

Memorandum

To: Chinese central government

From: Xintong Wang

Date: May 8th, 2017

Subject: Property Tax Implementation in China

China's housing market is overheated for many years. According to the Ministry of Housing and Urban-Rural Development of China's annual report, the average housing price surged 150% from 2004 to 2014. ¹The price increase in major cities is more dramatic than the average. In Beijing, Shanghai, Guangzhou, and Shenzhen (four major cities in China), the price from 2004 to 2014 was raised by 374%, 346%, 505%, and 420% respectively. ² Many people in China appeal to the government to implement a property tax to cool off the housing market. In 2006, the National People's Congress approved the plan "to reform the real estate tax system, to implement the property tax when condition permits, and to cancel the corresponding fee." Until now, no country-wide property tax was executed and the future implementation is uncertain.

This memo is going to introduce the existing property-related taxes in China and the land transfer fee in China, analyze the rationale that China should implement the property tax and the reason it has many opponents, evaluate the two pilot cities' property tax regulation, and recommend a property tax reform in China.

Property-related Taxes in China

There are five property-related taxes in China. They are real estate tax, urban land use tax, cultivated land occupation tax, land value increment tax, and deed tax.

Real estate tax is the most equivalent to property tax in China. It is a tax levied on commercial real estate. The tax rate and tax base differ whether the property is for self-use or for renting out. When it is for self-use, the tax base is the purchase price *(70 to 90 percent) and the tax rate is 1.2 percent. The specific portion which is taxing on is determined by the local government. When it is for renting out, the tax base is the rental and the tax rate is 12 percent. The real estate tax is not based on the assessed value.

Urban land use tax is a tax levied on the "use right" of land. In China, the land belongs to the country, not any individual. When any entity or individual "buy" a land, they only own the use right of the land and they need to pay a one-time land use tax. The tax payable per unit is differentiated with different ranges for different regions, i.e. large cities, medium-sized cities, small cities, and mining districts. The amount of tax payable is computed based on the actual size of the land occupied by the taxpayers and by applying the specified applicable tax payable per unit. ³

Cultivated land occupation tax is similar to urban land use tax. The difference is that this one applies to farmland and the previous one applies to urban land. The tax payable is different for different tax brackets. The tax brackets are determined based on the average size of farmland occupied per person and the local economic situation. Overall, the tax rate is higher for urban land than farm land.

Land value increment tax is collected at the time of use right transfer based on the total increased value of the land calculating at multiple progressive tax rate. It refers to the total present value at the

¹ <http://finance.sina.com.cn/zl/china/2016-02-23/zl-ixprucu3150102.shtml> (In Chinese)

² *ibid*

³ <http://www.by-cpa.com/html/news/20076/589.html>

time of land use right transfer deducting the present value at the time of “acquiring” the land. The tax payer for this one is the grantor.⁴

Deed tax is the tax that grantees need to pay when the property transferred. It includes the transfer of the use right of land and the ownership of house. The formula for computing the tax payable is tax payable = tax base * applicable rate.

We can summarize from the previous descriptions that China’s property-related tax has the following features: a) The taxation is very complicated. Some of them overlap with each other. b) Most of the taxes are applied in the transition stage, not the holding stage. Only the real estate tax we talked before is a possession tax. c) The tax base is not the assessed value but the purchase price, which is not the real value of an asset.

Local Government Main Revenue Stream- Land Transfer Fee

The five property-related taxes make up for 18.21 percent of the local government revenue, which is not a high portion comparing to other countries.⁵ In addition, the median debt/GDP ratio across 30 provinces is 31.4 percent in 2016 (see figure 1) and the total local debt/GDP increases to about 40 percent in 2014 over the past 17 years (see figure 2). By comparison, the most indebted state’ debt-to-GDP ratio in the U.S. is 23.46 percent in 2016.⁶ We can conclude that China’s local governments are running with relatively high risk. One reason for the insufficient local funding is the tax-sharing system in China. Even though taxes are collected by the local government, there is a pre-set portion of the total tax revenue that the local government should transfer to the central government. In terms of the five property-related taxes, 75 percent of the land value increment tax should go to the central government.⁷ In order to raise fund for its running, local governments collect land transfer fee when they auction the land out. It is a one-time collected fee for using the land within its use duration. It is 70 years for residential property, 40 years for commercial property and 50 years otherwise. In 2015, the land transfer fee accounts for 39.2 percent of local government revenue.⁸

Without property tax, the five property-related taxes and the land transfer fee account 74 percent of the real estate sales revenue in 2014.⁹ Even though there is no explicit property tax, the taxes attached to property are mainly undertaken by the consumers.

