should be permitted to realize the benefits of the economic asset it has created. The provision directing that all lease payments be paid directly to the mortgagee contradicts this fundamental principle of real estate investment.

The authors believe that Chinese lawmakers should interpret Article 37 of the Urban Mortgage Measures to apply only when the property is completely leased under one lease agreement and not when the mortgagor is providing extended leasing services to multiple tenants (such as in an office complex or shopping center context). When Article 37 does apply, it is likely that mortgagors expecting to generate lease revenues will seek contract language altering its effect. The validity of such contract language is discussed below.²⁰³

When property subject to a lease is subsequently mortgaged, the mortgagor has a legal responsibility to inform the mortgagee of the lease and to inform the lessee of the mortgage.²⁰⁴ The mortgage has no impact on the lease, however, and neither the lessee nor the mortgagee has the right to object to the mortgagor's actions.²⁰⁵

8.10 Condition of Property; Insurance

8.10.1 Physical Condition of Property

The Urban Mortgage Measures create a duty on the mortgagor to avoid waste. This duty is quite similar to that borne by mortgagors under typical Western mortgages. The Urban Mortgage Measures confer on the mortgagee a specific right to inspect the property in order to ensure compliance with this duty.²⁰⁶ Article 36 of the Urban Mortgage Measures states that during the term of the mortgage the mortgagor has a duty to maintain and

²⁰³See *infra* notes 245-259 and accompanying text.

²⁰⁴Urban Mortgage Measures, *supra* note 4, art. 21.

²⁰⁵Security Law, *supra* note 4, art. 48.

²⁰⁶Urban Mortgage Measures, *supra* note 4, art. 36.

There is no express limitation on deficiencies. Such limitations are part of the mortgage laws in many American states. The principle of fairness expressed in the General Principles of the Civil Law, however, may place a limit on the ability of a lender to collect a deficiency when the price obtained from a foreclosure sale is for some reason not a true reflection of the market value of the security. The deficiency claim and the general judgment, of course, are credit rights under the Chinese system of legal rights.

8.18 Summary and Conclusions

China's most recent statutes and regulations dealing with mortgages have addressed most of the important issues concerning the structure of a modern commercial mortgage. It can no longer be said that Chinese real estate law is a "void" with respect to such issues. In a number of respects, Chinese legislators are to be complimented for the thoroughness and thoughtfulness of their work on a market system so alien to their traditions. Three major problems with mortgage law in China remain, however: (1) too great a preference for lenders, (2) too great a preference for lessees, and (3) "mechanics" or uncertain policies that seem at odds with the overall goal of a working financial marketplace. These problems are summarized below. In addition, as noted elsewhere in the text, the authors recommend that China adopt interpretive policies which permit clarity, flexibility, and true enforceability for commercial mortgage agreements.

8.18.1 Problems Resulting From Overfavoring Lenders

Chinese mortgage lenders are largely state-supported banks,³¹⁹ and the traditional socialist preference to give the government all the cards is evident

³¹⁹Although the authors do not have precise statistics on mortgage lending by state commercial banks, the domination of the state commercial banks is obvious. The profits of the "big four" (the Industrial and Commercial Bank of China, the China Construction Bank, the Agricultural Bank of China, and the Bank of China) accounted for 50% of the profits in China's banking system in 1998. These banks hold 68% of the nation's deposits, 77% of all loans, 75% of the country's total assets, and employ 66% of those who work in the banking sector. These percentages were calculated by the authors based on statistics provided in China Financial Outlook. See ZHONGGUO JINRONG ZHANWANG [CHINA FINANCIAL OUTLOOK], 81, 82-86 (The People's Bank of China 1999).

in certain provisions of China's mortgage law. In a number of circumstances, the laws give the mortgagees more benefits than they need. The most important example is the provision that gives lenders control over the resale of mortgaged property even when the lender is to be repaid fully from the proceeds of the resale. Although it might be said that the lender routinely will approve such proposed sales, allowance must be made for bureaucratic delay and ineptitude.

In the modern world of sophisticated real estate transactions, delay can kill a transaction, especially when the delay is caused by uncertainty related to the enforceability of the transaction agreement. The authors urge Chinese lawmakers to read the mortgage laws to permit the resale of the property without the prior consent of the lender when the mortgage is to be wholly paid as a result of the sale. The mortgagee suffers no harm from such a rule. Furthermore, under the present law, the sale proceeds must be applied to the mortgage debt, so it is not necessary for the law to require that such language appear in the sale agreement before the agreement can be enforced.

