Projection of full implementation of pilot property tax over Chinese property holder and improvement of government budget for co-prosperity

Vincent Lam Hing-Po, Assistant professor of Media and Communication in United International College, Hong Kong Baptist University, Beijing Normal University.

Suk Fun Lo, Lecturer, United International College, Hong Kong Baptist University, Beijing Normal University

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Abstract: According to Decision of the Standing Committee of the National People's Congress on authorizing the State Council to carry out pilot projects for real estate tax reform in certain regions on 23nd October 2021, it announced to introduce full implementation of property tax in selected area for a trial period of 5 years.[1]

The total value of China property market is over 400% of GDP and the property price of Shanghai alone is equal to the entire US's property market value.

The Chinese government reveals that the total mortgage amounts up to 2020 was CNY 4955 billion of 320% over Chinese GDP. In addition, Chinese cities' financial budget is highly dependent on one off land sales.[2]

China property market has witnessed a boom over the last thirty years. The current property price valuation in leading cities such as Beijing, Shanghai, Shenzhen by any measurements including rent-price yield ratio, house price affordability by average income, negative cash-flow all show indication of overvaluation by international standard. The market price has remains flat mainly due to the fact that China does not tax on the property holding like in Canada or in the US, therefore there is very little holding cost apart from mortgage repayment and property management fee.

The article will look into how the proposed annual property tax will add on the financial burden on landlord through increasing annual expenses as well as how the the added tax revenue collected from property tax substitutes government financial budget.

Keywords: Property Tax, Financial budget, Real Estate in China, Co Prosperity

Introduction

According to Decision of the Standing Committee of the National People's Congress on authorizing the State Council to carry out pilot projects for real estate tax reform in certain regions on 23nd October 2021, it announced to introduce full implementation of property tax in selected area for a trial period of 5 years.[3]

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[1]http://www.gov.cn/xinwen/2021-10/23/content_5644480.htm
[2]http://www.gov.cn/xinwen/2021-01/29/content_5583656.htm
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Chinese GDP. In addition, Chinese cities' financial budget is highly dependent on one off land sales.[4]

To compare with mayor economies including USA and Japan, China's property remains to be highly very valued. Baldacci et al. (2011) proposed an indicator of debt burden ratio as the proportion of city's debt amount to its GDP, which applies the amount of city's debt and GDP to reflect the degree of the debt risk, the higher the debt burden ratio, the greater the city's debt risk. Therefore, any burst in property sector may trigger economic recession and bad debt in Chinese banking industry.

Compared with other studies, this paper outlines the policy measures taken by Chinese government to curb the further ballooning of Chinese property bubble. In particular, how proposed property tax assists the transformation from city's heavily dependent on one off land sale auction to regular annual property tax to support city's financial budget without injecting further fuel on property price.

In 1994, Chinese government has adopted a tax-sharing system between the central and local government. The power of tax revenue are split into state tax bureau and local tax bureau as the process of decentralization and tax revenues collected from local tax bureau including property sales tax is for the urban development (Mello, 2000; Liu & Lin, 2014; Cao et al., 2019).

Since then, local governments need to rely on its funds to seek for funds themselves for the city development (Ho & Lin, 2003; Cai et al., 2019; Zhang et al., 2019a; Narbón-Perpiñá et al., 2020).

The literature of Chen et al. (2017) reviews that Chinese cities with high land financial dependence are likely to put local government at potential debt risk as the up-scaling of debt repayment will undermine cities' financial well-being and eventually constricts the economy growth potential.

According to 2020 economic figures from Shenzhen/Shanghai/Beijing Government Website, the property sector accounted about 15% of the City's total GDP.

	Total GDP in 2020	Total Property values by market estimation	Total City Tax Revenue in 2020	One off Land Sales Revenue in 2020[5]	City budget dependent on Land sales ratio	Price to annual income ratio[6]
Shenzhen	CNY 2720 billion[7]	CNY 1510 billion[8]	CNY 859 billion[9]	CNY 105 billion	12.2%	35.2
Shanghai	CNY 3870 billion[10]	CNY 2800 billion[11]	CNY 1596 billion[12]	CNY 295 billion	18.4%	25.1
Beijing	CNY 3610 billion[13]	CNY 3000 billion[14]	CNY 1280 billion[15]	CNY 195 billion	15.2%	23.9

[4] http://www.gov.cn/xinwen/2021-01/29/content_5583656.htm
[5] https://caifuhao.eastmoney.com/news/20210108225738868210780
[6] http://admin.fangchan.com/uploadfile/uploadfile/annex/2/1702/5e7d8e2390c3d.pdf
[7] http://www.sz.gov.cn/cn/xxgk/zfxxgj/tjsj/tjgb/content/post_8718466.html
[8] https://www.163.com/dy/article/G0EE4U1H0535TNRH.html
[9] https://shenzhen.chinatax.gov.cn/qhswj/gzdt/202102/559d6ff6f7114228aeb2c8edef67ae14.shtml
[10] http://tjj.sh.gov.cn/tjgb/20210317/234a1637a3974c3db0cc47a37a3c324f.html
[11] https://www.163.com/dy/article/G0S464H705356Y5Z.html
[12] http://shanghai.chinatax.gov.cn/tax/xxgk/sstj/202004/t453193.html
[13] http://tjj.beijing.gov.cn/tjsj_31433/yjdsj_31440/gdp_31750/2020/202101/t20210120_2227344.html
[14] https://www.163.com/dy/article/G0PID1DH0515983V.html
[15] http://beijing.chinatax.gov.cn/bjswj/c105844/202101/f3ac3b1a916b48fc8f1ddea797d11cdf.shtml

