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IS CHINA READY FOR A PROPERTY TAX? 1
PROPERTY TAX IN CHINA COULD SPELL BIG CHANGES FOR MARKET 2
XI'S TIGHTER GRIP WILL TAX CHINESE REAL ESTATE 2
MORE DETAILS ON CHINA'S LOOMING NATIONWIDE PROPERTY TAX 3
CHINA PROPERTY TAX BASED ON 'APPRAISAL VALUE', WITH LEGAL PROCESS TO BE IN PLACE BY 2019 4

Is China Ready for a Property Tax?

The announced tax is part of the Chinese government response to property market changes.

Revealing a roadmap for an annual property tax, Chinese Finance Minister Xiao Jie lately indicated that this long-awaited initiative is being fast tracked, starting a new chapter in the housing market. Xiao suggested property tax legislation will be rolled out in March 2019, followed by nationwide taxation. Charged on estimated home prices, rather than market ones, the tax will be levied by local authorities. Most importantly, the current land-related taxes and fees will be reduced in both category and value, to be gradually replaced by a single tax.

To contain the damage from rounds of housing stimulation, China's policymakers are stepping up efforts to fix some structural issues in the market, which had given rise to price volatility. Rental and subsidized homes will correct an over-commercialized market with few alternatives. Also, in a managed process, collectively owned land is being authorized for development without government acquisition. Bypassing local authorities, who pocket the majority of land added value, the new source of land supply will not only ease current market tensions but also create room for future price maneuvers. Although a nationwide property registry system, set to be effective in 2018, will extend important technical support, the tax marks an inevitable turn in China's property market.

After repeated stimulation of the real estate market, especially this round, the financial market has built up significant risk, leaving little, if any room for mistakes. Guarding against financial risks has been the government's top agenda item, reiterated at different high-profile events. Putting a positive shine on the topic, Chinese President Xi Jinping at the 19th Party Congress this October stressed the Party's preference for growth quality over pace. Against this backdrop, it's more likely than ever before that China will be retiring a growth model with the housing market as a key driver.

The current land-related tax system, including taxes and fees, encourages construction and transactions, subjecting the market to speculations. After years of promotion of housing development, the tax system is extremely distorted, incentivizing quick construction and sales while overlooking sold homes. Among the dozen or so taxes and fees currently in place, only two are levied on end home users, with the rest on developers and the like. In terms of value, the 2016 budget showed developer income tax alone generated revenue of 3.64 trillion yuan ($550 billion). On the contrary, the two taxes on held homes contributed 448 billion yuan ($68 billion).

Lastly, as China's property market matures, the reduced number of new homes will decrease demand for land, generating shrinking land sales fees in the long run. Since land sales fees account for a major proportion of local revenue, the market shift urges the central government to find new revenue sources for local governments. Official data show land sales fees likely peaked at 4.26 trillion yuan in 2014, decreased to 3.25 trillion yuan in 2015, and recovered to 3.75 trillion yuan in 2016. Although set to beat 2016 figures, it may be difficult for the 2017 amount — 3.60 trillion yuan as of October — to hit the 2014 record. With existing homes to exceed newly built ones, there is an irresistible drive for authorities to bring in an annual property tax on home users.

With a framework for the property tax in place, the government still faces other challenges ahead. First and foremost, a continued and stronger campaign against speculation is needed to reverse, if possible, public expectations, the strongest support for a housing boom in the short term. It has become household knowledge in China that restrictions imposed during boom times would be relaxed in lean times, resulting in ever bigger price hikes. Over a year after market tightening, even though transaction controls so far have curtailed sharper price increases in many cities, the public still expects home prices to go up, not down. With powerful self-fulfilling effects, this public expectation lures speculators to enter the market at any cost, driving up prices.

Second, although authorizing local governments to levy the tax will render great flexibility in tax rates and deductions nationally, the process could be prolonged, demanding skilled design. Because they currently generate the lion's share of local revenue, it will take time to replace land sales fees without disrupting local finances. As any tax paid by the previous buyer could be easily passed down to the next, a smart structure to reverse this trend will challenge tax experts. Additionally, authorities will have to walk a tightrope to implement feasible tax rates without disturbing the market.

In the long run, a property tax is only part of the needed fixes for China's housing market. To defuse the bubble, land supply and use efficiency should be increased, especially in megacities, while money creation should be slowed down. New investment alternatives should be in place for households to preserve their wealth as well.

Property tax in China could spell big changes for market

Speculation that a property tax will be introduced in China is hotting up, as legal process could be in place by March 2019.

Currently Chinese residents are only taxed when they buy or sell a property, and the proposed introduction of an annual property tax has become a highly contentious issue.

