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- BASED ON CALCULATION OF PROPERTY TAX BURDEN
WEIQUN XI

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COMMENT
LARRY LIPSHER



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ABOUT THE JOURNAL

The importance of China on the global economic stage cannot be ignored, and its unique legal and tax systems are of great interest to international scholars and business people alike. China's tax system is acquiring western features while remaining entrenched in its rich cultural and historical roots. This makes for interesting study, analysis and comparison as its laws are becoming more accessible.

The Journal of Chinese Tax & Policy focuses on the policy, administrative and compliance aspects of the Chinese tax system. It also welcomes comparative studies between China and other countries. The Journal is an internationally peer-reviewed scholarly publication.

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COMMENT

CHINA AND THE COMING OF THE PROPERTY TAX

LARRY LIPSHER

Editorial

The 2014 special issue of the Journal of Chinese Tax and Policy features articles invited for the 2013 International Conference of Chinese Tax and Policy. The theme of the conference was "Tax Policy and Tax Law for China in a Time of Change --Taxation of Real and Immovable Property".

Long and Bao's paper, focused on the real estate tax as a method of regulating the Chinese real estate market. The highlight of the article was an examination of the degree of taxation burden, its impact on housing prices, the real estate economy, and the impact on Chinese citizens' income tax burden. The article further suggested recommendations for the future reform to regulations on the real estate market.

Analysis of the Financial Function of Real Estate Tax by Wang and Peng is a contribution to the discussion on the role of real estate tax in China. The article began with an analysis of the contribution of real estate taxes to government revenue in other jurisdictions. By applying the analysis to the recent development of China's real estate market, it reached the conclusion that it would be financially feasible for the real estate tax to play a dominant role in raising revenue for local governments. The article also discussed the political acceptance from a taxpayer's perspective on real estate tax reform.

Xi's article evaluated the impact of real estate tax on household consumption. The special contribution of the paper was to reconceptualise the impact of different indicators based on Keynesian consumption models. The author suggested that increasing the holding cost of property by introducing a real estate tax or to impose inheritance and gift taxed could reduce saving and stimulate consumption.

Zhu's article comprehensively addressed the legal issues of the three core components of the current real property tax (RPT) reform: Defining the functions of RPT, levying RPT fairly, and the legislative process of RPT laws. The article also pointed out that the reform needs to be practical, rather than merely based on the desire of idealism.

The comment in this article was written by one of our practitioner contributors - Larry Lipsher. The comment included the observation of the financial concern of the government after rapid urbanisation and the gradual exhaustion of land resources, as well as the significance of real estate tax in the current dynamic of China's economy.

Eva Huang

Sydney, September 2014

The Impact of Tax and Non-tax Policies on Adjusting Housing Prices in China

Dr Zhaohui LONG, Ning BAO[☆]

Abstract: Chinese government has made many policies to adjust the development of real estate market in recent years. For the sake of researching on the policies effect, this paper divides all Chinese provinces into three regions according to Chinese government classification standard. Then the paper respectively analyse the notability degree which tax factor and five non-tax factors influence on housing price of three regions. These five non-tax factors include affordable housing, construction cost of residential housing, urban resident's income, and loan scale. The paper appraises tax and non-tax policies effect, and gives some suggestions for the continued policies.

Key Words: Housing Price; Taxes Burden; Affordable Housing; Housing Cost; Urban Resident's Income; Loan Scale; Policy Suggestions

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Ning BAO, Student, Master by research, Sun Yat-Sen University, Lingnan (University) College, China. The research for this article was undertaken while the author was a Postgraduate Candidate at the Sun Yat-Sen University, Lingnan (University) College 2012, under the supervision of Dr Long, Associate Lecturer, Sun Yat-Sen University, Lingnan (University) College. The author would like to thank Dr Long for her contribution and invaluable assistance in this research and the resulting article.

Preliminary Remarks

Real estate investment and sales are rapidly growing since the Chinese housing reform in 1998. The Chinese central government enacted many regulations in the beginning of 2003. The purpose was to increase the government's ability to control the real estate market. Imposing tax on real estates is one of the significant strategies for the Chinese government to control housing prices. The main regulatory policy is divided into two categories: taxation policy and non-taxation policy. Taxation policies include the following: adjustment of business tax in imposed on the transfer of residential real estate, land capital gains tax, urban land usage tax and real estate tax. Non-taxation policies include the following: promotion of the building of affordable housing, strict control of real estate credits and the increasing the supply of land for residential purposes. The intention of this paper is to provide a better understanding of the impacts of these different policies.

In accordance with a number of fellow Chinese scholars, Du et al's paper¹ uses panel data which included thirty-one provinces. The data included real estate prices and the relationship between local fiscal expenditure and real estate tax burden. Peng et al² analysed the reasons for the unreasonable high real estate prices in China from a theoretical perspective. The paper suggested the factors included the speculative behaviour of real estate developers, transferring large funds from other industries to real estate, the undersupply of affordable housing by the government but overemphasising the importance of real estate on GDP growth, and rent seeking by local government officials. Liang et al³ selected certain provinces as representative samples from the eastern, central and western regions to examine the effects of monetary regulations in different provinces and price fluctuations. Wu⁴ performed regression analysis on data from housing prices in twenty-two provinces was made in accordance with the following factors: urban GDP per capita, urban residential investment index, urban residents' per capita wages and other variables in the year of 1998; and arrived at a developmental feature of urban housing prices and basic conclusion of urban housing price comparison between the provinces.