The authors also believe that the requirement for mortgagee approval should be eliminated entirely, even for situations in which the proceeds would not be adequate to retire the mortgage. The mortgagee can protect itself by inserting a due-on-sale clause into the mortgage, which would give the mortgagee the right to call in the loan if the property were transferred. This provision is an adequate deterrent against transfers. Assuming that land registration records are available for the mortgagee's inspection, landowners know that if they transfer property without the mortgagee's consent, they will face serious and immediate economic consequences. In most cases, this threat is sufficient to prevent resale without prior arrangements with the mortgagee in most cases, just as it is in most commercial settings in America.³²⁰ To go further and permit the mortgagee to invalidate the sale or pose a threat of doing so unnecessarily dampens the marketing of mortgaged properties. Open markets are stronger markets and produce more secure values in property. This ultimately benefits lenders as well as borrowers.

³²⁰It must be admitted that in some circumstances, particularly in some housing markets, homeowners do try to avoid the due-on-sale clause by hiding evidence of the sale. But China's rigid registration requirements should give the mortgagee greater power to prevent such deception than an American mortgagee would have.

establish real estate development companies either by themselves or with Chinese partners according to laws and regulations governing foreign-invested enterprises.⁸³

A real estate development company must register itself with the Administration for Industry and Commerce and record itself with the local construction administration within one month after such registration.⁸⁴

A real estate development company can be established for a special project. Companies set up for a special development project cease to exist when the project is completed.⁸⁵

Already existing companies falling within one of the following categories can apply to expand their businesses to real estate development:⁸⁶

- (1) Non-production companies or trust investment companies with more than 200,000,000 *yuan* equity, among them, at least 100,000,000 *yuan* must be current funds.
- (2) A-level construction engineering companies subordinated to Ministries of the Central Government with equity assets no less than 100,000,000 *yuan*, of which, at least 50,000,000 *yuan* must be current funds.
- (3) Other A-level construction engineering companies with no less than 50,000,000 equity asset, of which, at least 30,000,000 *yuan* must be current funds.^{86a}

Ministry announced that it would "experiment" by identifying a few companies for registration, but that open registration would be considered only when the experiment had been completed. "China Real Estate Firms Still Cannot Go Public," China Online, 4/26/00 <http://www.chinaonline.com/topstories/00426/2/C00041906.asp>

⁸³Regulations Governing Real Estate Development and Operation in Urban Areas, Section 6.

⁸⁴Law on Urban Real Estate Administration, Section 29; Regulations Governing Real Estate Development and Operation in Urban Areas, Sections 7, 8.

⁸⁵Zhang & Cheng, 80.

⁸⁶*Id.*

^{86a}The authors surmise that the lower capital requirements imposed on companies not subordinate to government ministries reflects an admirable candor in the regulators concerning the special risk of state owned entities expanding into new areas of enterprise.

10.5.3. Qualification Control on Real Estate Development Companies:

Real estate development companies⁸⁷ are classified into five levels based upon their equity assets and current funds, personnel, experience and past record of success.⁸⁸ A-level real estate development companies (the highest rating) must be certified by the provincial construction administration with the approval from the Ministry of Construction; real estate development companies below A-level can be certified by the provincial construction administration without the approval of the Ministry of Construction.⁸⁹ An enterprise must have been certified before it can go through the Administration for Industry and Commerce registration.⁹⁰ Afterwards, the enterprise must be recertified annually.⁹¹

E-level real estate development companies can only do development projects in local towns and villages.⁹² Real estate development companies at other levels may carry out real estate development projects based upon a "sliding scale."⁹³

10.5.4. Control on the Ratio of Registered Capital to the Total Investment:

In accordance with Section 30 of the Law on Urban Real Estate Administration, a real estate development company's registered capital must account for a certain proportion of the total investment in a project.⁹⁴ With

⁸⁷Regulations Governing Real Estate Development and Operation in Urban Areas, Section 9. The rating does not apply to project real estate development companies and real estate developers whose main business are not real estate development. Zhang & Cheng, 81.

⁸⁸Zhang & Cheng include a detailed discussion about the rating criteria. *Id.*, 82-83.

⁸⁹*Id.*, 81.

⁹⁰*Id.*

⁹¹*Id.*

⁹²*Id.*, at 82.

⁹³*Id.*, at 81.