	Total Property Value USD billion in 2020 by market estimation[16]	House price /GDP
China	6260	414%
USA	3360	148%
Japan	1080	233%

With the tax-sharing system as background, a trail run for the annual property tax were introduced in Chongqing and Shanghai in 2011.

According to Article 7 of Shanghai Property Tax Version 2011, the annual property tax collected is for generation a more stable tax base for the improvement of social welfare especially to subsidy the construction of subsided housing for people who cannot afford to purchase from private market.

As such there have been measures taken by the Chinese government to cool down property market in order to prevent the booming of property bubble going further.

Measure taken to cool down property market so far

	Policy Aim	Affecting the cost of purchase	Increase the cost of holding
Purchasing qualification restriction for eligible buyers	To limit number of available buyers in the market	**Yes**	**No**
Suspension of Second Hand Property Mortgage	Pushing all buyers for first hand property to absorb the available stock of empty property	**Yes**	**No**
Abolishing school admission by property ownership	Taking away additional values to hold up price of property	**Yes**	**No**
Down valuation of first hand property mortgage	Increase the down payment amount	**Yes**	**No**
Increasing interest rate for first hand property mortgage	Increase the financial burden of monthly repayment	**Yes**	**No**
Increase in Stamp Duties	Increase the cost to purchase property	**Yes**	**No**
Introduction of Rental Income Tax	Reduce the absolute rental return to cover the mortgage repayment	**No**	**Yes**
Annual Property Tax based on property valuation	To increase financial burden of holding property	**No**	**Yes**

Currently there has been trial run of property tax in Chongqing effective from 13 Jan 2017 to impose tax for property 200% on the average property price with 180 square meter exemption for villa and 100 square meter exemption for high rise building. In 2017, the property tax in Chonqging collected was CNY 470 million of total tax revenue CNY 460 billion.[17]

[16] https://opinion.caixin.com/2021-07-22/101743676.html
[17] https://zh.news.fang.com/open/41935143.html

In Shanghai, Effective from 27th Jan 2011 to impose tax of 0.6% and 0.4% with 60 square meter per person.[18] In 2020, the property tax in Shanghai collected was CNY 19.8 billion of total tax revenue of CNY 1596 billion[19]

The trial run of property tax in Chongqing and Shanghai have not made any significant impact of the property transaction because lots of people are actually exempt from being levied the tax.

Methodology

Analysis of how the 0.5% annual property charge based on valuation will increase the burden of property investor in Shanghai

Although there are no solid details of how the new property tax will be introduced, a projection is made to be based on the 0.5% property tax levied by property valuation of the current estimated market price as the benchmark tax rate in Shanghai applied on in three major cities. Based on the Real Estate Agent for an average property price in Shanghai of CNY 60000 per sq meter for a 100 square meter flat[20]

Scenario 1

With 70% mortgage

Property Price	CNY 6 million
Down payment at 30%	CNY 1.8 million
Monthly Mortgage repayment for Interest rate at 5% for 70% mortgage for 30 years	CNY -22500
Shanghai Average Income	CNY 114962 / 12 = CNY 9580[21]
With 0.5% of property tax charged by market valuation per month	CNY 6 million x 0.05% = CNY 30,000 /12 = CNY 2,500
Total Cost of holding without rent	-CNY 22500 - CNY 2500 = - CNY 25000
Monthly Rent	CNY 6000
Total Cost holding with rent	CNY 22500 - CNY 2500 + 6000 = - CNY 19000
Net Return without cost of capital with rent	- CNY 19000 x 12 / 6 million = - 3.8%
Net Return with cost of Capital with rent	(- CNY 19000 x 12) – (3% x 30% x 6 million) = -228000-54000/ 6 million = - 4.7%
One – year Fixed Deposit Rate	3%

Scenario 2

Cash Buy

Property Price	CNY 6 million
Shanghai Average Income	CNY 114962 / 12 = CNY 9580[22]
With 0.5% of property tax charged by market valuation per month	CNY 6 million x 0.05% = CNY 30,000 /12 = CNY 2,500
Monthly Rent	CNY 6000
Total Cost holding with rent	CNY 6000 – CNY 2,500 = + CNY 3500