The belief is that if a tax was introduced on existing homes, it would deter people from buying multiple properties – therefore giving first-time buyers a better chance of getting on the property ladder.

The Chinese government had the idea of taxing owners of residential flats, the biggest part of Chinese households' wealth, for many years – in a bid to slow rapidly increasing house prices.

However, many people argue that, unlike other countries, Chinese citizens do not actually own the permanent rights to their homes, they just hold 70-year leases on the properties and therefore should not be forced to pay any property tax.

Appraisal value

Others also fear that a new tax would seriously dampen the property market – a huge part of the Chinese economy and one that is already cooling.

But, in an article published by the communist party's flagship newspaper just before Christmas, finance minister Xiao Jie confirmed that a tax will be introduced and that it will be based on "appraisal value".

"Existing industrial and commercial properties, as well as individual houses, will be taxed on the basis of an appraisal value, while current taxes on new builds will be lowered," he said.

However, an official announcement is yet to be released.

Xi's tighter grip will tax Chinese real estate

A ministerial demotion is set to upend the Chinese property market. President Xi Jinping is preparing to sidestep traditional policy shops, such as the Ministry of Finance, to put decision-making into the hands of a smaller group of individuals. One consequence will be an accelerated push to pass a national property tax.

Xiao Jie, head of MOF, seems set to step down after little more than a year into his job, according to Reuters sources. His likely successor, Ding Xuedong, suggests the finance ministry's influence is being watered down. Ding rose through the ranks of the ministry as a human resources functionary, with a reputation for implementing policies, not making them.

MOF will not be the only bureaucracy demoted by Beijing, part of a wider thrust to consolidate power in the hands of individuals loyal to Xi. While a smaller group of policymakers will entail trade-offs, it might be more willing to push through politically contentious policies that MOF struggles with, especially a nationwide property tax.

A levy is overdue. Giving local governments a recurring source of tax revenue would decrease their need to sell land to fund their budgets. It might also discourage housing speculation and put downward pressure on rents by making it more expensive to hold apartments empty. It's also relatively easy to administer.

Such a move is guaranteed to incur the wrath of homeowners. however. Pilot programmes in Shanghai and Chongqing were rolled out in 2011, but some studies subsequently suggested the Shanghai tax knocked up to 15 percent off average property prices. Other research published by the Lincoln Institute of Land Policy suggests a nationwide scheme could take a 10 percent bite out of home values. In the worst case, the tax could trigger a wider downturn. Real-estate related business activity is estimated to drive around a quarter of GDP growth.

But now that the economy looks to be humming, the tax has quietly crept back into the discussion. The Ministry of Finance, provincial leaders and others have struggled to achieve consensus, but with policymaking power increasingly in other hands, the tax might move forward next year and pass the legislature as early as 2019. Developers and investors should be ready.

More details on China's looming nationwide property tax

Investors and property developers have long viewed property tax as a threat. It would certainly increase the holding costs for property owners, especially those who have several properties. As such, it may force owners to sell some of their properties, which in turn may dampen the housing market.

Meanwhile, the property tax will mean a new income source for local governments, which have been highly reliant on land sales revenue for years. But it may also prompt local governments to tolerate deeper housing price corrections.

In an article published in the People's Daily earlier this week, Finance Minister Xiao Jie touched upon this sensitive issue. Although his article did not make it quite clear, many readers thought Xiao aimed to publish a specific property tax rule in 2019 and implement it in 2020.

Xiao first outlined the principles behind a property tax, along with a roadmap to its eventual rollout, in a book that was published to help the public understand the lengthy work report that President Xi Jinping delivered during the 19th national congress of the Communist Party last month.

Currently, there is a pilot property tax scheme being implemented in Shanghai and Chongqing, which started in 2011. But both cities continue to lead other mainland cities in home price rises.

Part of the reason is that there are a lot of exemptions.

For example, the tax only applies to new purchases after the trial tax scheme became effective. First-time home buyers are exempted. Also, the levy is based on historical transaction value rather than on the typically much higher appraised market value.

A Shanghai millionaire who already owns a dozen properties before the government rolled out the property tax will not have to pay the tax on his properties.

If he has just bought another property at 5 million yuan (US$759,000), his tax bill, at the rate of 0.6 percent, will amount to just 30,000 yuan per year. Even if the market price of his new property doubles to 10 million yuan a few years later, his tax bill will remain at 30,000 yuan per year.

If the same property tax rule is applied nationwide, the impact will be very minimal. There are no details yet, but at least Xiao has confirmed that the new tax will be based on appraised value, so it will be harsher.

That said, Xiao also said a step-by-step approach will be taken, which means the tax might be rolled out in some cities first before being applied to others. In some cities, it may not be implemented at all.