Reviewing current literature, this paper found five main factors beyond the effects of taxes related to operating a real estate enterprise, which affect the real estate sales price. These are: affordable housing prices, affordable housing sales proportion in the real estate sales market, domestic loan schemes for real estate enterprise, the construction cost of residential real estate, and disposable income per capita of urban residents. Using 2002 – 2011 statistics, we intend to analyse the impact of these tax

¹ 杜雪君,黄忠华,吴次芳 [Du Xuejun, Huang Zhonghua, Wu Cifang], 《房地产价格、地方公共支出与房地产税负关系研究——理论分析与基于中国数据的实证检》 [Study of Relationships between Real Estate Prices, Local Public Budget and Real Estate Tax—Theoretical Analysis and Empirical Examination based on data of China] (2009) 1, 数量经济技术经济研究 Journal of Quantitative and Technical Economics.

² 彭骥鸣,彭浪川 [Peng Jimmin, Peng Langchuan], 《我国房地产市场价格虚高的成因及治理》 [The Cause and Solution of the Falsely Increased Price in the Chinese Real Estate Market] (2010) 3, 扬州大学税务学院学报 Journal of Tax Department of Yangzhou University.

³ 梁云芳,高铁梅 [Liang Yunfang, Gao Tiemei], 《中国房地产价格波动区域差异的实证分析》 [Empirical Analysis on Real Estate Price Fluctuations in different provinces in China] (2007) 8, 经济研究 Economic Research Journal.

⁴ 吴建峰 [Wu Jianfeng], 《我国城市住宅价格研究》 [A Study on Housing Prices in China] (2002) 2, 城市开发 Urban Development.

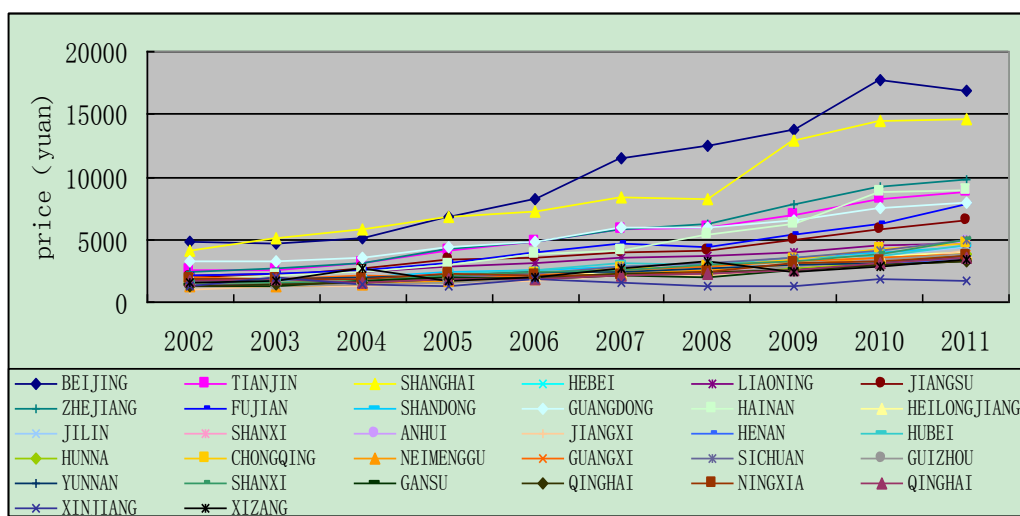
and non-tax policies on the real estate sales price and to propose recommendations for potential amendments of the regulations and policies.

1. Classification and Trends of Housing Price in the Three Main Regions

The method to divide China into three regions, eastern, central and western, was officially announced by the Seventh Five-year Plan passed by the Fourth Session of the Sixth National People's Congress in 1986. The eastern region implemented the open-door policy at the earliest stage and it has the highest level of economic developments. The Central region's economy is still at the developing stage. The western region remains poorly undeveloped. The eastern region includes eleven provinces: Beijing, Tianjin, Hebei, Liaoning, Shanghai, Jiangsu, Zhejiang, Fujian, Shandong, Guangdong and Hainan. The Central region includes the following eight provinces: Heilongjiang, Jilin, Shanxi, Anhui, Jiangxi, Henan, Hubei and Hunan. The western region includes the following twelve provinces: Sichuan, Chongqing, Guizhou, Yunnan, Tibet, Shanxi, Gansu, Qinghai, Ningxia, Xinjiang, Guangxi and Inner Mongolia.

In accordance with Chart 1, below, the commercial housing price for eastern region is the highest during the period of 2002 to 2011 followed by the central and eastern regions. The timeframe was limited to the period 2002-2011 because of the Chinese land and property auction trade and policy. The availability of the data system in 2002 to 2011 was taken into account in the implementation of the national land auction and the price of land transactions. In addition, the relevant data of Shanghai and Tibet was removed due to the special circumstances of the Tibet Autonomous Region and unattainable affordable housing data in Shanghai. In order to make the analysis in this paper more effective, twenty-nine cities (except Shanghai and those in Tibet) will be divided into eastern, central and western regions. Chongqing is assigned to the central region for the purpose of this paper; it is one of the four municipalities which continuously improve the level of economic developments in recent years.

Chart 1 Commercial housing prices across the nation (including municipalities under direct control by the Central Government and autonomous regions)



According to the results, the average housing price in the eastern region had a maximum increase of 25% in 2005 and a minimum increase of 5% in 2008. The housing price increased from about CNY 2500/m² in 2002 to about CNY 8000/m² in 2011. In the central region, the average housing price had been slowly increasing from about CNY 2000/m² in 2002 to about CNY 4000/m² in 2011. It had a maximum increase of 15% in 2009, the same as the western region. In the western region, there was a slow increase from about CNY 1400/m² in 2002 to about CNY 3500/m² in 2011. The lowest rate of 3% appeared to be in 2003.

