

land use right as contribution in kind in incorporating Chinese companies

Description

Land use right in China is regarded as a form of real estate. In practice, land use right can be used as contribution in kind in capitalizing a company in China. China Company Law says in its Article 27 that upon incorporating a company, an investor can use cash, intellectual property, land use right etc. that can be valued and transferred as contribution in capitalizing the said company. China Law on Administration of Real Estates says in its Article 28 that legally acquired land use right can be contributed in the equities in joint real estate development projects.

Under China Property Law, land use right can only be set up on state-owned lands only. But in reality, rural land use right is often used to form enterprises that are not regarded as legal persons under Chinese laws.

Though the laws seem quite clear in this regard, in practice, there are still some confusions that shall be heeded esp by foreign investors in China.

1. 25% investment ratio requirement

Despite that China Law on Administration of Real Estates states clearly that land use right can be contributed in joint real estate development projects, Article 39 of the same law provides that transfer of real estates whose land use right are granted (other than allocated) shall be subject to two conditions: (1) the land grant premium/land grant fee has been paid in full and land use right certificate is issued, and (2) the real estate development on the land has been completed up to 25% of its total investment.

The second condition of 25% investment ratio is aimed to prevent land flipping/speculation. However, this clause has given rise to huge confusion as against Article 28 in the same law. Till now, there are people (for example, Shanghai Bar Association) holding that land use right before development can be used as contribution in kind based on Article 28, but some people (esp people at government land agencies) holding otherwise based on Article 39.

There has been no formal and official clarification on the point leaving people wondering. However, I noticed recently in April, China Land Ministry indicated on its website in reply to a question raised to it that when the land use right holder wishes to use the right as contribution in incorporating a company, the contribution shall be regarded as “transfer” of land use right. Together with Article 39, the Land Ministry is equally saying that the contribution in kind in the form of land use right shall meet the condition of 25% development ratio.

Meanwhile, without a formal clarification from top, this can be arbitrary at lower governments with people having good connection with local government can skirt such rule and still managed to contribute the land use right in setting up a company. This has been proved in some real estate bribery scandal where it was found that the land use right was immediately transferred to another company before any development was done.

Foreign investors shall be in a safer position if their Chinese partners have developed the land so as to meet the condition laid down by the law.

2. rural land use right

Rural land use right refers to land use right created on the land collectively owned by farmers as provided by China Constitution and Land Law.

There is even more confusion, contradictions and complexity in regard of use of rural land. The general picture is as follows: China Law on Administration of Lands clearly prohibits the development of rural land for real estate or industrial purposes except as otherwise permitted in a few limited circumstances. The reason is simple: China wants to keep as much arable land for agriculture as possible.

However, the industrialization has posed insatiable demand for land for industrial purposes throughout the country in particular in the eastern coastal provinces. The encroachment and erosion of agriculture land is inevitable and irreversible. As a result, in the name of land reform, many local provinces have come to allow the transfer of rural land in the same way as state-owned land. Many places have allowed the creation of land use right on the rural land for a certain period of time for certain purpose just as if it was the urban state-owned land.

However with the Land Law still in effect there, it is like a sword of Damocles hanging there. Strictly speaking, the use of rural land in this way is illegal.

There has been hot debate as to whether to legalize the local reforms on rural land and how to regulate its transfer. So far, there has been no consensus on the point. Indeed, the reform of rural land is not just an economic issues but very much a political one. Many foreign investors that wish to buy industrial land in China always avoid using rural land.

However, it shall be noted that in practice, local courts tend to give respect to local rules that may seem to be against national laws. In Shanghai, Shanghai government has a special regulation in regard of use of land by foreign invested enterprises (Equity joint venture, contractual joint venture and WFOE) in which it is expressly provided that rural land can be used by foreign invested enterprises.

3. Registration of land use right as contribution in kind

In the above, we discuss land use right used as the contribution in kind in setting up a company in China. In this sense, the company I refer to is regarded as a legal person with its shareholders protected by the limited liabilities rule under Chinese laws. In other words, such legal persons shall have their own assets and properties coming from the contribution made by its shareholders. So as a result, such assets and properties shall be given to or registered in the name of the company.

When a shareholder makes contribution in kind in the form of land use right, the land use right shall be

accordingly transferred to the company so that at law the property will be deemed as the property of the company not its shareholders’.

In practice, there is one case related to foreign investment in China where the land use right does not have to be transferred to the legal entity formed, namely, the non-legal person contractual Sino-foreign joint venture enterprise. Because it is not a legal person, the enterprise so formed does not have to own its own assets as its liabilities will ultimately go to its owners who provide cooperative conditions in setting up the joint venture enterprise.

There is much more to be discussed such as tax implication which will surely demand a separate post to deal with.

If you wish to know more about the topic, do not hesitate to contact the author, Jason Tian.

Additional Read of the Topic: [land use right as a cooperation condition: an analysis](#) by Wantao Yang.

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