The Rationale of the Property Tax

⁴ http://web.kinmen.gov.tw/Layout/sub_C/AllInOne_en_Show.aspx?path=10576&guid=d706791c-f85d-45cb-9cdd-1cc10d7b2a37&lang=en-us

⁵ <http://finance.sina.com.cn/zl/china/2016-10-19/zl-ixwvpar8421254.shtml>

⁶ http://www.usgovernmentspending.com/compare_state_spending_2016pH0d

⁷ https://books.google.com/books?id=j_FTDQAAQBAJ&pg=PT65&lpg=PT65&dq=%E6%88%BF%E4%BA%A7%E7%A8%8E+50%25%E4%B8%AD%E5%A4%AE&source=bl&ots=-bkQr7v4ge&sig=n5eWqmBYOTR1Oy4f3rqe9ZhNFjc&hl=en&sa=X&ved=0ahUKEwiz-OT81-HTAhU14YMKHZeqDMAQ6AEITTAG#v=onepage&q=%E6%88%BF%E4%BA%A7%E7%A8%8E%2050%25%E4%B8%AD%E5%A4%AE&f=false

⁸ Ibid 6

⁹ <http://finance.sina.com.cn/zl/china/2016-10-19/zl-ixwvpar8421254.shtml>

In essence, property tax is an asset tax. It is taxing on the land value and the building value. Even though people in China do not own the land, the use right of land can also be thought as an asset. Here are some reasons why I believe China should implement the property tax.

First, the property tax should be the main revenue stream for the local government. As we discussed before, the current funding situation for local government is in high risk. It needs extra fund to realize its functions, such as maintain transportation system, aid local education, etc.. Even though the land transfer fee now serves as the main revenue stream, it should not be based on its nature. A fee is not as transparent as tax and it does not have a strong legal foundation standing behind. In addition, land transfer fee is not stable in the long run. Land may be used up some day. How would the local government deal with it then?

Second, property tax, from its nature, can capture the socially created value of the property. Since the property tax is (or should be) collected bases on the assessed value, the tax revenue goes to the government will be used in the local infrastructure and therefore increase the assessed value, which captures the value that created socially. Other property-related taxes in China are all based on purchase price, which cannot reflect the value added and is not the real value of the asset.

Third, the implementation of property tax is a good opportunity to reform the current tax-system in China. Property tax should be implemented while some of the taxes are combined or eliminated. Otherwise it is just one more tax type for the citizens and makes no sense. What's more, it is also a good chance to reform the tax-sharing system, which seizes much of the revenue from the local government to the central government but does not return to the local people.

Forth, it is a good way to fight against the real estate speculators. Though this object is regarded as the major one by many scholars in China. I do not think this should be. Implementing property tax may reduce the housing price. But the more important measures are building a more developed financial market for people to gain value and balancing the housing market's supply and demand.

Where are the opposition from?

Property tax is good for local government (main revenue stream) and taxpayers (paying a legal term while gain local infrastructure improvement) from my previous analysis. But, why both seem to stand on the opposite side?

The local government opposes it because they have more discretionary power over land transfer fee than property tax. But this cannot be a legitimate reason. The government is not running for anyone's personal profit or running in a way which is convenient but not legitimate.

The ordinary citizens, who do not use houses as speculative vehicle, are also against it. One reason is that they are afraid it is another tax on property, without eliminating any existing ones. Another reason is that they do not think the property tax will be used for the local improvement. The two concerns remind the policy maker to a) consolidate all the property-related taxes, not add a new tax type. b) take steps to make sure the government spending is transparent, reasonable, and supervised.