2. Analysis of the impact on housing price by different influencing factors

In order to analyse the impact of tax and non-tax regulations, this paper takes *SJ* to be the commercial housing price of different provinces. *TAX* is business tax and surcharges for real estate development enterprises in different provinces, which include sales tax, land tax, urban land usage tax, arable land occupation tax, real estate tax and deed, etc. *JJ* is affordable housing price in different provinces, *RATE* is the proportion of affordable housing sales and the area of commercial housing, *LOAN* is the domestic loan scale of real estate development enterprises in different provinces, *COST* is the construction cost of the commercial housing in different provinces, and *INCOME* is the disposable income per capita in different provinces. The regression model was established to show the commercial housing price. It was concluded that there are six essential elements which affect the housing price.

$$SJ_{it}=a+bJJ_{it}+cRATE_{it}+dTAX_{it}+dLOAN_{it}+fCOST_{it}+gINCOME_{it}+\varepsilon$$

In the above formula, *a* represents a constant value, *b*, *c*, *d*, *e*, *f*, *g* are the impact factors of different elements.

In the period 2002- 2011, the statistic includes one hundred pieces of data from 10 eastern provinces, ninety from nine provinces in the 9 central provinces and one hundred from 10 western provinces, which constituted three sets of panel data. The following table shows the statistics in accordance with the panel data regression. (After verification, the White robust regression test shows obvious group wise heteroscedasticity). In addition to the real estate tax payable and the mentioned five non-tax factors, the regional housing price was also affected by factors formed by its own regularity: economic and geographical conditions, technical level, traditions, etc. Therefore, the factors affecting the regression coefficients obtained were not necessarily applicable to other regions and regions in China. However, to a certain extent it can contribute as a preliminary judgment to the analysis of various effects of the regulatory policies.

Table 1: Regression result of the panel data in the three regions

	Eastern	Central	Western
	-1	-2	-3
	<i>SJ</i>	<i>SJ</i>	<i>SJ</i>
<i>JJ</i>	-0.0821	-0.203	0.225
	(-0.24)	(-1.25)	-1.88
<i>RATE</i>	329.9	906.3*	-419.1
	-0.09	-2.66	(-1.93)
<i>LOAN</i>	0.000164*	0.00000756	0.000165
	-3.13	-0.18	-1.99
<i>COST</i>	-0.606	0.915***	0.405*
	(-0.59)	-5.38	-2.53
<i>INCOME</i>	7.096**	-0.949	1.206**
	-3.34	(-1.20)	-3.99
<i>TAX1</i>	-0.00509*		
	(-2.30)		
<i>TAX2</i>	-0.00461*		
	(-2.48)		
<i>TAX3</i>	-0.00376*		
	(-2.50)		
<i>TAX4</i>	-0.00286*		
	(-2.48)		
<i>TAX5</i>	-0.00264*		
	(-2.93)		
<i>TAX6</i>	-0.00199**		
	(-3.69)		
<i>TAX7</i>	-0.00191**		
	(-4.49)		
<i>TAX8</i>	-0.00157**		
	(-4.25)		
<i>TAX9</i>	-0.00122***		
	(-5.72)		
<i>TAX10</i>	-0.00122***		
	(-4.82)		
<i>TAX</i>		0.00000856	0.000202
		-0.08	-1.48
yr2		151.7*	
		-2.55	
yr3		443.1***	
		-5.52	
yr4		737.8***	
		-5.21	

yr5		881.0**	
		-4.59	
yr6		1270.2**	
		-4.71	
yr7		1429.8**	
		-4.08	
yr8		1765.1**	
		-4.47	
yr9		2370.4**	
		-4.91	
yr10		2950.3**	
		-4.96	
_CONS	-283.5	1079.5*	265.2
	(-0.13)	-2.65	-1.72
N	100	90	100

Remark: Parentheses report value is T value; “*”“**”“***” indicate the significant level of 10%, 5%, 1%.

The above regression results show that the negative effect on tax policy region on housing price in the eastern region was significantly different every year, which indicated that the real estate tax region has played an important role in curbing housing prices in this region. Other significant influence factors in the eastern region include disposable income per capita and local real estate development enterprise loan schemes.

In the central region, the cost of commercial real estate had some significant impacts. This indicates that the completion of real estate prices has promoted the rise of housing prices in the area to some extent. On the other hand, the ratio of affordable housing sales area to marketable housing sales area is another influential factor.

In the western region, the significant factor affecting the housing price is the average income per capita and the cost of marketable real properties. Other factors affecting the price of real estate were weak.

Based on the above results, this paper analyses the following separately: tax policy, affordable housing policy, marketable housing cost, income of urban residents, real estate development enterprises credit scale and other non-tax policies which affect marketable housing price. Accordingly, this paper proposes some appropriate policy recommendations.

3. Tax Policies’ Regulatory Effect and Possible Recommendations

3.1 Regulatory effect

Tax policies have always been one of the major housing rate regulatory methods in China. However, the effect of its regulation has been controversial. In order to carry out adjustments, the Chinese government has enacted a number of policies and has increased management since 2007. Most of the real estate enterprises have had a

heavier tax burden ever since. In accordance with the statistics, the eastern regions have received significant negative impacts from tax revenue on their property prices. However, the impacts in the central and western regions are positive and less significant.

Contrast with the intention of the policy, the average price of marketable housing have not reduced due to the increase of enterprises tax payable, but have simultaneously grown with the increase of tax payable. In 2007, before the adjustment policies and strengthening tax collection, the eastern region had a slightly lower tax burden in comparison to the central and western regions regarding the real estate development business tax payable. After the policy adjustment and increasing tax payable enacted in 2007, the tax burden in the eastern region was significantly higher than in the central and western regions. At the same time, the housing price growth rate was also higher in the eastern region. This indicates that the tax burden has been successfully passed on to consumers.

In summary, we suggest the policy failed to achieve the original aim to curb the excessive growth of housing price by strengthening the administration of land capital gains tax and increasing the tax burden of real estate developers. There has been no significant result other than an improvement on the fiscal position.

