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China's Property Tax Struggles to Get Off the Ground

China's government has for years been mulling a nationwide tax on home ownership that advocates believe would drive out the speculation that is pushing housing costs way beyond the means of ordinary people.

A new round of property tightening began at the end of September on the orders of the central government in a bid to rein in surging home prices and pre-empt a shift in speculation to other cities. In September, new-home prices in Beijing jumped by 27.8% year-on-year, 32.7% in Shanghai, and 34.1% in Shenzhen, data from the National Bureau of Statistics (NBS) show. As authorities clamped down in overheated regions, prices there cooled, but gains picked up in many second-tier cities such as Shijiazhuang in the north, Zhengzhou and Changsha in central China, and Haikou on the southern island of Hainan.

So far, more than 40 local governments have taken action, according to Hong Kong-based property agency and research firm Centaline Property, most typically by raising down-payment requirements and mortgage interest rates. Some cities have also limited the number of properties each family can own.

Expectations that legislation to enact a property tax would be put to the annual meeting of the National People's Congress (NPC), the country's legislature, last month were raised after a key economic planning meeting in December. A statement released by China's leaders after the conference said that "homes are for living and not speculating on." They called for a "long-term mechanism" to be established to ward off property bubbles, which would involve the use of fiscal, financial, tax, land and legislative measures.

However, Fu Ying, spokeswoman of the NPC, told reporters that the draft law on the tax would not be submitted to lawmakers for review, indicating that legislation is not on the official agenda for 2017, and that implementation of a levy will be kicked even farther into the future.

The real estate tax faces a mountain of challenges and complexities. These include vested interests such as multiple-home owners, technical and technological problems, the potential loss of fiscal income for local governments, the negative impact on the housing market and economic growth, disagreement over the legality of such a levy, controversy over the design and structure of the taxation system itself, and concern about adding to the existing burden of property-related taxes and fees.

Privatization Trigger

An annual tax on homeownership based on the value of the property is ubiquitous throughout the developed world but is a relatively new concept in China due to the nature of the economic system and the real estate market.

Up until the early 1990s, most urban homes were owned by the state and provided through work units, but the government started to privatize public housing and encourage private real estate development to boost the economy. As private ownership of land is not allowed, the state sells land-use rights which, for most residential housing, cover a period of 70 years.

Property and land have long been subject to a range of one-time transaction-based taxes, but an annual tax paid by owners based on the value of their homes was not proposed until 2003, when the private housing market took off and property started to be seen as an asset and an investment vehicle.

In 2011, Shanghai and the municipality of Chongqing in southwest China were chosen to conduct trials of a property tax and took different approaches.

In Shanghai, a tax rate of 0.6% is charged on 70% of a property's assessed market value on all homes, excluding the first, owned by people officially registered as local residents through the "hukou" system. It is also levied on the first home of residents without a local hukou. There are exemptions for households whose per capita construction floor space is smaller than 60 square meters, and the tax rate drops to 0.4% if the per-square-meter price of the property is less than double the average price of new homes in the city the previous year.

Chongqing focused on curbing demand for luxury properties. It imposes a tax on individual owners of villas and other residential properties in nine urban districts in the city where prices are more than two times the average new-home price in those areas. Ordinary homeowners who have no investment or job in Chongqing and are not officially registered as local residents are also covered by the tax which is levied at a rate of 0.5%, 1.0% or 1.2% of the purchase price.

But implementation has been ineffective, and studies show that the amount of money collected from the tax has been low. The levy in Shanghai has done little to help curb the increase in housing prices — in February, new-home prices in the city jumped by 21.1% from a year earlier and were 37.7% higher than in February 2015, according to NBS data.

So far, no other cities have been added to the trials. In a sign that the central government is struggling to come up with a unified national tax system, the State Council, China's cabinet chaired by Premier Li Keqiang, released guidelines in January to encourage local authorities to find innovative ways to allocate resources, including the exploration of a real estate tax.

Economic Pressure

Opponents of the levy on economic grounds claim that its imposition could trigger a correction in property prices, adding further downward pressure on the economy whose growth rate is only just starting to recover after a slowdown that started in 2011. The economy grew by 6.8% year-on-year in the fourth quarter, the first acceleration in eight quarters, as private investment and real estate development picked up.

About 25% to 30% of China's gross domestic product (GDP) is linked to final demand from the property and construction sectors, Moody's Investors Service estimated in a report last month.

"This creates the potential for developments in the property market to have large macroeconomic effects," Michael Taylor, a chief credit officer for Asia Pacific at Moody's, wrote in the report.