[18] http://shanghai.chinatax.gov.cn/zcfw/zcfgk/dcs/201101/t305661.html
[19] http://shanghai.chinatax.gov.cn/tax/xxgk/sstj/202004/t453193.html
[20] http://sh.cityhouse.cn/market/ALL/
[21] http://tjj.sh.gov.cn/tjxw/20200629/fc54a4124e70400098921b6fc5680e1e.html
[22] http://tjj.sh.gov.cn/tjxw/20200629/fc54a4124e70400098921b6fc5680e1e.html

Net Return without cost of capital with rent	CNY 3500 x 12 / 6 million = + 0.7%
Net Return with cost of Capital with rent	(+3500 x 12) – (3% x 6 million) = +42000- 180,000 / 6 million = -2.3%
One - year Fixed Deposit Rate	3%

Financial Burden over Shanghai resident

Shanghai Average Income	CNY 9580	Financial Burden over average income
Total Cost holding without rent and 0.5% per annual property tax with 70% mortgage	-CNY 25000	260%
Total Cost holding without rent and 0.5% per annual property tax with cash buy	-CNY 2,500	26%

As evident from the illustration of 0.5% projected property tax based on annual valuation, an average flat worth CNY 6,000,000 alone needs to pay CNY 2,500 per month which is already 25% of an average individual income. For the best scenario of having a debt free property, the financial burden with 0.5 projected property tax is at 26% of an individual average income.

The property tax also heavily erodes the value for rental property in Shanghai as property tax accounts for about 40% of monthly rent without taking into consideration of property rental income tax currently at 5%.

Average monthly Rent for a 100 square meter flat	6000
Projected monthly property tax for a 100 square meter flat	2500
Property tax / rent ratio	2500/6000 = 41%

Analysis of Property Tax implementation as a mechanism for co-prosperity of wealth re-balancing through adopting 0.5% annual property charge based on valuation to increase government financial budget

The Chinese government announced on 3rd November 2021 of Proposals of the Central Committee of the Communist Party of China on Formulating the Fourteenth Five-Year Plan for National Economic and Social Development and the Long-term Goals for 2035 to achieve co-prosperity.[23]

The Article 22 stipulates to improve the modern tax system, improve the local tax and direct tax system, optimize the tax system structure, appropriately increase the proportion of direct tax, and deepen the reform of the tax collection and management system.

Market expects to expand the coverage of all household units for 0.5% annual property charge based on valuation to increase government financial budget with no exemption.

In order to generate a more stable tax base for the improvement of social welfare especially to subsidy the construction of subsided housing for people who cannot afford to purchase from private market as the purpose stipulated on the Article 7 of Shanghai Property Tax Version 2011, it only generates less than one % of additional new tax revenue

Should the annual property tax be completely to replace the reliance on one-off land sales, the tax rate would have increase from 0.5% to 10%.

[23]http://www.gov.cn/zhengce/2020-11/03/content_5556991.htm

However, by doing so, for an average 100 sq meter property in Shanghai worthy CNY 6 million, the annual property tax amount would be CNY 600,000, which is 60 times of an average monthly income of a Shanghai resident. The chain effect may lead to collapse of property market with spiral effect on mounting bad debt on the Banking system as the unpaid mortgage will become become debt.

The calculation is follows;

	Total Property values by market estimation	Total City Tax Revenue in 2020	One off Land Sales Revenue in 2020[24]	Annual Property tax levied at 0.5% of property valuation	Additional new tax revenue % of total tax revenue	Annual property Tax % of one all sales revenue
Shenzhen	CNY 1510 billion[25]	CNY 859 billion[26]	CNY 105 billion	CNY 7.5 billion	0.879%	7.14%
Shanghai	CNY 2800 billion[27]	CNY 1596 billion[28]	CNY 295 billion	CNY 14 billion	0.875%	4.7%
Beijing	CNY 3000 billion[29]	CNY 1280 billion[30]	CNY 195 billion	CNY 15 billion	1.17%	7.69%

In conclusion

The Proposals of the Central Committee of the Communist Party of China on Formulating the Fourteenth Five-Year Plan for National Economic and Social Development and the Long-term Goals for 2035 to achieve co-prosperity and improvement on the taxation system is key for the wealth redistribution.

Property Tax has been selected as an important mechanism for the wealth redistribution as it is a specific tax to target people with asset. As analysis shows that a full implementation of current 0.5% annual property tax with no exemption can only generate in average 1% additional tax revenue for city government. However, that extra tax burden immediately takes away 40% of average monthly income of a Shanghai resident, and it may lead to consequence of restricting in consumer spending and worse borrowing debt to pay for the annual property tax.

Should the tax rate be expanded to 10% per annual of property valuation, the tax payment alone will be equal to 60 times of an average monthly income of a Shanghai resident and it is not a workable financial model worth to own property.

Therefore, the property tax alone cannot be a single tool for the purpose of co prosperity and substitute the dependency of the land sales for the major city finance.

[24] https://caifuhao.eastmoney.com/news/20210108225738868210780
[25] https://www.163.com/dy/article/G0EE4U1H0535TNRH.html
[26] https://shenzhen.chinatax.gov.cn/qhswj/gzdt/202102/559d6ff6f7114228aeb2c8edef67ae14.shtml
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