Table 2 An overview of the three regions: Real estate tax payable, growth rates of housing price and tax burdens⁵

	Area	2003	2004	2005	2006	2007	2008	2009	2010	2011
The growth rate of real estate tax revenues	Eastern	32%	33%	31%	27%	45%	28%	32%	33%	23%
	Central	31%	35%	35%	29%	38%	42%	30%	50%	31%
	Western	53%	28%	31%	25%	31%	53%	31%	34%	32%
The average house price growth	Eastern	5%	13%	27%	16%	22%	6%	16%	21%	16%
	Central	5%	12%	17%	6%	16%	5%	17%	19%	15%
	Western	2%	8%	14%	7%	14%	8%	15%	15%	14%
Real estate tax revenue / Total operating Revenue	Eastern	10%	10.6%	10.4%	11%	12.7%	14.1%	15.3%	17.2%	20%
	Central	12.7%	13.6%	13.2%	13.2%	12.4%	14.5%	14.5%	16.4%	16.2%
	Western	11.5%	12%	11.9%	11.6%	11.1%	14.5%	13.5%	12.2%	15.8%

⁵ 《地增值税数据来源于中国税务年鉴——税务部门组织收入分地区分税种情况统计(2001-2008年)》 [Land value tax statistics from the Tax Year Books of China – Census of revenue from State Administration of Taxation by geographical regions for years 2001-2008].

3.2 Countermeasure recommendations

3.2.1 Real estate tax reform

Despite the efforts of the central government, the rapid growth rate of housing price is still deemed to be socially unacceptable. People are now more concerned with the risk of housing market bubble and the polarising distribution of wealth. Citizens are looking forward to the trial individual real estate reform, hoping that it could play a role in curbing the rapid growth of housing prices. The Third Plenary Session of Eighteenth Central Committee of CPC stated that “the drafting of real estate tax legislation needs to be speeded up and reform needs to be implemented accordingly.” The Ministry of Finance said that there will be an expansion in the scope of the trial of the real estate tax reform. The purpose is to try and improve the relevant system as soon as possible. The aim is to fully implement the policy after a transitional period and to clearly define the real estate tax as the main type of region/county government tax revenue.

Table 3 Real estate tax reform pilot scheme in Shanghai and Chongqing

	Shanghai	Chongqing
Levying scope	Administrative districts in the city	Nine downtown districts
Levying on housing stock?	No	On houses
Objects of taxation	Shanghai hukou: taxable after the first Non-Shanghai hukou: New purchased residences	Chongqing hukou: houses and new purchased luxury residences Non-Chongqing hukou, unemployed individual: taxable after the first
Duty-free proportion	Under 60 square meters per capita	Housing stock: 180 square meters, New purchased: 100 square meters, per family.
Tax rate	0.4% or 0.6%	0.5%, 1% or 1.2%
Tax calculation	The tax payable = new residences taxable area * unit price * corresponding tax rate * 70%	Tax payable = taxable construction area * unit price * corresponding tax rate

There is some room for improvement for the current trial tax reform schemes, detailed as follows:

Firstly, Shanghai’s current real estate tax reform scheme is only levied on new housing rather than on available housing. Accordingly, the regulation of housing prices will be affected to some extent. This scheme is unfair on the basis that there should be no difference when addressing new housing and available housing for taxation purposes.

Secondly, the individual real estate tax should be calculated on the basis of market value, and not transaction value. The true market value of the real estate may not be accurately reflected because of the existing bubble effect. Assessing market value as a tax basis is beneficial as it aligned with the “Ability to pay” taxation principle. The policies of other countries in relation to real estate taxation on the basis of the market assessment value provides an interesting international perspective. Taxation on such a basis is indeed a more suitable strategy for today’s society. Therefore, the Chinese government should refer to the advanced strategies of foreign countries. Taxation levies should be assessed on the basis of market value rather than the transaction value. Nonetheless, as the real estate assessment system has not yet been established in China. Supporting regulations are also unrefined. The priority now is to create a sound evaluation system with fair and transparent assessment method and standard, in the meantime a group of relevant professionals need to be trained for the imminent demand.

Thirdly, other than the relevant real estate tax, the real estate turnover tax burden should be reduced. Accordingly, the individual real estate tax should increase at an appropriate level. Real estate turnover tax can only increase revenue, but overall it cannot achieve the expectation of real estate regulation. Nevertheless, real estate tax belongs to the individual capital levy category. It cannot change the price in any way and cannot be transferred easily. It can increase the cost of real estate investment and reduce investment speculation. Accordingly, this strategy reduces the real estate investment demand, thus lowering the price of real estate in the market. Fundamentally, in order to maintain the existing real estate tax burden, the policy maker should shift their focus from real estate tax to turnover tax. The turnover tax can provide an improvement in the tenure links of the real estate.

3.2.2 Real estate tax reform

China has an imperative real estate tax reform. The Third Plenary Session of Sixteenth Central Committee of CPC stated that “the reform on urban maintenance and development construction taxes and fees should be implemented. When the conditions are met, the real estate tax should be levied according to a unified standard, and relevant fees should be abolished accordingly. The taxation management function should be granted to local governments when there is uniformed tax administration.” For a long time the chaotic situation of “using tax in exchange of rent, using fees in exchange of tax, using tax in exchange of fees, using fees to squeeze out tax and overlap between tax and fees” has greatly crippled the macroeconomic regulatory function of taxation policy. Real estate tax needs to be distinguished from fees with clear boundaries. The tax reform should merge the relevant administrative fees and appropriate taxes. Management and regulation of service fees should be strengthened and transparent. Unreasonable fees need to be cancelled. The above steps are preparations for the incoming reform on real estate taxes.