Two Pilot Cities in China- Shanghai and Chongqing- Description and Evaluation

In 2011, property tax was launched in two cities, Shanghai and Chongqing. They have different policy design. The main comparison is shown in the chart below.

	Shanghai	Chongqing
Date	Jan 28 th 2011	Jan 28 th 2011
Rules	a) Resident: if the new purchase is the second (or more) house of the family b) Non-resident: new purchase	a) Single family villa b) New purchase of luxury house (twice the average unit price) c) For non-resident, non-job holder, and non-investor, the new purchase of the second (or more) house
Tax rate	0.4 to 0.6 percent	0.5 to 1.2 percent
Tax base	Purchase price*70%	Purchase price
Current owned property?	No tax on the current owned property	Yes, but only for the single family villa

To evaluate the two policies, I would like to view from two perspectives. First, whether they work to reach their objectives. Second, whether they were designed in the way that a property tax should be.

First, we see whether they reach the objectives. a) property tax has not been the main revenue stream for the local government. In 2014, the property tax revenue accounts for 1.3 percent and 0.7 percent of the total tax revenue.¹⁰ Figure 3 shows the property tax contribution for Shanghai (no data for Chongqing), which is not a significant amount. b) Property tax did not capture the socially created value since they do not use the assessed value. c) Property tax did not help establish a new tax system since it neither eliminates any current taxes nor reforms the current tax sharing system. d) It helps a little with reducing the housing price. Figure 4 and 5 show the housing price drop after the implementation of the property tax, but not by a significant amount.

Second, I would like to view it from the point whether it is designed in a way that a property tax should be. From this perspective, I think both are not good property tax design. a) They did not use the assessed value, which is the core of an asset tax. b) They did not apply to current owned property (Chongqing applied it to the current owned single family villa only), from which we conclude it is a policy targeting at the new purchase house (lowering the housing price), not the property.

New Design for the Property Tax in China

The property tax implementation is hard because it is a reform that requires change of central-local government relations, change of current taxes, improvement of related assessing and housing registration techniques. My objective is to design a property tax that could address provide fund for the local government and benefit the residents in the long term. This design may not be implemented at one time, and may not be launched immediately.

¹⁰ <http://finance.sina.com.cn/china/dfjj/20150930/075123385349.shtml>

a) Tax base: all the property (commercial and residential, current owned or new purchased) should be taxed on. This is a fair way for all citizens. To do so requires the following:

- 1) Set up a country-wide real estate registration system. This is the basis to apply the property tax. The good news is the central government requires all the cities complete the real estate registration within this year. Though it did say it is the preparation for the property tax, it actually meets the prerequisite.
- 2) Combine current real estate tax, urban land use tax, and cultivated land occupation tax into the new property tax, eliminate land value increment tax (since it overlaps with business tax and corporate income tax), keep deed tax, and eliminate the land transfer fee.
- 3) Make the property tax a local tax, not a shared tax, which can further make it the main revenue stream for local governments.
- 4) Set and disclose more transparent and accurate budget and spending. The most efficient way to do it in China is to let central government approve an executive order asking the local government to do so. In addition, provide citizens the appealing channel if they find something unclear.

b) Tax rate: the central government can set up a tax rate range. The local government can set up the specific rate based on the budget. In this way, the legislative authority still belongs to the central government, which is essential for centralized government, and the local government can have autonomy based on their specific cases.

c) Assessment: this is the core issue of implementing property tax. My recommendation is as following:

- 1) Who: I recommend that the assessment is conducted by the local Real Estate Administrative Bureau. Firstly, there are professionals who are able to complete assessing. Secondly, Real Estate Administrative Bureau is not the tax collection department so it is not the immediate stakeholder. Thirdly, it had related data which is the foundation to assess value. Forth, comparing to other new established independent assessing agency, the official one has more credibility.
- 2) How: I recommend using the comparable method with mass appraisal. The comparable method is relatively accurate compared to the income capitalization method and the cost method. But it requires data such as recent sale data, which China may need some time to obtain. The mass appraisal is a wide-used method. The challenge here is gather relative information and build a model.
- 3) Reassessment: I recommend China reassesses every year. The reassessment time is mainly related to two factors: the reassessment cost and the market price change. Since the technology is widely used in assessing, the cost should not be an issue. China's property market price fluctuates. So, I suggest to reassess every year, at least for the recent 5 years.
- 4) Appealing: If citizens do not think the assessed value is reasonable, they could appeal to the higher level assessing department.

