IPTI Xtracts
Property Tax and Assessment News from Around the World

CHINA – March 2022

CONTENTS

WHAT DOOMED CHINA'S MUCH-ANTICIPATED PROPERTY MARKET REFORM PLAN?

Once again, China's government failed to approve a property tax law, seen as a key part of reforming the real estate sector.

The 2022 National People's Congress surprised many China observers – not because of what happened, but because of what did not happen. The Chinese government failed to approve a property tax. The Government Work Report did not even mention property market reform.

After the real estate sector's structural crisis in 2021, reforming the property market seems inevitable, and implementing a property tax is the first step toward property market reform. In an essay in Qiushi, the official theoretical journal of the Chinese Communist Party, top leader Xi Jinping singled out a property tax as the flagship project for property market reform and vital to his "Common Prosperity" campaign.

Following Xi's essay, the National People's Congress drafted and approved a decision to expand the property tax experiment. Minister of Finance Liu Kun declared that the Ministry must "prepare for property tax experiments." As a result, an insider of the Chinese government predicted with confidence that the central government would launch property tax during the 2022 National People's Congress.

In Xi's eyes, the real estate market is the epitome of China's unsustainable growth model. It supports nearly 25 percent of China's GDP, a rate higher than both Spain and Ireland before the Eurozone crisis. Since the housing market reform in the late 1990s, Chinese housing prices have grown so fast that a typical apartment in Beijing now costs 25 times the annual wage. Thus, high housing prices add a tremendous burden on Chinese people and suppress their consumption and innovation power.

In addition, the collapse of Evergrande Group, one of China's biggest real estate developers, showed that the real estate sector might become a ticking time bomb for the Chinese economy. As a result, Xi has made reforming the real estate sector his primary target for the Common Prosperity campaign, declaring that "houses are for living, not for speculation."

The root causes of China's distorted real estate markets are twofold. From the supply side, the 1994 fiscal system reform shifted tax money to the central government without reducing the burden on local governments. As a result, local Chinese governments cover over 80 percent of all government expenditures while only receiving half of the tax money. Facing local resistance, then-Premier Zhu Rongji, the engineer of this reform, made a deal with the localities that allowed them to raise their own government budget by all means. Thus, with the acquiescence of Beijing, local governments across China use land sales as the most important source of revenue and artificially keep the property prices high.

From the demand side, a financial repression policy that aims to benefit banks and state-owned enterprises deprives Chinese households of viable investment options. Thus, the Chinese middle class views the ever-booming housing market as the most profitable place to put their money. As one Chinese observer said, only the housing market constantly generates positive returns to investors.

On paper, a property tax is a perfect solution to correct the market distortion. It both disincentivizes people from viewing real estate as an investment tool and raises budget for local governments. As a result, Xi assigned Han Zheng, the executive vice premier and the potential successor for Premier Li Keqiang after the 20th Party Congress, the task of rolling out a comprehensive property tax plan. However, Xi's property tax plan received negative comments from both CCP elites and rank-and-file members; even retired senior party leaders petitioned against the new tax. They argue that since many party members own more than one property, the tax will add an unnecessary burden and become a social stability issue.

In addition, Xi's ambitious goal of taming the property market does not align with the interests of local officials, who view generating economic growth, securing government budgets, and preventing social chaos as their priorities. Cadres from Shanghai emphasized "stability" as the most important goal of their economic work in 2022. For them, the emphasis on stability means the Shanghai government will bail out real estate developers to prevent a housing market crash. An official said, "The real estate price of Shanghai will never fall, just like the housing price of New York." Another economic planning official explained that the Shanghai government must increase infrastructure investment by 14 percent to offset the shrinking housing market.

However, Shanghai is unlikely to hit this infrastructure investment increase target since most infrastructure has already been built. Therefore, the government will support the housing market by freeing real estate developers from regulations on land-rights conversion, receiving bank loans, selling houses, and issuing bonds.

What is the rationale for this plan, which essentially undoes the de-leveraging campaign in the past five years? After all, Xi has expressed that GDP growth is no longer the sole indicator in cadre evaluations. The new Five-Year Plan also abolished the annual GDP growth target in favor of slower but more balanced "high quality" growth.

The Shanghai official admitted that the city did not receive an economic growth target from the central government. However, the cadre also said that the importance of economic performance is embedded in the mind of officials because they suffer comparisons with other local leaders. Generating higher GDP growth is still the best way for ambitious officials to outshine their peer competitors and secure promotion. This consideration might be especially true for Shanghai Party Secretary Li Qiang, a rising star in Chinese politics who has the aspiration to bid for vice premier, or even a seat in the Politburo Standing Committee, during the 20th Party Congress this fall.