3.2.3 Establishment of real estate information sharing platform

An information sharing platform should be built collectively by the organisations that have association with the real estate industry, such as office, national tax bureaus and local tax bureaus at local levels of governments, planning bureaus and

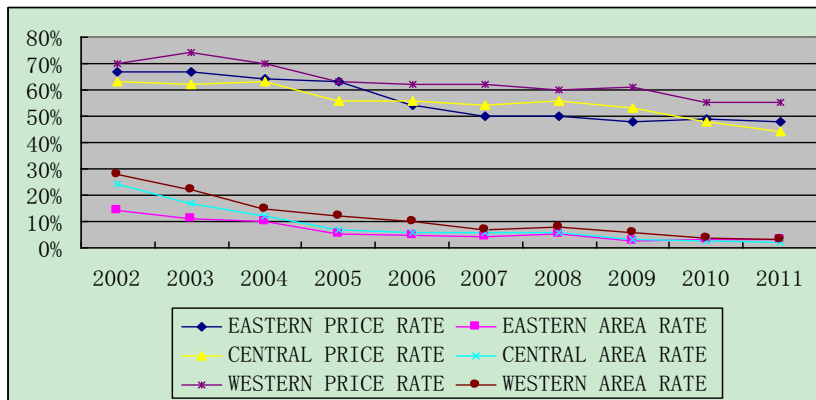
commissions of urban planning, commission of housing and urban-rural development, housing administrative bureaus, land and resources bureaus and financial service providers, in order to better ascertain the accuracy of the information on tax returns. This platform should house data on the following details on real estate developers: detailed project information, reserved land areas, constructed areas, sales progress, receipt of prepaid housing prices and property title exchange. The platform can enhance the authenticity of tax returns auditing and is necessary in order to build information and monitoring systems which are comprehensive and accurate when tax loopholes appear. In accordance with the various data from different provinces and cities, it is suggested that in order to build a database to store real estate taxation information, it is necessary to gather census data of the real estate business and individual taxpayers and census register information. In order to accomplish a perfect data set, the information sharing can promote supervision and management in many different aspects. It can also provide guarantees for real estate tax collection and administration.

4. Effect of China Affordable Housing Policy and Recommendations

The affordable housing policy does not seem to have a discernible impact on the housing prices in the three regions. Statistic data shows that only in the central region the ratio between affordable housing sales and commercial housing sales has a positive impact on the housing prices. The preferential pricing policy should be enhanced on affordable housing, although the trend will continue to decrease even though prices of affordable housing will increase with commercial housing prices.

On the other hand, the ratio between affordable housing sales area and commercial housing sales area decreases every year. There was a significant drop from 28% to 3% in the western region, from 20% to 2% in the central and from 14% to 3% in the eastern region. Compared to the central and eastern regions, the ratio in western region has decreased more substantially.

Chart 2: Price and area ratio between affordable housing and commercial housing sales in the three regions.



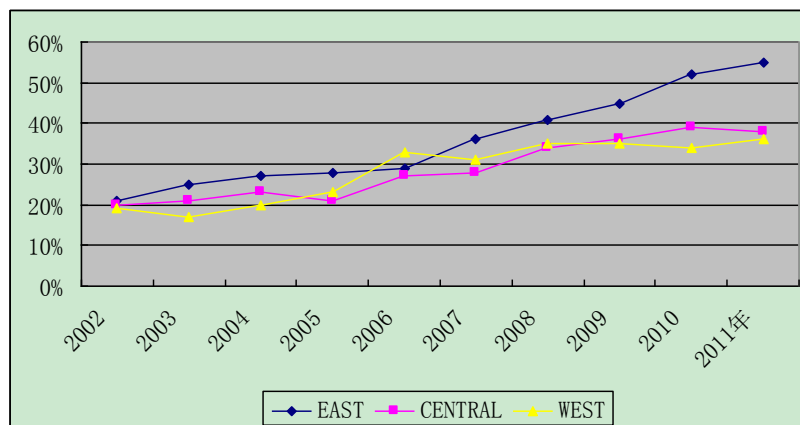
One of the reasons why the affordable housing policy has failed to have significant effect is because the policy is not powerful enough. For instance, the ratio of affordable housing sales area to commercial housing sales area is too low. Therefore, one of the key focuses of the government's efforts in controlling housing prices is to increase the supply of affordable housing. A couple family with an average income level in their locality can afford a set of 60 m² affordable housing after working 8 years. However, the ratio of affordable housing sales area to commercial housing sales area was only 3% until 2011, assuming only residents whose annual per capita income is 50% lower than the average level in the locality are entitled to purchase the affordable housing, they would have to work 16 years before they can afford the housing. To tackle the problem of excessive price of affordable housing in the western region, we can refer to the strategy of external commercialization adopted by foreign countries regarding indemnificatory apartment. Germany, for example, has established an independent Real Estate Assessment Committee to set a benchmark price for the different types of affordable housing in different localities. If the housing price set by property developers is 20% higher than the benchmark, it would be categorized as "excessive price" and is illegal; a price that is 50% higher is "exorbitant price" and would constitute a crime.

5. Effect of China Land Policies and Recommendation

In the eastern region, the effect of commercial housing prices at completion to sales prices is negative and insignificant. The land purchasing prices constitute the greatest proportion in the total building costs of projects. From 2002 to 2011, the proportion of unit land purchasing price in the sales prices of commercial housing increased from 20% to 55%. The unit land purchasing price in the eastern regions increased substantially in 2007, from 1200 yuan to 3100 yuan per square metre, resulting in an increase of 1000 yuan per square metre in the commercial housing sale price. The central regions also saw the significant influence of unit land purchasing prices on commercial housing prices, where the unit land purchasing price increased from 400 yuan per square metre in 2002 to 1600 yuan per square metre in 2011, constituting 40% of the sale prices, a figure 20% higher than that in 2002. The increase is less significant than that in the eastern regions. The unit land purchasing price in the western regions witnessed an 1120 yuan increase per square metre from 280 yuan per square metre in the 9 year period since 2002. In the western area, this price

increased from 280 yuan per square metre in 2002, constituting a similar proportion of sales prices with that of the eastern regions, namely from 20% to 40%, only with greater fluctuation.

