IPTI Xtracts

Property Tax and Assessment News from Around the World

CHINA – September 2021

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Why China has no property tax, but might soon

Xi's push for "common prosperity" is raising speculation over whether China will introduce taxes on the real estate market, a nexus of growing inequality in the country

Chinese President Xi Jinping's new policy goal of "common prosperity" is the subject of keen interest and vigorous debate.

The Chinese government has already imposed sweeping regulations on Big Tech platforms, private education, the gaming industry, and media entertainers under the slogan of "adjusting excessive income." Now, attention is focusing on whether the Chinese government will target the real estate market, the nexus of inequality in the country.

To start with, the Chinese authorities have placed a 5 percent cap on yearly rent hikes and taken measures aimed at tamping down the demand for homes in good school districts, known as "xuequfang" in China.

But many experts think the litmus test for Xi's common prosperity is whether China will impose inheritance and property taxes.

Real estate prices in China's biggest cities, including Beijing and Shenzhen, are among the highest in the world. Housing prices there start in the millions of dollars, yet many in the affluent class own dozens of luxury properties. That's due to the lack of tax obligations in China, which doesn't tax property or inheritance.

China privatized the real estate market in 1998 along with a raft of reforms at state-owned enterprises. Prior to that, people had rented houses from state companies for a nominal fee. But the reforms allowed them to buy those houses at a price much lower than market value. The government even threw in subsidies and interest-free loans.

That constituted the largest transfer of wealth from the state to the individual in history.

In the following years, housing prices skyrocketed amid China's lightning-fast growth, creating immense wealth for residents of China's big cities. The urban middle class and elite, who reaped the most benefits from the privatization of the real estate market, effectively became the most reliable base of support for the Chinese Communist Party (CCP).

On the other hand, migrant workers from the countryside and those who were unable to buy houses during the initial phase of privatization were permanently excluded from those benefits.

Property-owning members of the urban middle class — particularly the families of senior cadres of the CCP — who own dozens or even hundreds of homes, have been the primary force preventing the implementation of property and inheritance taxes.

On an ideological level, the state ownership of land remains a crucial variable. Some claim that imposing property taxes or inheritance taxes would undermine state ownership of land, which is regarded as the bedrock of socialism.

Local governments that are financially dependent upon real estate development are opposed to property taxes, which would cool down the real estate market and thus reduce their income from land sales and erode their budget. In 2020, land sales accounted for 30.8 percent of revenue for local governments.

The debate over tax reform has continued for more than 20 years. Property taxes were implemented on a trial basis in Shanghai and Chongqing in 2011, but they only apply to a tiny fraction of the market, such as high-end villas.

Given the recent emphasis on "common prosperity," some expect this trial program will be expanded to other parts of China this year, though not the entire country.

Inheritance taxes are an even more serious issue. As a result of the one-child policy, young people in China's urban middle class are inheriting at least three properties — one from their parents, one from their paternal grandparents, and one from their maternal grandparents. That would mean a married couple will end up with at least six properties, and all without paying a cent of tax.

"This is the biggest challenge for 'common prosperity.' To resolve it, Chinese authorities will need to consider the option of limiting inheritance through the state ownership of land," predicted Jee Man-soo, director of the international financial research team at the Korea Institute of Finance.

Some are cheering China's common prosperity as the realization of socialism while others are worried that it represents a second Cultural Revolution. But the fact is that China is struggling to even adopt the basic market principles of property and inheritance taxes.

Surging real estate prices have made wealth inequality a highly sensitive political issue — both in China and South Korea.

Growing Signs Suggest China May Launch Countrywide Property Tax

Experts say the levies could provide revenue for local governments to invest in public infrastructure and services.

China is likely to roll out its much-discussed property tax to more cities before the end of this year, which analysts say will help close the wealth gap amid growing calls to achieve "common prosperity" by the central government.

The reform will allow local authorities to levy taxes on private properties, giving them the means to collect money from homeowners that could be invested in improving public services and infrastructure development. China currently doesn't have a countrywide property tax system for private properties, though an annual taxation scheme has existed in Shanghai and Chongqing for over a decade.

Shi Zhengwen, deputy director of the fiscal and tax law research society under China Law Society, said such a national property tax is "highly likely" and might be piloted by the end of 2021. He told state-run China News Weekly earlier this month that there were "strong signals" from the central government that they're preparing to roll out the plan.

Such signals have been shown time and again from the highest echelons of the government. Most recently, in August, the Ministry of Finance had hinted at "positively and stably advancing" the property tax reform, while a ministerial-level meeting convened to discuss the issue in May.

Huang Zhonghua, a professor specializing in real estate studies at East China Normal University in Shanghai, said that the central authority's efforts to promote so-called common prosperity and a new land transfer policy this year would speed up the wider rollout of property tax. Under the goal of common prosperity, the country plans to "adjust" the excessive incomes of the wealthy to combat inequality.

"The tax has the function to reasonably adjust the wealth gap among people," Huang told Sixth Tone. "The reality is, in many cases, the wealth gap resulted from disparate property ownership is wider rather than gaps in income. So it's a good approach to work towards common prosperity by imposing property tax."

Experts like Huang believe that the tax reforms would be beneficial for local governments and provide them with a stable revenue to invest in public infrastructure projects.

"It's also a means to adjust the local real estate market," he said, referring to how the tax could deter people from investing in more than one apartment, as has been a growing trend.

Shanghai started collecting property taxes in 2011 from homeowners with second properties at an annual rate of 0.4% and 0.6% of the property price, dependent on the size of their real estate. Meanwhile, Chongqing imposed taxes of 0.5% to 1.2% on villa owners and those with high-end luxury apartments.

Experts say such rates are similar to the United States and the United Kingdom, which collect annual property taxes between 1% and 3% of the total property value. Referring to his own research findings, Huang said higher taxes led many owners to move to smaller and cheaper apartments to help them balance out their expenses.

"Some people believe it's a waste to pay such a high fee for property tax and live in too big an apartment. So the tax actually can play a role in reasonably adjusting people's needs for living. Of course, in China (in the pilot cities), such effects are yet to be seen."

Huang believes that the country's first-tier cities, which have seen their property prices soar, would likely be among the first places to pilot property tax.