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Real Estate Tax Reform

South Korea’s real estate tax reform has taken shape. On July 3, a presidential committee on fiscal reform submitted its recommendations for tax reform proposing to raise taxes for people with high-priced real estate and with financial assets. Here is Park Won-gap, real estate senior analyst at KB Kookmin Bank, to examine what the recommendations are all about and their potential effect on the market.

The property tax reform, which is a hot topic in the real estate market in the second half of the year, is shaping up. The most attention-grabbing part of the reform plan unveiled by the fiscal reform committee is the comprehensive real estate tax, which will be reformed for the first time in ten years. The committee proposed to raise the fair market value rate by five percentage points every year over the next four years so the current rate of 80 percent will increase to 100 percent in 2022. Different versions of the tax also apply to vacant land and commercial or office land space. The new proposal calls for raising this tax and a tax on income from property leases as well.

Last month, the presidential panel on fiscal reform proposed four possible scenarios: increase the taxable portion of real estate transactions; raise the comprehensive real estate tax rate gradually; both; or apply different taxes on people who own a single house and those who own multiple homes. Among them, the committee now calls for raising both the taxable portion of market value and the tax rate itself for the comprehensive real estate tax. That would mean a gradual increase in the fair market value rate on an annual rate of five percentage points and a tougher progressive rate system on property ownership. Mr. Park explains why the committee has proposed to strengthen the comprehensive real estate tax, which was eased drastically in 2008 when the Lee Myung-bak government came into office.

The property holding tax includes the comprehensive real estate tax and the property tax. A hike in the property tax may draw backlash from those in the low-income and middle class, who also pay the property tax as long as they own homes. The comprehensive real estate tax, on the other hand, is levied on owners of very expensive or multiple homes. The Lee Myung-bak government eased the burden of this tax which resulted in a sharp decrease in the number of taxpayers and the tax amount, creating disputes over taxation equality.

According to the committee, the number of comprehensive real estate taxpayers fell by 47-point-three percent since the tax revision in 2008. As of the end of 2015, the rate of the property holding tax to the GDP dropped to zero-point-eight percent and the effective tax rate of property holding tax was zero-point-16 percent. The figures are significantly lower than the OECD averages of one-point-one percent and zero-point-33 percent, respectively. The new comprehensive real estate tax is estimated to affect 346-thousand home owners and generate one-point-one trillion won or about one billion US dollars in tax revenue. The proposed tax overhaul is expected to place a heavier burden on people who have multiple homes. Mr. Park explains.

Many owners of multiple homes are expected to find a breakthrough by registering themselves as landlords with rental businesses and show greater interest in high-yield real estate such as small buildings and stores. When the Roh Moo-hyun government decided to impose a higher comprehensive real estate tax on multiple home owners in 2005, money flooded into commercial properties, as far as I remember. Amid rising interest rates and sluggish consumption, I imagine investors will continue to focus on areas with a large floating population. Owners of multiple homes may seek to diversify their asset portfolio by reducing the number of their houses.

Despite the announcement of higher taxes on high value properties, the real estate market has yet to show any signs or adverse effectsBut the new plan may prompt multiple home owners to sell some of their houses and invest in stores or officetels instead for a lower tax burden. An "officetel" refers to a multi-purpose building with residential and commercial units. Even so, housing transactions are expected to decline, due to a series of real estate policies that have been released since last year and a possible increase in property taxes. Moreover, the committee has also proposed to levy more taxes on people with large financial incomes, increasing the tax burden further. Mr. Park continues.

The committee has recommended lowering the threshold for the comprehensive financial income tax to ten million won from the current 20 million won. In 2016, about 90-thousand South Koreans were subject to the comprehensive financial income tax. But the tax change will affect around 310-thousand people, and the number of people who will be subject to the tax will rise from 90-thousand to 400-thousand. The government and the ruling party are reluctant to accept the proposal, saying that lowering the standard to ten million won might be too drastic since the affected people will include retirees and middle class earners as well… so the government may not follow the committee's recommendation.

This proposal aims to improve equality in taxation, considering that the top ten percent of earners are capturing more than 90 percent of financial income. But the Ministry of Strategy and Finance says that it is difficult to accept the committee's proposal to execute the plan from next year. The financial income tax change will deal a blow to a number of retired people who live on pensions or rental income, and a heavier tax burden may affect consumption negatively. Bearing these concerns in mind, the government and the ruling party seem to be taking a cautious approach. Mr. Park says that it is necessary to adjust the speed when imposing higher property, financial income taxes.

In about 40 real estate adjustment areas, including Seoul, owners of multiple homes face 52 to 62 percent of the capital gain tax rate when selling their homes. In the case of those who have owned homes for a long time, they should be exempt from paying the tax. But even if they want to sell their houses because of the property tax burden, they actually can't, due to the high capital gain tax. In a phrase, they are caught between a rock and a hard place. The government should supplement the capital gain tax so multiple home owners can find an exit. I think the basic direction of property tax reform has been set properly. But a hasty implementation may spark tax hike resistance or produce unexpected victims. It is necessary to carry out the plan more flexibly in consideration of various factors, including the market atmosphere.