Chart 3 Ratio of unit price of land purchasing to sales prices of commercial housing



Since the implementation of land transfer and auction policies in China, the ratio of purchasing prices to development costs has increased substantially, and the more regulated land markets have rendered real estate development enterprises less likely to gain the huge profits that they used to earn because of the low land prices. The short-term objectives of the implementation of the policy have been fulfilled. However, the auction prices of land are growing faster than the sale prices due to the rapid development of economy, and when the unit land purchasing prices constitute about 50% of sales prices, land auction becomes more of a tool to increase government income, rather than a device to control the huge profits of real estate industry. The housing prices are forced to increase due to the excessive costs of land purchasing, resulting in the much accused “land finance”. Under these circumstances, the government should actively increase the supply of land to reduce land prices, and keep using the profits generated by land transfer as a substantial source of government revenue and retaining its high growth rate would be detrimental to the real estate industry or even the entire area.

Internationally, the occupation of state owned lands are usually through a state owned land leasing system. For instance, until 1997, Hong Kong was “leased” to the United Kingdom by the Qing government. Therefore the British authorities had a system to manage the land through public leasing where a rent is paid annually. The current land possession fees revenue in China allows the government to collect the revenue generated by land in the next few decades in a lump sum, which is the local government consider it as their main financing source. However, this practice would result in the abuse of land resources and land revenue by incumbent officials. Adopting the public leasing system with annual rent would allow the government to collect land revenue annually, which would help stabilise financial income and reduce land resource abuse driven by vested interests. Meanwhile, in order to add value to the land, and utilize the land resources more effectively, local governments will try to improve the environment and attract investment.

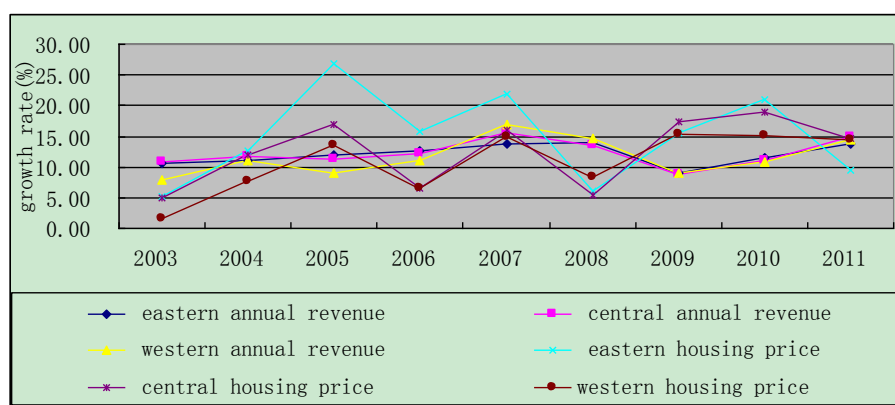
6. Effect of Urban Residents' Incomes Policy and Recommendations

In the eastern and western regions, the per capita annual income of urban residents is exerting a positive and more significant influence on housing prices, and is helping to increase the demand for housing. Its impact on the housing price in the central regions is negative but less significant. From 2002 to 2011, the annual per capita income in urban cities and the housing price in the three regions all showed an upward, but slightly different trend throughout the period.

In the eastern regions, the growth rate of housing prices has been higher than that of per capita income of urban residents except in 2008 and 2011, with a biggest gap of nearly 15%. Most parts of the urban per capita income growth only reflect the income growth of wealthy people due to the large Gini coefficient in China, and the middle and low-income groups are actually enjoying little or no growth of their income, and are thus facing greatest pressure in house purchasing. The middle and low-income groups are the most demanding of habitable housing, yet their income growth is much slower than the growth of housing price, which makes it difficult to create a sustainable and healthy real estate market, and to provide habitable housing to most residents.

In the eastern and western regions, the gap between the growth of annual per capita income and that of housing price is narrower, fluctuating from 5% to 17%. In these circumstances, central and western urban residents are facing less pressure in house purchasing than the residents in the eastern regions, and are less likely to panic about being unable to afford an apartment due to the growing gap between income and housing prices.

Chart 4 Growth rate of annual per capita income in cities and commercial housing prices per square metre



Based on the above information, the government's macro-control policy should include two aspects. Firstly, to solve the housing problem of low-income groups by affordable housing, it should focus on increasing the proportion of construction on affordable housing and rent-subsidised housing. Secondly, it should focus on the housing problems faced by middle-income groups, preventing the situation where they could not afford commercial housing nor are they qualified to purchase affordable housing. The most effective approach to solve the housing problem of

middle-income groups is to increase their income, to keep the growth rate of their income with that of housing prices. The government can provide certain labour market guidance to promote income growth of middle-income groups. A further reform of the individual income tax system should be promoted to reduce the tax burden of middle and low-income groups and increase their disposable income.

