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Study on Real Estate Taxation in China

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ABSTRACT

China is on the rapid urbanization procession and the real estate market grows very fast. There are some problems on the Chinese real estate taxation system, such as levying heavy taxes on development and transaction but neglecting property tenure stage; different taxations on domestic and foreign taxpayers, which affect the social fairness of real estate resource allocation. These problems do harm to the healthy growth of real estate market. The Chinese government wished to promote reform in order to smooth the whole real estate taxation system, and to facilitate the real estate industry more healthy. By analyzing the tax burdens on different chains of real estate industry, we give our suggestions on the reform of real estate taxation in China.

Key words: Real Estate Taxation; Real Estate Market; Tax Burden

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1. Introduction

The real estate industry in China started in 1980s. The fast development of urbanization offers the industry growth a good environment and opportunity. The real estate market in China is not perfectly competitive, where the real estate developers or the owners have much power in pricing. The local governments in China levy taxes on real estate development and transaction, and they also collect quite a bit administrative fees and funds on both actions. In fact, the land grant fee is the biggest one in real estate development cost, usually 30-50 percent in the whole cost. The land grant fee and other fees have been the important resource of local government. The local governments collect land grant fees on the use rights of land for decades of years later, which overdraft the revenues of future governments.

The real estate tax system adapted to the political and economic systems in China, which also changed from planned economy to market economy. The tax system reform in 1994 formed the base of current real estate tax system. Now in the chains of Chinese real estate industry involving land grant, real estate developing, transaction and retaining, there are 14 kinds of taxes.

There stand four problems in the current real estate system. First, there are different taxations on domestic and oversea taxpayers. Second, the exemptions are very large. The non-business houses held by urban residents are out of taxation. Third, the taxable basis and tax rate designation are not scientific. Fourth, there are too many names of taxes and fees related to real estate, which do harm to the market. On the new round of tax system reform, the central government plan to consolidate some kinds of taxes and contract the tax system. They consider the tax levied on domestic taxpayers and foreign taxpayers should be consistent and fees on real estate developing, constructing and selling should be cleaned up. The range of real estate tax should be extended and taxable basis should be identical. Focus should shift to real estate retaining. The real estate tax can be a steady revenue resource of local government.

Fixing on the tax burden and effective tax rate is the focus in the real estate tax reform in China. Liu et al (2001) measured average effective tax rate in mainland provinces with corporate income tax on real estate development firms, by use of effective tax rate method and Boston Consulting Group (BCG) method. He argued that real estate tax on coastal region was heavier than on hinterland, and taxes on real estate development firms were unreasonable. Lou (2004) and Chen (2004) both argued that the level of new real estate tax should be decided on the basis of taxes and fees burden on real estate development and construction. Ji (2004) researched the tax burdens in real estate market and pointed that mass taxes and fees on real estate developing and transaction had done harm to the transaction of real estate rights. Zhang (2005) reckoned the ad valorem real estate taxation after the tax reform using the dynamic analysis method. He argued that the tax burden should be equal to the summation of the land grant fee and current real estate taxes, considering the property

appreciation and tax burden changes in real estate life cycle. Tian (2006) researched the issues in real estate taxation, and analyzed the influence of real estate taxation on house asset price by use of asset pricing theory. She then concluded real estate tenure taxation can lower the real estate purchase threshold. In the long run, real estate tenure taxation lowers the asset appreciation of housing investment and restrains the real estate speculations. It facilitates the effective use of the real estate, and keeps the house price steady in the future. The real estate research group in Development Research Center of State Council P. R. China (2006) proposed the foundation of *ad valorem* real estate taxation. Tax rate should be based on the percentage of GDP the current real estate taxes accounting for, taken the residents' income and foreign experiences into consideration.

This study analyzed the current real estate tax system influence on the real estate market. We argued that under the monopolistic real estate market structure, heavy taxes and fees levied on the real estate developing and transaction were easy to be pre-shifted to purchasers, which resulted in appreciating of real estate prices. The purchasers' price elasticity of housing demand was low and made most of the real estate taxes laid on the purchasers. The real estate tax system led to the "lock effective" under the incomplete housing welfare system. In other words, though purchasers want to improve their housing conditions, high price caused by heavy taxes made it difficult for low-and-middle-income households to change their houses or buy new houses. In this paper, we give our proposition that the taxes and fees burden that levied on real estate developing and transaction should be cut down, and those taxes and fees reasonable could be integrated to levy on real estate retaining. The new real estate tax should be *ad valorem*.

2. The Development of Real Estate Taxes System after the Establishment of P.R.C.

2.1 The Historical Evolution of the Real Estate Taxation

From 1949 to 1978, the planned economy system reigned in China. The role of real estate tax was to collect fiscal revenues, which accounted for small proportion of government revenues. The role of adjusting the economy was not recognized.