Based on the recommendations, the government will submit its tax reform plan for next year to the National Assembly's regular session in September. It plans to wrap up the legislation procedure within this year and start implementing the plan next year. The key is how the tax change will influence the real estate market and the economy. The Moon Jae-in government is simultaneously pushing for two goals, namely, securing taxation equality and stabilizing the housing market.

The success of the real estate tax reform will be determined by how the government handles the situation.

South Korea's property tax reform could be the toughest yet

Presidential committee on real estate tax reform recommends high hikes to government's appraisal rate

A presidential commission is recommending some of the harshest changes to South Korea's property tax regime.

The Special Financial Reform Committee convened by President Moon Jae-in has chosen the toughest of four proposals for the nation's comprehensive real estate tax, the Korea JoongAng Daily reported.

The changes will be done incrementally, the committee proposed. The government is to raise the fair market value ratio by 5 percentage points every year until 2022, bringing the taxable amount of a home's government-assessed value from 80 percent to 100 percent.

The government-assessed value itself represents only between 60 percent and 70 percent of the property's actual market value.

The commission also recommends hiking the housing tax rate by 0.05 percentage points to as much as 2.5 percent. Land owners, on the other hand, may expect a tax rate of as much as 3 percent.

“The proposal was focused on realising justice in taxation through a rational taxation system that not only enhances fiscal transparency but also improves accountability and fiscal policy,” said Kang Byung-goo, leader of the presidential commission.

The property tax reform could net the government a 56.1 percent increase in tax revenues next year to KRW3 trillion (USD2.7 billion).

Around 346,000 people, including 274,000 apartment owners, will be affected by the new levies, the committee estimated. Owners of multiple apartments will see their taxes rise by anywhere between 6.3 percent to 22.1 percent.

Factoring in the commission’s recommendations, the government will finalise its plans for the tax reform by the end of July. The National Assembly will vote on a bill in September.

If the bill passes, the reform should be implemented in 2019.

S.Korea to raise possession tax on high-priced, multiple home owners

South Korea's government announced a plan Friday to raise possession tax on owners of high-priced and multiple home and land from next year.

The revised tax code aimed to increase tax burden for high-priced and multiple home and land owners to control speculative investment in the real estate market, while the possession tax for commerce buildings and factory land would be unchanged, according to the Ministry of Strategy and Finance.

If the tax code is revised according to the government's plan, approximately another 742.2 billion won (662 million U.S. dollars) was expected to be collected in property possession tax from some 349,000 home and land owners.

The tax code revision would have little impact on one-home owner.

Those who possess a home worth 1.2 billion won (1.07 million U.S. dollars) in posted price, or 1.7 billion won (1.52 million U.S. dollars) in market price, will be required to pay 50,000 won (44.6 U.S. dollars) more in property tax from next year.

Those having a home worth 3.5 billion won (3.12 million U.S. dollars) in posted price, or 5 billion won (4.5 million U.S. dollars) in market price, will be required to pay 4.33 million won (3,863 U.S. dollars) more in possession tax.

People who have at least three high-priced homes will be required to pay additional 11.79 million won (10.520 U.S. dollars) in property possession tax from next year.

With the higher possession tax rate, the government expected the ratio of property possession tax to gross domestic product (GDP) to rise from 0.8 percent in 2015 to 1 percent by 2022.

De-Briefing: Real Estate Tax Reform

Real estate speculation has long been a contentious topic in Korea. Governments, particularly liberal ones, are keen to stop profiteering buyers from snapping up too many apartments in prime areas.

President Moon Jae-in’s government, emboldened by its victory in the June elections, has embarked on a campaign to raise the comprehensive real estate tax, which is aimed squarely at Korea’s wealthiest property owners. Here’s a primer on this controversial tax and the latest effort to increase it.

Q. What is the comprehensive real estate tax?

The comprehensive real estate tax is a national tax levied on owners of multiple properties and more expensive real estate. It is separate from the property tax levied by the local government.

Different versions of the tax also apply to vacant land and land used for industrial, business and agricultural purposes.

The tax was first proposed in October 2003 under the Roh Moo-hyun administration and was put into law in 2005. It applied to 70,000 apartment owners in its first year and that number jumped to 341,000 in 2006.

The goal was to suppress the real estate speculation that was driving up housing prices in the greater Seoul area, particularly in the capital's three Gangnam districts in southern Seoul - Gangnam, Seocho and Songpa. During the Roh administration, the three districts saw their apartment values rise by an average of 80 percent.

However, when the conservative Lee Myung-bak took over in 2008, it eased the comprehensive tax which it said was punitive and irrational. It raised the cutoff for those required to pay the tax from 600 million won ($538,950) to 900 million won for owners of just one property.