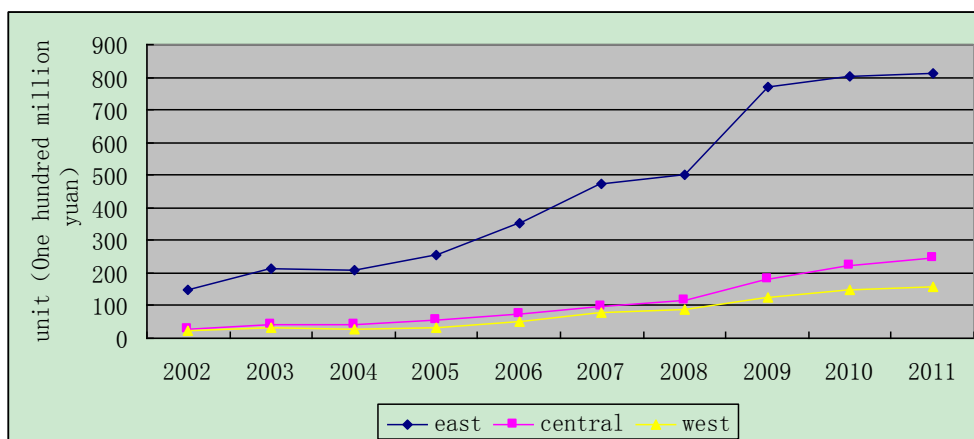
7. Effect of Credit Policy and Recommendations

Real estate projects often require a long period of time and large investments, and some major projects may require more than a billion in upfront investments. Without the support of credit funds, the project would not survive the initial stage of land auction. According to the regression results, the impact of real estate developers' credit scale on commercial housing price is more significant in the eastern region, but not as significant in the central and western regions.

Statistics revealed a greater gap between the credit scale of the eastern and mid-western regions. The value of loans in the eastern region increased from less than 20 billion yuan in 2002 to more than 80 billion yuan in 2011, while the value of loans in the central and western regions only increased to 20 billion yuan in 2011 from approximately 3 billion yuan in 2002. It is evident that the significant influence loans have on commercial housing prices in the 10 eastern provinces is due to the large scale and rapid growth rate of credit loans, and the smaller scale and slower growth of loans in the 19 central and western provinces is the reason why a less significant influence on housing prices was observed there.

In addition, from the credit structure of real estate development enterprises, only a small proportion of credits are from non-financial institutions, while more than 90% of the credits are issued by financial institutions. Therefore, the government's macro-control policy on housing prices should focus on controlling the credit scale provided by financial institutions, especially in the eastern region where the housing prices are soaring.

Chart 5 Scale of loans in the three regions



8. Conclusion

The excessive housing price is a focal point of social and economic conflict in China. The constantly growing housing price disturbed financial order, increased income polarisation, and eventually exerted detrimental effect on the healthy development of China's economy. The real estate industry is one of the pillar industries in China, involving a long supply chain and a large number of associated sectors. Although the current problem involves mainly structural issues in some parts of China, it is likely to evolve into nationwide issues if not properly dealt with, resulting in severe inflation or other serious consequences. Regulating the housing price is a systemic issue, and tax policies would not only directly influence various aspects of the real estate industry, but carry out a dual function of revenue distribution and regulation. These functions are best fulfilled when being used in coordination with non-tax regulatory policies. Constant and systematic analysis and detailed studies to the various tax or non-tax policies issued by the government is necessary in order to exert effective control on real estate industry.

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Analysis of the Financial Function of the Real Estate Tax

Jinxia WANG, Ze PENG [☆]

Abstract: By analysing the contribution of real estate taxes to local governments' tax revenues in foreign nations, this article concludes that, as Chinese real estate market has been developing for many years, the existing properties and new properties provide abundant sources for imposing real estate tax, making it financially feasible to let real estate taxes play a dominant role in local revenue raising. As the reform on real estate tax involves an "infringement" of private property rights, when considering the factors in designing the framework, China not only have to consider the demand of raising revenue by the tax levier from a macroscopic perspective, but also examine whether a taxpayer is able to afford the tax financially and accept it politically from a microscopic perspective. Therefore the reform on real estate taxes should be a gradual process.

Key Words: Real Estate Tax; Revenue; Tax Reform

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Introduction

Since the 21st century, the reform on real estate tax has become an important component of Chinese government's financial and tax scheme, and at the same time it has attracted national attention. Due to the multiple roles given to the reform and an excessive expectation from it, the reform has been progressing with cautiousness. In May 2003, Chinese Ministry of Finance and State Taxation Administration, divided in three teams, launched trial simulations of assessments on real estate taxes in ten provinces, regions and municipalities - Beijing, Liaoning, Jiangsu, Shenzhen, Chongqing, Ningxia, Fujian, Anhui, Henan and Dalian - and thirty-two county regions and cities that are specifically designated in the state plan. In October 2003, on The Third Plenary Session of the sixteen Committee of the Communist Party of China, the Central Committee proposed a reform of taxes on urban constructions. When condition is satisfied, a regulated standard real estate tax will be imposed on immovable properties, and other relevant fees will no longer be charged. In October 2010, the Central Committee made the "study on how to promote the tax reform of real estate taxes" as part of the reform on financial and tax schemes, which was proposed in the national 12th Five-Year Plan. On 28th Jan 2011, trial reform on real estate tax was launched in Shanghai and Chongqing, which marked the starting point of China's real estate tax reform.

Taxation is never a simple financial issue. In contrast, it involves balancing different stakeholders. In order to decide on the basic tone of the reform on real estate tax, it is important to weigh the functional position of real estate tax and the order of priorities when designing the scheme of real estate tax. These are the essential issues especially under the backgrounds where property prices remain high, the income inequality among residents is worsening, and the system of local taxation yet needs to be improved.

1. The contribution of real estate tax to the tax revenues of a local government in a foreign nation.

Real estate tax are an international category of taxation. By considering the roles of real estate tax in the local tax systems of various nations, no matter federal or unitary nations, real estate tax are stable, continuing and balanced revenues in most of the local governments, and always occupy a large share in the local tax revenues. These account for 100 percent in the United Kingdom and Australia, 50-80 percent in the United States, 69 percent in France, 85 percent in Canada and 32 percent in Japan¹. For example, see Table 1 for the ratio of revenues from various tax categories to tax revenues of governments at different levels:

¹ Jiangang Wang et al, 'How the Property Tax suppresses the Property Price in Foreign Markets', *Reference (Cankao) News* (Beijing), 11 February 2010, 13.