Furthermore, the emphasis on stability overruled the urgency of reform. The Central Government Work Meeting on Economic Affairs at the end of 2021 moved away from Xi's unwillingness to create moral hazard by bailing out real estate giants. The meeting emphasized stability in the lead-up to the 20th Party Congress and instructed local governments to prevent any economic crisis. Following the meeting, Chinese banks are ready to soften up the "three red lines" to foster a soft-landing for several real estate companies.

The complexity of China's property market problem, which accumulated over decades, is another challenge Xi must face. The current institutions are so intertwined that step-by-step reform, which Beijing prefers over a drastic and comprehensive "shock therapy" reform, becomes impossible. An old Chinese saying perfectly summarizes the current situation: "pulling one hair will move the entire body" (牵一发动全身); changing one policy will result in unintended social chaos.

Construction accounts for 16 percent of urban employment. MacroPolo, an in-house think tank of the Paulson Institute, forecasts that a collapse of the construction industry following a property market recession would drive 15 million people out of work. The sudden rise of unemployment would certainly impact social stability. In addition, Chinese banks made 30 percent of their loans to housing construction, and 60 percent of bank loans are backed by property as collateral. Thus, if the property market collapses, China will experience a financial crisis.

Thus, a property tax will conflict with other major social programs and create unintended social instability. It will increase, rather than decrease, social inequality unless accompanied by reform to the hukou (household registration) system. The hukou system institutionally separates city residents from migrant workers, who remain official registered as residents of their rural hometowns. Thus, migrant workers cannot access social welfare programs in the cities, such as pensions, health care, and education for their children. The goal of a property tax is to provide an alternative source to fund social welfare programs so local governments can move away from the traditional land-sale-for-funding scheme. There are 376 million urban migrant workers, and they will become significant contributors to any property tax. Even those who cannot own houses in cities will pay the property tax through higher rents. Without hukou reform, property tax will force these migrant workers to pay for social services they cannot enjoy. It might exacerbate the conflicts between urban incomers and old residents.

Xi's failure to reform the property market illustrates the challenges to his Common Prosperity campaign. Xi views this campaign as necessary to not only improve social equality but also reconstruct the Chinese economy. His primary goal is to rebalance the Chinese economy from the current investment-driven, export-oriented growth toward a more sustainable development model. The campaign is bound to meet resistance from groups with vested interests, who fear the reforms will potentially hurt them. The concern of social stability, which has been a dominant theme of Xi's administration, will also offset the urge to reform.

Xi once described the current stage of Chinese reform as "cracking the bone after eating meat," meaning that his predecessors finished the easier parts of the reform and left him the difficult parts. Xi will certainly face tremendous resistance and challenge, just like reformers throughout Chinese history. Whether he can push through that resistance is an open question.

CHINA WILL NOT EXPAND ITS PROPERTY TAX TRIAL THIS YEAR

Government see 'no condition' to expand trial after study

China will not expand a trial on property taxes this year amid a housing market slump and growing pressure on the world's second-largest economy from a renewed virus outbreak and geopolitical turmoil.

There are no conditions to expand the property tax reform pilot program within this year after considering all aspects, Xinhua News Agency reported, citing an unidentified Finance Ministry official. Some cities have carried out investigations on the tax trial after the country’s top legislative body approved the reform plan, the official said, according to Xinhua.

The missive comes after an earlier announcement from Beijing on Wednesday designed to stabilize markets after a historic selloff. China’s top financial policy committee, led by Vice Premier Liu He, said it would “actively introduce policies” that “benefit” the market.

In October last year, China’s parliament authorized the expansion of property tax, which would begin taxing some residential property owners in more areas. While the announcement didn’t include a starting schedule, some market watchers forecast that it could begin by the end of this year.

China’s home prices fell at a faster pace in February, data showed on Wednesday. New home prices in 70 cities, excluding state-subsidized housing, declined 0.13% last month from January when they dropped 0.04%, National Bureau of Statistics figures showed. Values in the secondary market dropped 0.28%, the same pace as January.

The rapid deterioration of the real-estate sector and the lack of any detailed implementation plan from the State Council earlier fanned speculation that the government would wait for a real estate market uptick before starting the tax.