China's financial sector would also be affected by any turbulence in the housing market. Almost half of last year's new bank lending went to real estate, mostly through mortgages, and outstanding bank loans to developers and homebuyers stood at 26.68 trillion yuan ($3.87 trillion) at the end of 2016, up 27% from a year earlier and accounting for a quarter of the total, central bank data show.

Financial institutions also have exposure to real estate, with the latest official figures showing that about 2.5 trillion yuan of funds from wealth management products (WMPs) was invested in the sector in the first half of 2016. That accounted for 13% of the WMP funds that were invested in projects that generate actual economic activity, according to a report by the official China Banking Wealth Management Registration & Depository Center.

But proponents of the tax argue that as vital as property is for the overall economy, the healthy and stable development of the market in the long run is what matters, and a levy is exactly what is needed to help bring that about.

The tax is "intrinsically a stabilizer" as the tax burden will grow in line with property-price increases, said Fan Gang, head of the National Economic Research Institute of the China Reform Foundation and a member of the central bank's monetary policy committee, in a speech in December.

Increase Supply

Practices in many countries have proved that the tax is effective in controlling housing prices, he said, citing Singapore and the United States as examples.

The theory is that if implemented forcefully, the tax would drive owners of multiple homes to reduce their holdings, which would increase the supply of housing and stem the speculation that is fueling price increases. That in turn could help narrow the country's yawning wealth gap as real estate now accounts for the lion's share of household wealth.

Based on a survey of 12,000 families in 25 province-level areas, real estate — as measured by the value of property after all outstanding debt such as mortgages is deducted — accounted for 65.61% of per capita household wealth in 2015, according to the research arm of the state-run Economic Daily newspaper.

Since home prices have increased so much, the biggest factor contributing to Chinese household wealth now is the number of properties owned, said Bai Chong-en, executive associate dean of the School of Economics and Management of Tsinghua University in Beijing. He said a progressive real estate tax system could be adopted, under which rates would increase for owners of larger or multiple homes.

"This would be the best tax," he said in an interview with Caixin last month. "It will create less distortion than other taxes and it has a far better ability to redistribute (wealth) than other taxes."

Other forms of taxes can drive wealthy individuals to move their assets overseas, but a real estate tax will not lead to that kind of distortion because property cannot be physically relocated, he said.

Fan and Bai are among the economists who say that over the long term, a property tax is a recurring source of revenue for local governments at is more sustainable than selling land-use rights.

Income from the sale of land-use rights totaled 3.75 trillion yuan last year, nearly 30% of the combined annual income of local governments, official data show, with some areas depending on sales for as much as 50% of their revenue.

Short-Term Benefits

Local authorities have been reluctant to push for real estate tax reform partly out of concern that it will hurt demand for land, reduce property values and cool the market. Some academic research has estimated that over the short term, income raised from the levy will be far lower than revenue from land sales, leaving a gap in local government finances.

Self-interest is also a factor. Chinese officials regularly transfer to other cities and provinces. As a result, they are incentivized to favor the lump-sum, quick reward from land sales that will improve their short-term performance.

"As long as land sales continue to be a major source of local government income, authorities will retain their enthusiasm for selling less land for more money," Zhang Yu, an analyst with investment bank China International Capital Corp., wrote in a recent report. "Bubbles in the property market will continue to grow" if the land-for-revenue model persists, he said.

Debate over the legality of taxing state-owned land has also held back implementation of the property tax.

The constitution of the People's Republic of China stipulates that land in urban areas is owned by the state. Companies and individuals can buy the right to use land, but not the land itself.

"It is an important legal doctrine that wealth taxes must not be imposed on state-owned land," said Xu Shanda, a former deputy head of the State Administration of Taxation. "Even though Chinese property owners own the building, the land (upon which their homes are constructed) is owned by the state."

But Liu Jianwen, a law professor at Peking University specializing in tax and the economy, contends that this legal obstacle was removed when the Property Law came into effect in 2007. The law defined rights to the use of land for construction purposes in a way that is “almost equivalent to ownership rights,” he said.

Heavy Tax Burden

Another point of controversy is that a real estate tax may lead to double taxation given that the government is already collecting significant fees from land sales.

There are also concerns that a new levy will add to the already onerous burden of existing taxes imposed during a property’s construction and transfer phases. These include a farmland occupation tax, urban land-use tax, land value-added tax, deed tax, corporate income tax, personal income tax, and stamp duty.

There are also two levies imposed on the possession, or ownership, phase — one on the building and the other on land use. But the tax on the building is paid only by companies, and homeowners are currently exempt.

Proceeds from the deed tax, land value-added tax, farmland occupation tax, urban land-use tax, corporate income tax and building tax amounted to 1.87 trillion yuan last year, or 14.3% of local governments’ annual income, according to Ministry of Finance data.