The implementation of property tax requires systemic changes. Hope it can be done gradually in the future.

Figure 1 [Adapted from <http://m.ftchinese.com/story/001055443>]

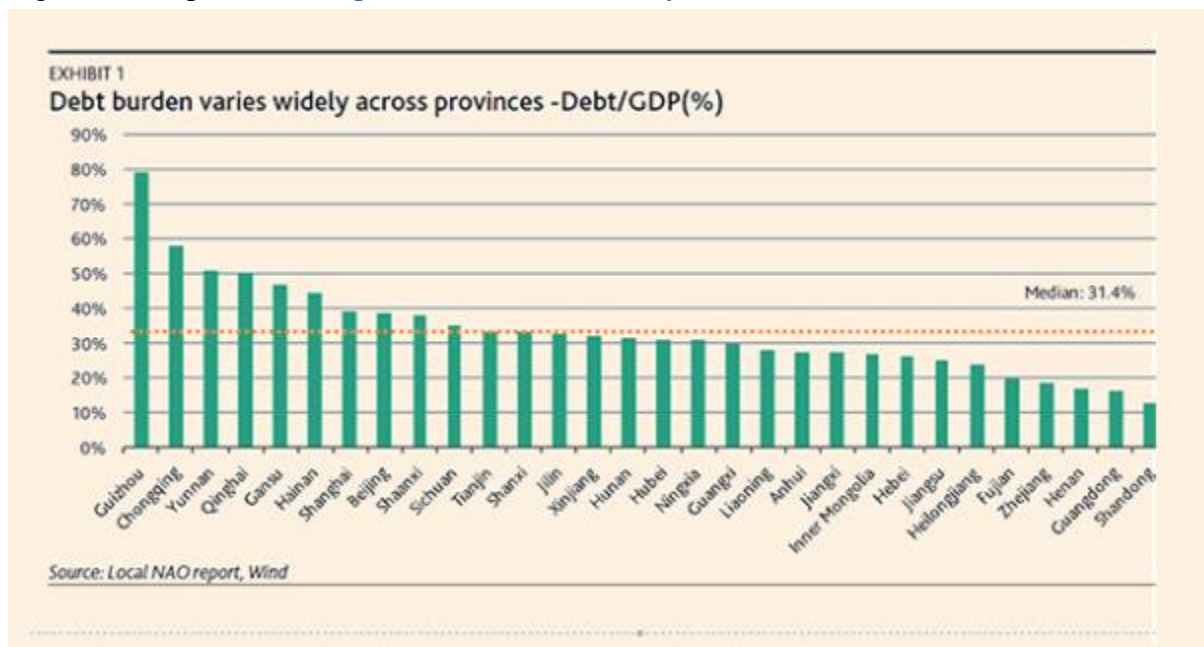
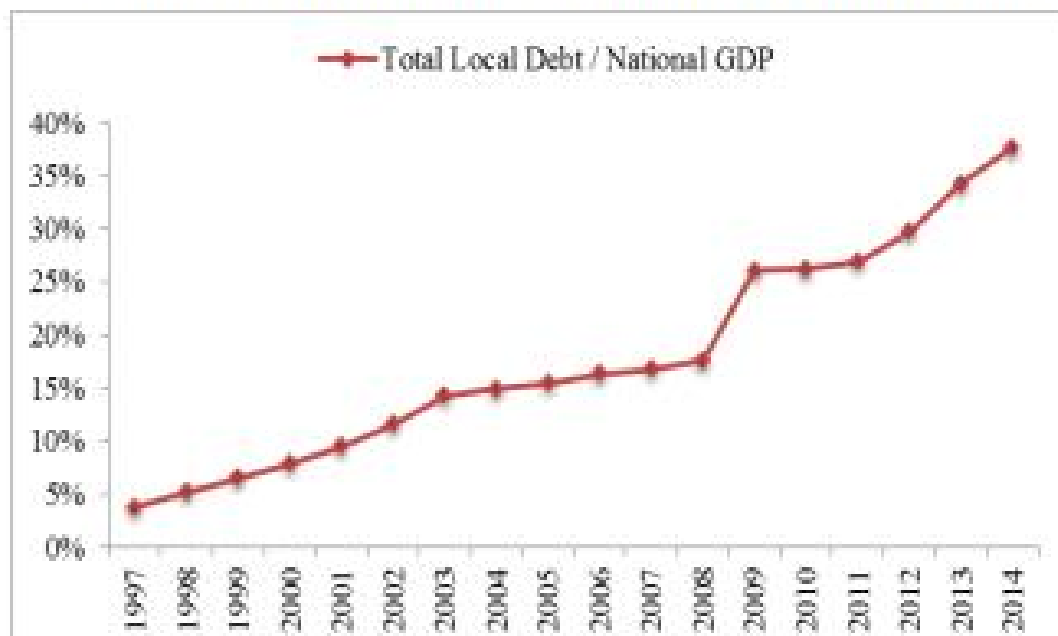