CONDITIONS NOT RIGHT FOR CHINA TO EXPAND PROPERTY TAX TRIAL THIS YEAR

The conditions are not right for China to expand a property tax trial this year, state-run Xinhua news agency quoted the finance ministry as saying on Wednesday, suggesting authorities are treading carefully to avoid further damaging confidence in the sector.

China's property market chilled last year as Beijing's deleveraging campaign triggered a liquidity crisis at some major property developers, resulting in bond defaults and projects being shelved or left unfinished.

Overall demand remains sluggish, though a slew of measures have been put in place to revive buying interest.

New home prices stalled in February after edging up a month earlier, official data on Wednesday showed. read more

The implementation of a property tax faces challenges, including macroeconomic pressures and downward pressure on the real estate market, said Yan Yuejin, research director of Shanghai-based E-house China Research and Development.

"This move is bound to reduce home buyers' concerns," said Yan, adding it was also favourable for real estate companies.

Chinese vice premier Liu He on Wednesday urged government bodies to roll out market-friendly policies and "cautiously" introduce measures that risk hurting markets. He also pledged to tackle risks in the property sector.

China will implement city-specific policies to promote the healthy development of the property sector, Premier Li Keqiang told the annual meeting of parliament earlier in March.

In 2011, China launched a property tax pilot in Shanghai and Chongqing, and the idea of rolling out a new trial has been resisted by stakeholders including local governments that rely heavily on land sales as a source of financing.

In October, the top decision-making body of parliament said it would roll out a pilot real estate tax in some regions, but did not identify the regions or give other details. read more

Most analysts were expecting the property tax to be delayed, according to a Reuters poll last month.

At the annual meeting of parliament earlier this month, China omitted a potential property tax in its 2022 legislative plan for the third consecutive year.

WHAT CHANGES ARE PLANNED FOR HONG KONG PROPERTY TAXES?

The 2022-23 budget outlined a new progressive rate system

A. Hong Kong introduced a progressive rating system for domestic properties in its 2022-23 budget, put forth by financial secretary Paul Chan late last month.

The standard levy for all properties is currently 5%, and that rate will stay in place for homes with a rateable value of HK$550,000 (US$70,335) and below, according to the budget. The rateable value is the estimated annual rental value of a property.

A progressive tax kicks in from there. Residences valued at HK$550,000 and above will pay 5% on that amount, then 8% on the next HK$250,000 and 12% on the value over HK$800,000.

"This can better reflect the 'affordable users pay' principle," the budget said. "It is expected that about 42,000 domestic properties will be affected, accounting for around 2% of the total number of private domestic properties."

The additional tax is estimated to generate about HK$760 million in government revenue each year. It is set to go into effect in 2024, according to the budget.

CHINA OMITS PROPERTY TAX FROM 2022 LEGISLATIVE AGENDA

Tuesday's legislative plan did refer to a pilot real estate tax in some regions, which was first announced in October, but did not disclose specifics

China omitted a potential property tax in its 2022 legislative plan announced on Tuesday for the third consecutive year, suggesting authorities are treading carefully to avoid further damaging sentiment in the already beleaguered sector.

Officials initially flagged the creation of a property tax more than a decade ago but the idea has met with pushback from stakeholders including local governments that rely heavily on land sales as a key source of financing.

The last time the Standing Committee of the National People's Congress, or parliament, included a real estate tax in its annual legislative agenda was in 2019, before the economy was hit by the coronavirus pandemic. No tax was formalised that year.

Premier Li Keqiang also omitted a property tax in the government's 2022 work report released on Saturday, but confirmed that more policy easing in the sector is coming, though only city-specific and not a full-fledged relaxation.

Pilot Real Estate Tax

Tuesday's legislative plan did refer to a pilot real estate tax in some regions, without disclosing specifics, which was first announced in October.

Most analysts in a Reuters poll in February said officials are likely to delay rolling out the pilot given the strain on the economy.

China's property sector, which accounts for about a quarter of gross domestic product by some metrics, is facing multiple headwinds this year as home prices sag and property investment slumps.

Property investment in December fell 13.9% from a year earlier, the slowest since January-February 2020, and home sales by value slumped 17.78%, according to calculations from data released by the National Bureau of Statistics.

New home prices rose for the first time since September on a monthly basis, official data for January showed, driven by improved demand in big cities.

In recent weeks, local authorities have begun easing property regulations to shore up the sector, including allowing smaller down-payments, lowering mortgage rates and cutting the deed tax.