Real Property Law in the PRC

Basic Introduction

Steven M. Dickinson
Harris Moure PLLC
Seattle
www.harrismoure.com/www.chinalawblog.com

I. Basic Legal Framework

A. Ownership of real property in the PRC is based on the Constitution as revised in 2004, and on four key laws:

1. The Property Law adopted on on March 16, 2007 and which became effective on October 1, 2007.

2. Land Management Law (Adopted 1986, amended 2004)

3. Urban Real Estate Management Law (adopted 1994)

4. Rural Land Contract Law (adopted 2002)

Laws 2 through 4 were not repealed by the new Property Law. However, they are subject to the provisions of the Property Law and the Property Law will control where there are differences. Laws 2 through 4 are supplemented by a series of regulations and rules at the local level. The multiple laws and rules on the same subject can lead to considerable confusion. None of these laws are very old and there is considerable controversy within China on interpretations of key provisions.

II. Rules for Ownership of Land

A. Pursuant to the Constitution, China makes a clear distinction between land and buildings/fixtures located on land. Only the state can own land. Ownership of buildings was a very unclear concept until the new Property Law clearly provided that buildings and fixtures on land are owned separately from the land on which they sit.

B. The rules for land are as follows.

1. Urban land is owned by the state. The State Council has the authority to represent the ownership interests of the state in land.

2. Rural land is owned by rural cooperatives. Rural land is exclusively reserved for agricultural purposes. The only permitted use of rural land is: farming and residences for framers together with essential buildings such as schools, hospitals and agricultural support facilities. All land that will be used for commercial purposes or non-farmer residences must first be transferred to the national government. Transfer of such land is highly restricted and constitutes one of the most difficult issues under modern PRC real estate law.

3. All commercial and residential development must be conducted on state land. However, land cannot be sold. Instead, the state has the power to transfer the use right in land for a fee. Use rights are transferred for a specific period of time. The basic time limits are as follows:

Residential: 70 years.
Industrial/Commercial: 50 years.
Recreational: 40 years.

Once acquired, land used rights can be transferred to third parties. However, such transfers are 1) subject to restrictions on use provided in the original contract of transfer and are 2) subject to the original time limit of the basic grant.

4. At the end of the relevant time period, in principal the land use right terminates. Extension of the land use right occurs as follows:

a. For residential land, the new Property Law provides that the land use right is automatically extended at the end of its term. This is a major change in the law. However, the Property Law does not state 1) whether or not the extension is for another 70 years or for some other term and 2) whether or not a land use right renewal fee must be paid at the time of renewal.

b. For industrial, commercial and recreational land, the basic rule is the the holder of the land use right can petition for renewal of the right. If no request for renewal is made, the land use right terminates and the ownership of any buildings or fixtures located on the land reverts back to the state. There are no specific provisions on the term for any such renewal or whether or not a new land use fee must be paid on renewal. The new Property Law provides that the parties to a land use rights contract have the right to provide for all of these issues in their original land use rights agreement. Only if such issues are not addressed in the agreement with the default rules under existing law be applied.

III. Rules for Ownership of Buildings/Fixtures

A. The rules for buildings/fixtures located on urban land are as follows.

1. Any natural or legal Chinese person has the right to own buildings located on land. This ownership is clearly separated from the ownership of the underlying land. Ownership is recorded in the local real estate register. Ownership of the buildings is subject, however, to the underlying land use right, both in terms of limitations on use and on the time limit of the underlying land use right. Buildings can be freely purchased and sold, subject to the underlying land use right. The land use right automatically transfers when the ownership of a building is transferred.

2. As a result, purchasers of buildings in China acquire what in the U.S. would be a defeasible ownership interest. The ownership right in the building/fixture is absolute, but is subject to the time and use limitations imposed by the underlying land use right. This system results in a great deal of uncertainty about real estate ownership in China: what will happen when the time limit for the land use right comes to an end? Will the state act reasonably in granting extensions and in limiting the imposition of new fees, or will the state see this as an opportunity to 1) earn a windfall profit from new fees 2) seize productive commercial property with no payment of a fee or 3) perform social engineering by restructuring ownership interests to accommodate new conditions? This uncertainty will grow more intense as time goes on and the deadline for the land use right grows near.

3. With respect to residential property, the uncertainty concerning the land use right time limit was partially resolved in the Property Law by the provision that such rights renew automatically. However, the failure to address the period of the renewal and the rules concerning new fees still leaves significant uncertainty. Nothing has been done to clarify the issue with respect to commercial, industrial and recreational real estate.

4. On the other hand, the basis of the new Property Law is the persons have an absolute ownership right to buildings and fixtures on land. This right has all the features of classic ownership, including the right of disposal (sale), inheritance and gift. The Property Law makes the critical decision that land use rights and ownership rights of buildings/fixtures are property rights and not contract rights. This is a major revolution in Chinese law that will have far reaching consequences. The fundamental point is that contract rights are personal to the parties and cannot be freely purchased and sold. Such rights are therefore not suitable for a market economy. Property rights have the opposite characteristics. Until the adoption of the Property Law, many of the rights to property were treated as contract obligations, preventing the development of a true market system. The Property Law also makes clear that with respect to dealings in land use rights and building property rights, the state and private persons are on exactly the same equal basis and have the same rights and liabilities. This too is a monumental change in Chinese law. The fundamental reason is also based on the need for the creation of a market economy in China. Since the state is so heavily involved as the owner of land, the state must be treated as an equal in order to allow the market economy to function.

IV. Special Topics for U.S. Investors

A. There are a several important issues that must be understood by U.S. and other investors coming from a common law background.

1. The Property Law is based on civil law models, in particular the German, Swiss and Japanese civil codes. These "Law of Things" codes descend from Roman law. The approach to real property is very different from our common law system. It can be very confusing from our point of view and care must taken not to impose our common law concepts onto this civil law system. The Property Law is made even more difficult because the German civil code concepts have been supplemented by a unique set of concepts that apply only to China and are only uneasily adapted to the civil law system. The most obvious example is the tripartite division of ownership between the state, collectives and persons.

2. I will give three examples that are common in my discussions with U.S. real estate professionals.

a. Under the Chinese system, there is no deed providing for ownership of property. Ownership of land, disposition of the land use right, and the ownership of buildings and fixtures are all settled by entries in the relevant land registry. One innovation of the new Property Law is to establish a unified real property registry so that all information is recorded in one place. Proof of ownership is evidenced by various certificates issued by the state land offices. Private deeds and contracts are of no meaning under this system. In fact, no transfer of any right with respect to real property is effective until it is entered into the land use registry.

b. Leases are treated as contracts under the civil law system. This differs from the U.S. system, which treats leaseholds as a form of real property right. It is therefore dangerous to analogize any form of Chinese real property as equivalent to a lease and it is also dangerous to interpret Chinese leases in accordance with real property principles.

c. Under the new Property Law, all real property is automatically burdened with numerous obligation that require accommodation for the rights neighboring property. This burden is automatic and does not require an easement agreement or the filing of any particular registration. Since these rights include the right of sunlight, view and ventilation as well as the right not to be inconvenienced by excessive noise or pollution, this new set of obligations could form the basis for much litigation regarding real property in the future in China.