Figure 2 [adapted from <http://gcfp.mit.edu/wp-content/uploads/2013/08/China-Local-Govt-Debt-CFP-policy-brief-final.pdf>]

Figure 2: Size of Total Local Debt Relative to China GDP



Source: NAO and China National Bureau of Statistics (NBS)

Figure 3 [adapted from

<http://static.zybuluo.com/fanxy/davjup99bswfmnhx6qkm76df/%E6%88%BF%E4%BA%A7%E7%A8%8E%E5%8F%8A%E5%85%B6%E8%AF%95%E7%82%B9%E7%9A%84%E4%B8%93%E9%A2%98%E6%8A%A5%E5%91%8A.pdf>]

Shanghai property tax contribution

Year	Property tax increase rate	Property tax contribution
2011	0.7677%	0.7139%
2012	0.8892%	0.3215%
2013	0.8520%	0.0962%
2014	0.8271%	0.5936%
2015	0.8850%	1.2523%

Figure 4: [adapted from *the property tax in China*]
Average housing price and growth rate in Shanghai

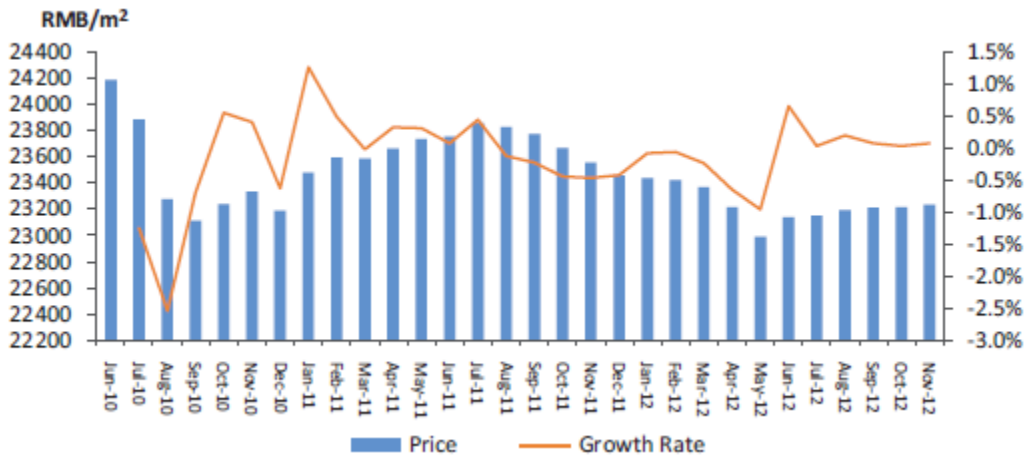


Figure 5 [adapted from *the property tax in China*]
Average housing price and growth rate in Chongqing



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