Xiao indicated that local authorities will be allowed to use their judgment and adjust policy details such as the final tax rate and allowances to reflect the market situation in their respective jurisdictions.

China property tax based on 'appraisal value', with legal process to be in place by 2019

Policy statement in People's Daily story on Wednesday offers strong hint long-delayed, much-debated property reform is gaining momentum, say analysts

China's new residential properties tax will be based on "appraisal value", Finance Minister Xiao Jie confirmed in an article published by the communist party's flagship newspaper, suggesting the top leadership has finally reached initial consensus, which should see an acceleration of its introduction.

However, apart from suggesting all legislative procedures will be completed by 2019, many of the finer details still remain unclear, in what has become one of the most contentious issues among residents.

"Existing industrial and commercial properties, as well as individual houses, will be taxed on the basis of an appraisal value, while current taxes on new builds will be lowered," Xiao said in an article published in the People's Daily on Wednesday.

China currently only taxes individuals when they buy or sell property, and the introduction of a new property tax has become a highly contentious issue.

It shows the top leadership is forming a clear vision on property taxes. It touches on the specific questions of how tax will actually be collected, and is a signal that property tax reform is gaining pace
The minister first revealed the likely residential properties tax will be based on appraisal values in October, in an official pamphlet that highlighted top officials' speeches and an interpretation of President Xi Jinping's main policy address, in a wrap-up of the 19th Party Congress in Beijing.

Reiteration of the government's plan to push ahead with a property tax, publicised in a Party newspaper with a much wider readership, suggests consensus has been reached and that the tax plan will go ahead.

"It shows the top leadership is forming a clear vision on property taxes. It touches on the specific questions of how tax will actually be collected, and is a signal that property tax reform is gaining pace," said Yan Yuejin, a researcher with the Shanghai-based E-house China R&D Institute.

The Chinese government has long toyed with the idea of taxing owners of residential flats, the biggest part of Chinese households' wealth, in an effort to tame skyrocketing house prices, redistribute wealth while at the same time boost government coffers.

Beijing has said in the past that allowing the country's vast residential stock – which some estimate to be US$44 trillion – to go untaxed was hugely unfair for those not yet on the property ladder or those who own one small unit, as people who have bought multiple homes have had years of value appreciation without paying tax. By levying the tax on existing homes, it is hoping to deter speculators from buying multiple homes.

China property tax unlikely any time soon, say analysts

Opponents of the proposed new tax argue that unlike other countries, Chinese citizens do not actually own the permanent rights to their homes, they just hold 70-year leases on the properties and should not be forced to pay any property tax.

Others also fear that a new tax would seriously dampen the property market, a huge part of the overall economy, which is already cooling.

Arguments have raged over whether to tax on current market value, or original purchase price, to tax all properties or only newly acquired properties, and what exemptions might be set, leaving the complicated issue of property tax effectively on hold in recent months.

A view of Bijie city in Guizhou province. Photo: Simon Song
But Xiao said in the article that legislation is being planned for the actual imposition of a new property tax but that its implementation will be pushed forward “step by step”.

He said all legislative procedures will be completed by 2019 and by 2020 and there will be clear laws on all kinds of taxation, given that some currently have no specific laws in place.

But doubts will still linger over the issue, with experts agreeing the devil will remain in the details.

What does ‘property long-term mechanism’ mean and how will it affect the Chinese market?

“If [the new tax] is purely based on market value, that’s unreasonable because the current market value contains lots of bubbles, and fluctuates a lot,” said Hu Yijian, a public finance professor with Shanghai University of Finance and Economics.

“But basing it on original price is also unfair, because the tax would fail to take into account asset appreciation.”

Hu said both simple market value, or original value, also failed to consider other complex issues, too, such as the size, type or range of residential properties to be taxed.

Xiao’s “step by step” comment, he added, implied a region-by-region approach to start, with taxes likely to be initially implemented in the cities with the biggest price inflation, then introduced to smaller cities and rural area.

Li Zhanjun, chief researcher with China Real Estate Association, a long-time critic of a new property tax, said if it is to be imposed, it should exclude the value of the land – all of which remains owned by Chinese government – and be based only on the value of the actual units.

How homes are evaluated is also likely to continue to be a potential flash point, he added, as it remains unclear if “appraisals” would be made on an individual basis, or generally on certain types and sizes of property, and where they are.

“Property tax reform should be a systematic project,” said Li.

“By imposing such a new tax, the state should also reduce redundant taxes currently levied on land purchase, construction and sale points.

“And they should make sure that after any reforms are made, the total tax burden on any individual does not increase, and the new tax can be offset by reductions in existing taxes.”