After 1979, the policy of reform and opening up was established in China. The economic system was shifted to market economy, under which circumstance the firms turned to be independent economic entities. In 1983 and 1984, a proportion of incomes of state-owned enterprises began to turn into taxes. The incomes from real estate developing enterprises, foreign-invested real estate enterprises and individuals included in the taxing scope. The implementation of urban land use reform formed real estate market, where the real estate transactions were frequent day after day. In 1990, the deed tax was resumed to protect the owners' property rights and stabilized the order of economy. The development of real estate industry drove the raising of construction industry and the real estate intermediary industry. The business tax

started to be levied on the transactions of land use right, sales and leases of building. The State Department divided the urban real estate tax into house property tax and urban land use tax for adaptation of the house-land divided management system. Foreign-invested enterprises and foreign companies still paid real estate tax. For consolidation of urban maintenance and construction, the urban maintenance and construction tax was designed to collect the funds for urban infrastructure instruction. The farm land occupation tax was designed to protect the farm land and collect funds for badlands development.

The 14th National Congress of Communist Party of China (1992) established the aim of building the socialist market economic system. A structural reform on the whole taxation system was launched in 1994. Now there are 14 taxes related to real estate industry. They are business tax, urban maintenance and construction tax, surcharge for education, fixed asset investment orientation regulatory tax, income tax for enterprises, income tax for enterprises with foreign investment and foreign enterprises, individual income tax, land appreciation tax, urban land use tax, house property tax, urban real estate tax, stamp tax, farm land occupation tax, deed tax. The local governments still collect fees on real estate developing and constructing except for those taxes.

2.2 The Problems of Current Real Estate Taxation

First, there are 14 kinds of taxes and fees on real estate, 12 kinds among which are levied now. They account for more than half of the numbers of all the current taxes, but the proportion of the revenues collected by them is low. See table 1.

Table 1. The Revenue of Real Estate Taxes (Unit: 100 Million RMB)

Year	1994	1997	1999	2000	2002	2004	2005	2006	2008
All Tax Revenues in China	5071	8226	10314	12661	17004	25718	30866	37636	54223
House Property and Urban Real Estate Tax	60	75	183	209	282	366	436	515	680.34
Urban Land Use Tax	33	44	59	65	76.8	106	137	177	816.9
Land Appreciation Tax	-	-	7	8	21	75	140	231	537
Farm Land Occupation Tax	-	-	-	-	57	120	-	-	314
Proportion of Real Estate Tax	1.83	1.45	2.41	2.23	2.57	2.59	2.31	2.45	4.33

Resource: Calculation on the base of website of State Administration for Taxation of China

Except for taxes, there are many kinds of local administrative fees. According to the statistic made by the Ministry of Construction of China, administrative fees accounted for 20 percent of the construction cost in real estate development and sale, though taxes accounted for only 10 percent. See table 2. In current real estate taxes and fees system, the problem of mess fees collection is very serious, which lowers the taxes importance and weakens the macro-control function of taxes.

Table 2. Taxes and Fees collected on the Real Estate Development

Items	Proportion of houses construction cost the taxes and fees accounting for (%)
Taxes	10
Administrative Fees	20
Including: Administrative Management Fees	3
Project Documents Fees	16.5
Certification Fee	0.5
Total	30

Resource: Statistic by the Ministry of Construction of China

Second, the structure of taxation system is not reasonable. Taxes levied on real estate tenure were very slight but on developing and transaction is very heavy. Common dwelling houses are out of the taxing range. Several taxes should be collected if transactions and leases were happen. On the stage of real estate development, the enterprises have to pay for land appreciation tax as high as 30 percent of total cost, 5 percent business tax and 33 percent income tax for enterprises. Third, the taxation system is not impartiality. See table 3. For example, tax systems for domestic and foreign-funded enterprises are quite inconsistent, and domestic enterprises' tax burdens are higher than foreign-funded enterprises, which is contrary to the WTO principle of national treatment and fair competition.

Table 3. Differences on the Tax Burden between Domestic and Foreign-Funded Enterprises

Tax Items	Domestic Enterprises	Foreign-Funded Enterprises
House Property Tax	Imposing	Only levy on houses
Farm Land Occupation Tax	Imposing	No imposing
Urban land Use Tax	Imposing	Only collect land use fee with no national uniform standards
Surcharge for Education	Imposing	No imposing
urban maintenance and construction tax	Imposing	No imposing

Resource: Laws and regulations on Taxation in China.

