



## PRC GOVERNMENT TO ENFORCE COLLECTION OF LAND APPRECIATION TAX

The Notice on Questions Concerning Settlement of Land Appreciation Tax over Real Estate Development Enterprises (“Notice”), issued by the PRC’s State Administration of Taxation (“SAT”), came into effect on February 1, 2007. According to the SAT, the purpose of this Notice is not to declare a new tax on property, but to fully enforce the collection of the tax that had been levied upon developers starting in 1994. Consequently, the SAT believes that the land appreciation tax (“LAT”) will not impose any additional tax burden on developers. However, the Notice has triggered strong objections from developers and has led to a plunge in property stocks in Shanghai and Shenzhen.

### THE CURRENT PRACTICE OF LEVYING LAT

LAT is payable at the time of the transfer of land and any buildings on the land, based on the realized gain. Previously, under the Detailed Implementing Rules of

the Provisional Land Appreciation Tax Regulations, developers were permitted, as an exception, to pay a provisional amount on account of LAT in advance of the completion and financial settlement of the whole real estate project. The amount permitted was usually in the range of 1 to 3 percent of the gross sales revenue, depending on the province, since the uncertainty of the cost made it impossible to calculate the added value of the project. The LAT was required to be settled, according to four progressive rates ranging from 30 to 60 percent, after the whole project was completed. However, this exception became common practice. While the developer was potentially liable for the balance of the LAT, its collection was frequently unenforced or avoided by developers who evaded the LAT by intentionally separating the project into several subprojects: some kept leasing part of the salable area of the project, while others might delay the liquidation and termination of the project company.

## EFFECTS OF THE NEW RULE

In order to plug the existing loopholes, the Notice says LAT must be paid based upon each separate development, *i.e.*, on a project-by-project basis. Where the project is developed in stages, LAT must be paid at the completion of sales for each stage.

Developers should submit an application for LAT settlement to the relevant taxation authority within 90 days of the date when:

- The construction and sale of the real estate project have been completed;
- The ownership of the whole project is transferred but construction has not been completed; or
- Title to land is transferred (where no building has yet been built).

It remains to be seen whether local authorities will continue to collect provisional LAT on the sale of each unit.

The relevant taxation authority may also require developers to pay LAT when:

- More than 85 percent of the salable construction area of a completed building project has been sold, or if less than 85 percent has been sold but the remaining construction areas have been leased or are being used by the real estate enterprise for self-use;
- Sales have not been completed for three years after a sale permit or pre-sale permit has been granted;
- The developer applies for the cancellation of its tax registration (when it is being liquidated) but has not yet paid its LAT liability; or
- Other situations specified by the provincial taxation authorities are present.

As LAT will primarily be levied on the sales price after the deduction of development costs, the notice lists permissible tax deductions, such as:

- Those deductions permitted under the LAT regulation of 1994 and its implementation rules, which include payment for the land-use rights, land and project development costs (including interest paid to the financing banks), and taxes related to the transfer of real estate (fit-out costs may be included in the development costs);
- Initial-stage engineering costs, engineering installment costs, foundation infrastructure costs, and ancillary development costs;
- Public facilities developed as part of the project, including buildings for the local community, kindergartens, hospitals, parking lots, property management facilities, power stations, central heating facilities, water plants, gyms, schools, and postal services; and
- Joint development costs for more than one project, which may be allocated according to the ratio of the area for sales in one project to the gross area of all projects, or other reasonable method.

A tax ratio, no lower than the current pre-tax ratio, will be determined and approved by the relevant taxation authority by reference to the rates of other local enterprises of similar business size and profitability when:

- Accounting books that are required by the laws and administrative regulations have not yet been established;
- A taxpayer destroys accounting books without authorization or refuses to provide information on tax payment;
- The entries in the required accounting books have not been entered in an appropriate manner or the information on costs, receipt vouchers, and expense vouchers is incomplete, causing difficulties in conducting an audit;

- A taxpayer who is obligated to pay the LAT fails to go through tax settlement procedures within the time limit prescribed by the tax authority; or
- The taxation basis filed by a taxpayer is obviously much lower, and without reasonable ground.

## CONCLUSION

The real estate sector has long been considered one of the most lucrative businesses in China; at the same time, the real estate industry has also been regarded as a pillar industry contributing substantially to China's national economic growth. In order to encourage investment in real estate, local governments around China have sold land-use rights at low prices and have not strictly implemented the LAT. In recent years, the central government has launched several measures to enforce and enhance its control over the real estate market, and taxation has become an important tool.

The central government has tripled its old land-use tax rate and doubled the land-use fees on new sites for construction. The land-use tax will apply equally to both local and foreign developers. But none of these adjustments has had the same impact as the LAT.

*This Commentary was prepared with assistance from He Sha, a summer associate in the Beijing Office.*

## LAWYER CONTACT

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