When the comprehensive real estate tax was first introduced, some said that it would unfairly punish people who saw their home prices rise on their own and weren't involved in real estate speculation. These sentiments resonated with retired people who lived in the same apartment in Gangnam for decades.

Q. How is the comprehensive real estate tax calculated?

Currently, the tax is levied on owners of multiple apartments exceeding 600 million won in total government-assessed value. However, for owners of only one property, the tax is levied when their real estate value exceeds 900 million won. The Ministry of Land, Infrastructure and Transport releases apartment values in April, and they are used to calculate the taxes.

The tax is also currently calculated separately by each member of a household. This means if a husband owns an apartment that worth less than 900 million won in government-assessed value and the wife owns an apartment valued less than 900 million won, they don't have to worry about the comprehensive real estate tax.

During the Roh administration's initial version of the tax, all property owned by family members regardless were combined under the tax. This was changed during the Lee administration in 2009. The comprehensive tax is also levied on land that has a combined value that exceeds 500 million won, and on commercial or office land space it goes into effect when the combined value of an owner's properties exceeds 8 billion won.

The tax rate is between 0.5 and 2 percent and applies to the amount that an apartment exceeds 900 million won for owners of single properties and 600 million won for owners of multiple properties. The taxed amount is 80 percent of the government assessed value over that, which is also between 60 and 70 percent of the property's market value. For land, the tax rate is between 0.75 and 2 percent, and for commercial properties it is between 0.5 and 0.7 percent.

According to the National Tax Service, last year 335,591 apartment owners paid the comprehensive real estate tax, 0.6 percent of the country's 51.8 million people.

Q. Why is the government planning to raise this tax?

The Moon government strongly believes that owners of multiple apartments were driving up apartment prices to unaffordable levels while curtailing the housing supply. In a move to encourage owners of multiple apartments to sell off their properties, the Moon government levied heavier taxes on sales of multiple apartments. But as the market showed no signs of cooling off, so the government is now planning to raise the comprehensive real estate tax.

Koreans invest heavily in real estate compared to other advanced economies. According to a study by the Bank of Korea, non-financial assets, which are mostly made up of real estate, account for 75.8 percent of average Korean household's total assets. In the United States, that ratio is 34.9 percent, Japan is at 43.7 percent and Britain 55.3 percent. Germany and France both have ratios above 65 percent.

There were 5,830 people who owned more than 11 homes in 2009, just 0.036 percent of the country's population. However, by 2016, that figure had surged to nearly 25,000, or 0.091 percent of Koreans. The number of people who own between six and 10 housing units increased from 9,479 to 26,559 during the same period.

The government believes one of the main reasons people are buying multiple homes, even if they have to take out large loans to do so, is because of the relatively low tax burden.

Korea's total property taxes are equivalent to 0.8 percent of the nation's GDP, well below the 0.91 percent average of Organization for Economic Cooperation and Development nations.

Q. How is the tax going to be changed?

The committee reportedly decided on Thursday to go with a plan that will raise both the taxable portion of market value from the current 80 percent to 100 percent by 2020 and the maximum tax rate from the current 2 percent to 2.5 percent. It is set to make its final recommendation to the Ministry of Strategy and Finance tomorrow.

This is the third option of four that the committee proposed.

The fourth option is likely to be scrapped in the final recommendation because it would "give preferential treatment" to those who own one expensive home, which would "undermine the fundamental purpose" of the tax increase, according to a statement released by an anonymous member of the committee.

Under the fourth option, both the taxable portion and the tax rate will go up for multiple home owners, whereas for single-home owners, only the taxable portion will increase by 2 to 10 percentage points each year until 2020. Single-home owners already receive a 70 percent deduction on their comprehensive real estate tax.

In the meeting on Thursday, the committee also agreed to include an additional tax hike for those who own more than three homes.

Q. What will be the effect of the increase?

According to the calculation by the committee, the government's tax revenue would increase by as little as 571.1 billion won or as much as 1.29 trillion won under the plan selected.

While the government will welcome the additional tax revenue, it represents an increased tax burden for homeowners.

Around 348,000 home owners are expected to see tax increases of as little as 12.5 percent or as much as 37.7 percent.

For an owner of a single property valued at 1 billion won, for example, a 10 percent increase in the taxable portion and a 0.5 percent rise in the tax rate would push up their comprehensive tax bill from 5.1 million won this year to 6.12 million won next year. For a 3 billion won apartment, the comprehensive tax would rise from 12.3 million won this year to 16.08 million next year.

For a person with two apartments both worth two billion won, the total real estate tax, including the comprehensive tax and property tax, will increase from 13.75 million to 26.49 million next year, nearly doubling, according to Shinhan Bank.

The committee anticipates that raising the comprehensive tax on owners of more than three homes would increase the cost of home ownership. This would eventually force owners to sell or register themselves as landlords with rental businesses (which qualifies them for deductions on property tax and lease income taxes), ultimately stabilizing the local real estate market in line with the government's intent.