3. The Influence on Real Estate Market Exerted by Current Real Estate Taxes System

The real estate market in China was imperfect. The real estate developers were more powerful when facing purchasers because they were main and only suppliers. The

land market was monopolized by the government. The raising of land grant fees made few powerful enterprises gain the land use rights to develop real estate. Mass real estate products were concentrated to few big real estate development enterprises. Most of Chinese consumers wished to have property rights when they could afford houses because of traditions and conventions. Yu (2004) proved that the housing consumption elasticity of Chinese urban residents was -0.34 and -0.37, by using the models of LES and ELES respectively. Houses and living goods ranked last by consumption elasticity. All in all, the real estate market was a monopoly market at micro level. In this market, the real estate enterprises have great power in pricing, and the purchasers had to accept the prices. Under that market structure, levying mass taxes and fees on real estate developing and transaction only led to pre-shifting of taxes and fees to the purchasers. See figure 1.

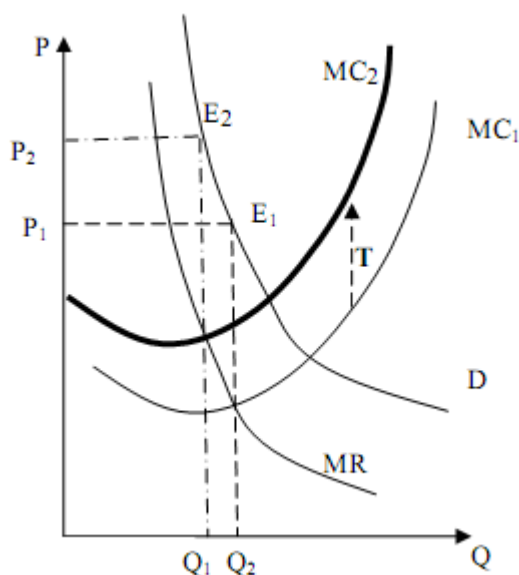


Figure 1. The Influence on the Market Entities Exerted by Real Estate Taxes

Assume there were no taxes and fees on the real estate developing and transaction. The real estate enterprise is a monopoly who decided to develop real estate when his marginal cost MC_1 equaled to purchasers' marginal revenue MR . The equilibrium price is P_1 . When taxes and fees were levied, the real estate enterprise developed real estate where new marginal cost MC_2 equaled to purchasers' marginal revenue MR . Notice that new marginal cost MC_2 equaled to the summation of original marginal cost MC_1 and taxes and fees T . The equilibrium price is P_2 , higher than original equilibrium price P_1 . According to Yu (2004), purchasers' demanding elasticity is weak when real estate price is high. As a result, most of taxes and fees are borne by the purchasers at the new equilibrium price P_2 .

The same analysis tool can be used for real estate transaction. The real estate buyers have pricing powers. They can shift the taxes and fees on sale process to the purchasers. It leads to high price, and make it hard for low-and-middle-income households to improve their living conditions.

According to above analysis, we argued that the current tax system intended to raise the real estate prices. Property appreciation, as well as taxes and fees on transaction led to “lock-in” effect. That is, real estate properties were concentrated to few venders, who had to retain the properties for avoiding being levied on transaction taxes and fees. So it was hard for low-and-middle-income households to involve in the transactions because of high prices. The unreasonable taxes and fees on real estate developing and transaction should be cleaned up. At the same time, the real estate tenure tax should be implemented, which could avoid vacancy or using properties with low efficiency. This new real estate tax could increase the real estate supplies, which would prosper the real estate market and facilitate the effective use of properties. The new tax should be assessed according to the market value of properties, matching proper tax rate. This is the usual international practice, and also helps to curb real estate speculation and hoarding, keeping the healthy growth of the real estate market.

When new real estate tax system is implemented, in principle, the whole tax burden should not exceed the sum of current taxes and fees related to real estate. The formula of tax rate can be written as follows,

Tax Rate= the sum of taxes and fees on real estate developing and transaction after cleaning up/ the whole market value by assessment.

Consider the diversity of market conditions and real estate stock in different places, local government could adjust the basic tax rate. The revenue effect should be taken into consideration when the real estate reform is in smooth. The new real estate tax could be a steady main revenue resource for local governments.

4. Conclusion and Discussion

The direction of the real estate tax reform is contracting tax system. The real estate tax will be levied on property tenure stage. It could conquer the shortcomings such as different taxations on domestic and foreign taxpayers, complicated kinds of taxes, and confusion of taxes and fees. It could decrease real estate developing costs effectively and lead to low prices. It also could increase real estate supply and prosper the market. The new real estate tax rate should consult the current tax burden related to real estate, and on the base of market value by assessment.

The implementation of the new real estate tax system is on the base of the property registration system and tax assessment system. Two aspects of future research are the issue of organization and establishment of real estate tax assessment system and the issue of floating scope of real estate tax rate in different places.

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