Technical Challenges

Technical difficulties have also held back progress on the tax. These include the development of a nationwide electronic database, coordination and data-sharing between different government agencies, and the establishment of an independent and effective property-valuation appraisal system and dispute settlement mechanism.

Nevertheless, preparations are underway. In March 2015, the government started requiring owners to register their properties with the land and resources, and housing departments, and officials have said they aim to connect local registries to a unified national database by the end of this year.

Zhou Hao, a China economist with Commerzbank AG in Singapore, suggested that delays in the launch of the real estate tax may be linked to the government’s wavering political will.

“The property sector really gives the economy a shot in the arm — the economy rebounds rapidly once the real estate market is driven up,” Zhou told Caixin. “The government can achieve whatever it is determined to achieve. The question now is whether it has the resolve.”

If and when the tax is eventually introduced, its success will hinge on the strength of enforcement by the government, analysts say.

“The tax is a tool to make it more convenient (for the government) to establish a long-term mechanism to adjust and control the property market,” said Zhang Dawei, chief analyst with Centaline Property. “But its impact will depend on how the tool is used.”

Tightening up of the exemption arrangement under the New Residential Stamp Duty

The Government today (April 11) announced the tightening up of the exemption arrangement for Hong Kong permanent residents (HKPRs) under the 15 per cent New Residential Stamp Duty (NRSD) measure.

Stamp duty has all along been charged on an instrument basis. Under the existing exemption arrangement, acquisition of residential property under a single instrument, irrespective of the number of residential property involved, is exempted from the NRSD rate of 15 per cent and is only subject to the lower ad valorem stamp duty (AVD) rates at Scale 2 if the buyer concerned is a HKPR acting on his/her own behalf and is not a beneficial owner of any other residential property in Hong Kong at the time of acquisition.

There has been public concern over the recent increase in transactions involving acquisition of multiple residential properties under a single instrument. To prevent local investors from making use of the above exemption arrangement to avoid the payment of NRSD, the Government decided to tighten up the relevant exemption arrangement.

The Government will amend the Stamp Duty Ordinance, to the effect that acquisition of a single residential property under a single instrument by a HKPR who is acting on his/her own behalf and is not a beneficial owner of any other residential property in Hong Kong at the time of acquisition will continue to be exempted from the NRSD rate of 15 per cent, and will only be subject to lower AVD rates at Scale 2. However, if a HKPR-buyer acquires more than one residential property under a single instrument, the transaction concerned will no longer be exempted, and will be subject to the NRSD rate of 15 per cent.

To cater for the genuine self-use needs of HKPR-buyers, a "single residential property" includes: a residential unit acquired together with a car parking space; two adjacent residential units with the partitioning walls between the units demolished to form a single unit as shown on the approved building plans; a residential unit with roof situated immediately above the unit; and a residential unit with adjacent garden. In determining whether the property concerned is a "single residential property", the Inland Revenue Department will consider individual circumstances and take into account relevant documents, including building plan, deed of mutual covenant, occupation permit, etc.

Other exemption arrangements under the NRSD measure and the arrangement of applying doubled ad valorem stamp duty rates to non-residential property transactions remain in force.

The tightened up exemption arrangement will take effect after midnight tonight, i.e. on April 12. Agreements for sale and purchase signed today or before today are not affected.

China Cancels Property Tax Plan

After seven years of studying a key measure to tame soaring property prices, China's government has backed away from implementation due to fears that the real estate bubble could burst.

Prior to China's annual legislative sessions in early March, analysts and officials predicted that the National People's Congress (NPC) would enact a nationwide property tax that has been under consideration since at least 2010.

Top officials of the Ministry of Housing and Urban-Rural Development indicated that the NPC was poised to pass the landmark tax law aimed at curbing speculation in the housing sector.

"It is a major task in China's tax reform determined by policymakers, and the lawmaking process will be accelerated," said Vice Minister Lu Kehua, the official Xinhua news agency reported on Feb. 23.

But one day before the start of the NPC sessions, a spokeswoman said there was "no plan to submit a property tax bill to lawmakers for deliberation this year."

"There have been a lot of discussions on this issue, as such a bill involves a wide range of interests," said Fu Ying, according to Xinhua.

The report noted that a commitment to the tax law was part of the sweeping reform plan approved by the Third Plenary Session of the 18th Communist Party of China Central Committee in 2013.

"However, in a year when the ruling Chinese Communist Party (CCP) will see a top-level reshuffle at its 19th Party Congress, observers have dismissed the likelihood of such a measure for it could destabilize the economy," The Sunday Times of London said.

