China's Property Tax Reform: Progress and Challenges

Joyce Yanyun Man

China has experienced rapid economic growth since 1978, when it adopted a policy of opening up to the world and instituting economic reform. It has become the second largest economy measured by the country's GDP, and its tax revenue has experienced an average annual growth of about 20 percent since the fiscal reform of 1994.

However, many subnational governments in China have experienced fiscal stress and incurred large local debt in recent years because of numerous unfunded central mandates and the large fiscal gap between expenditure responsibilities and revenue capacity. For example, in 2008 subnational government in China accounted for 79 percent of total government expenditure, but only 47 percent of total government revenues (Man 2011).

Unlike many developed countries, China's local governments (provincial, prefecture, county, and township) have not been granted any legal authority for taxing or borrowing, and the property tax plays a very limited role in the local public finance structure. As a result, many local governments turn to extra-budgetary revenue sources, fees for leasing land use rights, other fees and surcharges, and indirect borrowing from banks to finance infrastructure investment and local economic development.

During the period from 1991 to 2008, the land leasing fees (also known as land transfer fees) increased from 5.7 percent of total local budgetary revenue to 43.5 percent. The overreliance on land leasing fees has been criticized as an important factor in pushing up housing prices and in the growth of corruption cases and land disputes in China.

Shanghai has started to collect property taxes on newly purchased second homes of residents and first homes of nonresidents.

Problems with the Current Tax System

The current land and property tax system in China generates a limited amount of tax revenue, even though five types of taxes are levied on land-related property at various stages of production (table 1). Local governments collect the Farmland Occupation Tax and Land Value Added Tax (LVAT) at the stage of land acquisition and transaction. At the possession stage, the Urban Land Use Tax and Real Estate Tax are collected, while the Deed Tax is levied when the ownership of the property is transferred.

This tax system has many problems and warrants structural reform. First, various taxes on land and property account for only 15.7 percent of local tax revenues. It is an unstable and inadequate revenue source for the Chinese local governments. Local government officials have relied upon other revenues sources, including leasing state-owned land for a large lump-sum fee from developers, to finance infrastructure development and capital projects. In 2010, Chinese local governments collected 2.7 trillion RMB from land leasing fees in addition to 8.3 trillion RMB in taxes and other budgetary revenues. The ratio of leasing fees to tax revenue was 32.5 percent, compared to 4.5 percent in 1999.

Second, China's current property tax structure focuses more tax burden at the transaction stage than the possession stage. For example, revenues collected from the annual urban land use tax and the real estate tax at the possession stage accounted for only 6.44 percent of local tax revenues in 2008, while about 9.25 percent of local tax revenue was raised at the land development and property transaction stages.

Third, owner-occupied residential property was not included in the tax base for the current real estate tax, thus significantly restricting the government's ability to capture value from the booming housing market that was fueled by the privatization of public housing, income growth, and massive urban infrastructure investment. By 2010, homeownership rates reached 84.3 percent of the formal urban housing stock, and housing values have experienced substantial increases in the past five years in many big cities (Man, Zheng, and Ren 2011). But the exclusion of the residential properties from real estate tax has resulted in wealth disparity and excessive demand for housing for investment and speculative purpose, raising vacancy rates in many coastal cities.

Finally, unlike the property tax system in many developed countries, the real estate tax in China is not levied on the assessed value of the property. Instead, it is based on the original price minus 10 to 30 percent of depreciation at a rate of 1.2 percent or levied at 15 percent of the actual rental income for leasing property. Government officials have little experience in the mass appraisal of the

TABLE 1
Taxes on Land and Property in China, 2008

Tax	Date Implemented	Tax Base	Tax Rate 2007	Collection Stage	Share of Local Tax Revenue
Urban Land Use Tax	1988	Taxable land size (only on domestic taxpayers before 2007)	30 RMB/m^2 to 0.6 RMB/m^2	Possession (recurrent)	3.51%
Real Estate Tax	1986	Real estate for business use	1.2% of original value or 12% of rental income	Possession (recurrent)	2.93%
Land Value Added Tax (LVAT)	1994	Land appreciation value	Progressive tax rate (30–60% on the LAV)	Transaction (nonrecurrent)	2.31%
Farmland Occupation Tax	1987	Farmland size	1–10 RMB/m^2 (5–50 RMB/m^2 after 2008)	Land Development (nonrecurrent)	1.35%
Deed Tax	1997	Self-reported value of land and house transfer	3% to 5%	Transaction (nonrecurrent)	5.62%

Source: National Bureau of Statistics (2009); calculated by Man (2011).

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market value of existing property, a fundamental skill for establishing a modern property tax system.

Recent Developments in Property Tax Reform

The Chinese central government has been exploring the possibility of reforming its current land and property tax system since 2003, when it first officially proposed to establish a modern property taxation system. Six cities were selected to conduct pilot projects in 2006, and that number was expanded to 10 cities a year later.

In 2010 the State Administration of Taxation (SAT), which is in charge of this pilot project, ordered that every province must choose at least one city to experiment with property value assessment in order to verify the housing sales price self-reported by home purchasers for the deed tax. These experiments have played an important role in the technical and information-based preparation of mass appraisal for future property value assessment. On January 28, 2011, the cities of Shanghai and Chongqing were permitted to collect property taxes on newly purchased second homes or luxury residential property, respectively.