⁹⁴There are no such provisions yet except for Sino-foreign joint venture real estate development companies. The State Administration for Industry and Commerce promulgated Interim Provisions on Ratios of Registered Capital to Total Investment for Sino-foreign Equity Joint Ventures (*guo jia gong shang zong jv guan yu zhong wai he zi jing ying qi ye zhu ce zi ben yu tou zi bi li de zan xing gui ding*) on March 1 1987, which applies to contractual joint ventures as well. *Id.*, at 86-87.

11.8. Value-Added Tax on Land:

11.8.1. Rational for the VAT:

The Value Added Tax (VAT) applies to gains on resale of goods and services. It uses different rates under different circumstances.¹²⁶ The VAT on land¹²⁷ is designed to make a reasonable adjustment for the benefit derived from land appreciation, as opposed to the improvement of land by the owner, and to safeguard the rights and interests of the State on land.¹²⁸ There are many policies in China designed to prevent what the Chinese view as “profiteering” in the market price of land. Land speculation is perceived as an evil in China, and, when it cannot be prevented, it is heavily taxed.

The perception of the government has been that many real estate developers have been reaping staggering profits from real estate transactions, taking advantage of the comparatively lower granting price and the loose regulations. The concept of the VAT on land is to impose a tax not on the whole profit the transferor obtains, but only on the extraordinary part of the profit. Where, indeed the initial granting price was artificially low, it is argued, the VAT on land does not raise the tax burden of the transferor, but

Tax, etc., to Foreign Funded Enterprises and Foreign Enterprises (*Quan guo ren min dai biao da hui chang wu wei yuan hui guan yu wai shang tou zi qi ye he wai guo qi ye shi yong zeng zhi shui, xiao fei shui, ying ye shui deng zan xing tiao li de jue ding*) (Adopted by the Standing Committee of the Eighth National People’s Congress on December 29, 1993).

¹²⁶VAT was firstly levied in pilot trial in several cities in 1979. The Tentative Measures on VAT (*Zeng zhi shui zan xing ban fa*) were adopted in 1982 by the Ministry of Finance and was effective as of January 1, 1983. The State Council promulgated the Interim Regulations on VAT (draft) (*Zeng zhi shui zan xing tiao li (cao 'an)*) in September, 1984. These Regulations went into effect on October 1, 1984. Several provisions were adopted by the Ministry of Finance afterwards to improve the VAT system. The latest Interim Regulations on VAT (*Zeng zhi shui zan xing tiao li*) were promulgated in 1993, which went into effect on January 1, 1994.

¹²⁷Interim Regulations on VAT on Land (*Tu di zeng zhi shui zan xing tiao li*), promulgated by the State Council on December 13, 1993 and effective as of January 1, 1994. The Ministry of Finance issued the Detailed Rules for the Implementation of the Interim Regulations on VAT on Land (*Tu di zeng zhi shui zan xing tiao li shi shi xi ze*), promulgated by the Ministry of Finance on January 27, 1995.

¹²⁸See Textbook of Finance Law, 241.

rather “recaptures” some or all of the price that the State should have obtained when it granted the land originally.

Before the implementation of VAT on land, there were several local Regulations imposing a “Land Value-added Fee.” The main difference between VAT on land and “land value-added fees” is that the land value-added fees were levied on all kinds of land use right assignments, whether or not for valuable consideration; while VAT on land is only levied on real estate transactions carried out for valuable consideration.

11.8.2. Incidence of the VAT:

All units and individuals receiving income from the transfer of state-owned land use rights, buildings and their attached facilities must pay the VAT on land.¹²⁹ Taxpayers must report the tax to the local competent tax authorities where the real estate is located within seven days of signing the real estate transfer agreement, and pay the VAT on land within the period specified by the tax authorities.¹³⁰ For taxpayers that have not paid the VAT on land according to these regulations, the land administration and the housing administration will not process the relevant title change procedures.¹³¹

The VAT on land will not be imposed on the transfer of real estate through inheritance or donation or other ways without compensation. And the transferors of real estate on the agricultural collective-owned land, for instance, the owner of the building on the collective-owned land, will not be the taxpayer of VAT on land.¹³²

11.8.3. Calculation of the VAT:

11.8.3.1. Calculation of the Amount of Taxable Appreciation:

The VAT on land is assessed according to the appreciated amount derived by the taxpayer from the transfer of real estate — the balance of proceeds received by the taxpayer on the transfer of real estate, after deducting

¹²⁹Interim Regulations on VAT on Land, Section 2.

¹³⁰*Id.*, Section 10.

¹³¹*Id.*, Section 12.

¹³²See Textbook of Finance Law, 242.