The reversal is important because the property tax has been seen as one of the few ways to deter speculative buying of multiple dwellings by well-heeled investors and families with savings seeking higher returns.

The practice of investing in unneeded properties has flooded the market with empty apartments and pushed home prices out of the reach of the poor.

But after years of preparation, the government has apparently balked at its own reform plan.

"This goes against the grain of what we thought way back in 2013 was the direction originally announced by the authorities," said Harvard University economics professor Dale Jorgenson.

"They don't seem to be able to carry this out," Jorgenson said in a phone interview.

Tax pilot programs

Since plans for the law were announced by the previous government of former President Hu Jintao and Premier Wen Jiabao, limited tax measures have been put in place under pilot programs only in the cities of Chongqing and Shanghai starting in 2011.

The taxes on high-end and multiple properties are meant to raise the cost of holding onto empty units for investment purposes. Housing speculation has been blamed for unnecessary building, double-digit price hikes and pollution in first-tier cities like Beijing.

"Houses are built to be lived in, not for speculation," President Xi Jinping said last year in a statement that has become a government slogan.

But instead of a national tax, the government has tried to discourage speculation by ordering cities to devise their own individual disincentives for buying second and third homes.

The result has been a patchwork of local rules covering higher down payments, mortgage histories and residency requirements, driving investment from one city to another.

Last month, dozens of cities took steps to limit housing purchases with a wide variety of differing rules and qualifications, according to Xinhua reports.

While property sales and building have boomed in big cities like Shenzhen, third-tier and fourth-tier cities have faced a glut with millions of unsold homes.

Local measures announced on March 17 by Beijing and three other big cities include increases in down payments from 50 to 60 percent of the sales price for second homebuyers.

The official English-language China Daily said that some buyers in Beijing would have to make a down payment of at least 80 percent for properties valued at more than 4.68 million yuan (U.S. $680,000).

In another step aimed at slamming the door on price hikes in the capital, Beijing authorities announced punishments against six projects and 15 real estate agent offices for selling "business apartments" to individuals as residences, Xinhua reported on March 27.

In another abrupt rule change to restrain prices, the southern city of Guangzhou announced Friday that sales of both new and existing homes would be prohibited if held for less than two years.

State media have cited National Bureau of Statistics (NBS) data as evidence that the municipal measures are working.

In March, Xinhua reported that the market had "stabilized" after the NBS found that more than half of 70 surveyed cities registered month-to-month price declines for new housing in February or increases of less than 0.5 percent.

The tortured reading was contradicted by a Reuters analysis of the same NBS data showing that the pace of average increases actually rose in February to 0.3 percent from 0.2 percent a month before.

RFA's review of the data found year-to-year price decreases in only 3 of the 70 cities with increases of more than 22 percent in Beijing, 23 percent in Guangzhou, and 21 percent in Shanghai.

Last month, the NBS reported a surprisingly strong 8.9-percent growth rate in real estate investment for the first two months of the year, topping industry forecasts.

Investment in residential properties rose 9 percent, while floor space for new construction climbed 14.8 percent, suggesting that the local rules have had little effect.

Although the government has pushed the national property tax as a more effective measure for years, Premier Li Keqiang had nothing to say about it in his annual work report to the NPC.

"We should better regulate housing development, marketing and intermediate services, and keep home prices from rising too quickly in popular cities," Li said.

Cities under pressure from rising prices "need to increase as appropriate the supply of land for residential use," Li said.

In the past, local governments have been criticized for relying too heavily on land sales for revenues. Property taxes were originally proposed as an alternate revenue source.

Years later, the idea of adding more land to overheated property markets may only encourage the speculative binge in an economy fueled by excess liquidity.

"Most cities, including the large ones, have an extra supply of land now. It's not as if there's some kind of land shortage that is driving this up," Jorgenson said.

The removal of the tax law from the NPC agenda suggests that the government has abandoned the plan as a solution for good.

The reversal is a sign of the government's increased concern with risks and "asset bubbles" in the economy as it focuses on stability at a time of declining economic growth.

Although slowing the price hikes remains a primary mission, the introduction of the property tax raises the risk that the bubble could deflate rapidly, putting pressure on the economy.

Jorgenson says the risk is one that the government should take, since the alternative is to rely on a thicket of local measures as prices keep rising.

He notes that speculative construction and unneeded development have contributed to excess production of power-intensive products like steel and cement that have been blamed for China's smog crisis.

By relying on inconsistent local regulations, the central government is continuing to allow interference with market forces.

"This is too complicated. Every time you turn around, there's some bandage pasted on this wounded system," said Jorgenson.

"The only way to deal with this is through markets, including land markets. And once you get to that point, then I think you immediately come to a property tax," he said.