Major Achievements

China's property tax reform aims to establish a system to tax the existing property (including both land and housing structures) based upon its assessed value on an annual basis to make the tax a significant revenue source for local governments. This system will utilize various assessment methods such as market comparison, cost, and income approaches and will be applied to business and industrial property as well as residential property, including owner-occupied housing.

Different versions of computer-assisted mass appraisal (CAMA) have been studied and subsequently implemented by some pilot cities, such as Hangzhou, Dandong, and Chongqing. The SAT has been training officials from local tax bureaus in every province about CAMA system development and its applications. It has also tried to establish technology standards for each assessment approach.

Single-family residences and newly purchased luxury apartments are targeted in Chongqing's pilot project on property value assessment.

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This Mediterranean-style single-family house and station wagon in the Beijing suburbs illustrate a trend toward new development on small parcels of expensive land.

In 2005, the SAT compiled a Real Property Assessment Valuation Regulation Trial that specified 12 chapters and 40 provisions covering data collection, standards, and the CAMA system. All the pilot cities have finished the simulation assessment and have calculated the tax burden and tax revenue according to different tax rate scenarios. In 2011 at least one city in each province had been selected to conduct property value assessment of newly purchased property for the collection of the deed tax.

The most important development occurred in early 2011, when Shanghai started to collect taxes on newly purchased second homes of residents and first homes of nonresidents based on transaction value, after the exclusion from the tax base of 60 square meters per person. The city of Chongqing is targeting the existing single-family residence and newly purchased luxury apartments of residents or newly purchased second homes of nonresidents. The program excludes 180 square meters for the single-family residences and 100 square meters for apartments in Chongqing.

About 8,000 parcels are reported to be levied a property tax in these two cities combined, although after this one-year experiment only a small amount of tax revenues has been collected, which was intended to finance low-income housing. Although the tax base, tax rate, and the collections are all very small in the two cities, these efforts represent a big step forward for property tax reform in China.

Future Challenges

China's property tax reform still faces enormous challenges, although it is now much better understood by Chinese citizens and the media. First, it encounters resistance from various influential interest groups. The biggest opponents of a property tax are local government officials, in addition to real estate investors and speculators. Many local governments believe that the adoption of such a tax will lower housing values and consequently lower the demand for land, thereby substantially reducing the land leasing fees obtained from the leasehold of state-owned land. Furthermore, local government officials in China are evaluated on their role in spurring local GDP growth, and infrastructure investment projects are often used as a stimulus to boost local economic development. Officials want unlimited access to land leasing fees because they can be raised and spent with little scrutiny, and they can generate a large amount of revenue for use during an official's tenure.

A second challenge is the slow progress on legal and assessment preparations for a property tax system. Property tax laws and regulations need to be established, including assessment laws and standards for assessors. Up to 100,000 assessors will have to be trained and certified to these standards. Third, consensus is still lacking with respect to the specifications of the tax base, exclusions, and exemptions; the assignment of responsibilities for administration, rate setting, and assessment; and the allocation of tax revenues. Fourth, general unfamiliarity with the property tax leads to continued misunderstanding and misperceptions about the tax.

At the same time, more urban dwellers realize that an annually collected tax on the assessed value of real property, both business and residential, can serve as an efficient and sustainable revenue source for local governments and help to reduce their reliance on land transfer fees and charges that contribute to higher house prices. Following the central government policy of house purchase restrictions and tighter monetary policy, fees from land leasing in 2011 have started to fall in many cities.

According to a recent report by the China Index Institute (2012), land transfer fees in 130 cities have decreased by 11 percent compared to 2010. In Shanghai and Beijing, they decreased by 16 and 35.7 percent, respectively. This rapid decrease may also offer opportunities for local governments to look for more sustainable ways to seek a balance between promoting economic growth and providing public goods and services. In the long run, establishing a property tax system to substitute gradually for the land transfer fees can offer an efficient, equitable, and sustainable way to finance local development and government spending.

The property tax has been perceived as an effective way to lower housing prices, dampen property speculation, and reduce vacancy rates. Many researchers believe that local governments tried to limit land supply to bid up land prices and maximize revenue, resulting in the rapid increase in housing prices and lack of affordable housing in urban China. Levying taxes on residential property can increase the opportunity cost of holding property vacant or idle and reduce incentives for speculative behavior. The tax is also viewed as an effective way to narrow the gap in income and wealth among urban residents and discourage speculative investment in the housing sector.

Conclusions

The property tax reform in China is making progress in research and in experiments with applications, and it has begun to accumulate momentum toward better understanding and acceptability among citizens and local governments. But the successful establishment of a property tax as a major revenue source in a modern local public finance system requires not only assessment techniques and tax design but also political determination and administrative reform. This reform could lead to a fundamental change in intergovernmental relations and the role of government in China's political and economic structure.

The Lincoln Institute began to support research on property taxation in partnership with the Chinese government in 2004, in conjunction with the Development and Research Center of the State Council (DRC), Ministry of Finance (MOF), and State Administration of Taxation (SAT). In 2007 the Peking University–Lincoln Institute Center for Urban Development and Land Policy (PLC) was established in Beijing, in part to help organize international conferences and training programs for government property tax officials in the pilot cities. The center continues to support international and domestic experts in conducting research and demonstration projects on property taxation and related issues.

ABOUT THE AUTHOR

JOYCE YANYUN MAN *is senior fellow and director of the China Program at the Lincoln Institute of Land Policy, and serves as director and professor at the Peking University-Lincoln Institute Center for Urban Development and Land Policy at Peking University in Beijing. Contact: yman@lincolninst.edu.*

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