Table 1 the ratio of revenues from various tax categories to tax revenues of governments at different levels

		Income and Profits	Social Security and Salary	Assets	Basic tax	Special Products and Services	Usage	Others
Federal States								
The United States	Federal	91.4	0.0	1.1	0.0	7.5	0.0	0.0
	State	40.1	0.0	2.5	31.3	16.5	9.6	0.0
	Local	5.2	0.0	73.4	10.5	4.6	6.2	0.0
Germany	Federal	37.1	0.0	0.0	34.1	25.9	0.0	3.0
	State	51.3	0.0	5.1	42.4	1.3	0.0	0.0
	Local	78.1	0.0	15.8	5.0	0.5	0.4	0.1
Mexico	Federal	34.3	0.0	0.0	25.3	38.3	0.0	2.0
	State	0.0	63.1	22.5	0.0	4.2	5.7	4.4
	Local	0.0	0.0	89.0	0.0	1.6	0.1	9.0
Unitary States								
Japan	Central	53.5	0.0	5.2	23.0	16.6	0.0	1.8
	Local	48.6	0.0	30.9	7.7	6.5	5.2	1.1
The United Kingdom	Central	49.8	0.0	9.3	24.9	14.2	0.0	1.8
	Local	0.0	0.0	100.0	0.0	0.0	0.0	0.0
Republic of Korea	Central	42.4	0.0	6.4	27.6	21.1	0.0	2.5
	Local	15.4	0.0	45.2	5.4	14.8	6.5	12.7

Sources: statistic database of Chinese National Knowledge Infrastructure (CNKI).

Note: Although the statistical definition of asset taxes of each nation is not exactly identical, real estate taxes are the largest component of asset taxes.

It can be seen from Table 1 that, among federal nations, asset taxes account for 89 percent of Mexican local governments' tax revenues, and 73 percent of tax revenues of local governments of the United States. Among unitary nations, asset taxes account for 100 percent of tax revenues of local governments of the United Kingdom. Also, real estate tax are usually collected and decided by local governments in foreign nations. Therefore even within the same nation, the ratio of real estate tax to the tax revenues of local governments are not all the same.

2. Analysis of the collection of real estate taxes in China

The real estate tax have experienced many changes along with the multiple reforms on the taxation system in China since the establishment of People's Republic of China. The real estate tax have been developing and improving through a tortuous

history, from the time when real estate tax were newly imposed, to the periods when the collection of real estate tax was stalled and resumed again later. Real estate tax' implication, socio-economic roles and functions varies depending on different historical point periods.

In 1950 the Government Administration Council of the Central People's Government issued the "National Guidelines on implementing tax policies" and decided to impose nationwide taxation in 14 tax categories, including real estate tax and land taxes. In 1958 and 1973, real estate tax almost had no implication in Chinese economic life and social life due to the tax reform, of which the leading theme was to simplify the taxation system. After the Third Plenary Session of the 11th Central Committee, the scheme of taxation collection resumed its development comprehensively. Also the collection of real estate tax was also gradually resumed with the gradual establishment of a taxation scheme. In 1984 China implemented national widely the second step of replacement of profits by tax and a broad reform on the industrial-commercial tax scheme. The collection of real estate taxes was resumed, and urban real estate taxes were divided into two tax categories, namely real estate tax and taxes on using urban lands. In September 1986, the Central People's Government enacted *Provisional Regulations of the People's Republic of China on Real Estate Tax*, which provided that the collection of real estate tax are limited to municipalities, counties, designated industrial towns and industrial and mining districts, applicable to domestic companies and individuals. Since then real estate tax started playing their due role. In March 1993, during the first plenary session of the 8th National People's Congress, China proposed to reform the financial and taxation scheme "in compliance with the requirements for establishing a market economics system of socialism", which was the fourth reform on the taxation scheme since the establishment of People's Republic of China. During this reform, China had full arrangements for real estate taxes, but left real estate tax as previous condition. By imposing real estate tax on domestic-funded enterprises and urban real estate taxes on foreign-related enterprises, China has retained the original parallel real estate tax system on both domestic-funded and foreign-related enterprises. In December 2008, the Central People's Government issued its 546th decree, stipulating that "Provisional Regulations on Urban Real Estate Tax" would be abolished since 1st of January 2009, and foreign-invested enterprises, foreign enterprises, organisations and individuals would pay real estate tax in compliance with relevant provisions in *Provisional Regulations on Real Estate Tax of People's Republic of China*. This step enabled mergers between real estate tax on domestic-funded enterprises and foreign-invested enterprises.

Although China's taxation system has been improving gradually, the development of the scheme of real estate tax and their performance are yet to be satisfactory. Real estate tax's financial functionality, especially in terms of fortifying China's local taxation system, has not been effective. See Table 2 for the contribution of real estate tax to the public financial revenues.

Table 2 the ratio of revenues from real estate taxes to local public financial revenues

Unit: 100 millions

Year	Real estate tax	Tax on using urban lands	Total taxation revenues from real estate taxes	Local public financial revenues	The ratios of revenues from real estate tax to local public financial revenues	The ratio of revenues from real estate taxes to local public financial revenues
1994	64.51	34.55	99.06	2311.60	2.79	4.29
1995	87.65	35.85	123.50	2958.58	2.96	4.17
1996	102.18	39.42	141.60	3476.92	2.94	4.07
1997	123.93	43.99	167.92	4424.22	2.80	3.80
1998	159.85	54.21	214.06	4938.95	3.23	4.33
1999	183.53	59.07	242.60	5594.87	3.28	4.34
2000	209.58	64.94	274.52	6406.06	3.27	4.29
2001	228.59	66.18	294.77	7803.30	2.93	3.78
2002	282.40	76.84	359.24	8515.00	3.32	4.22
2003	323.90	91.60	415.50	9849.98	3.29	4.22
2004	366.30	106.20	472.50	11879.75	3.08	3.98
2005	435.90	137.32	573.22	15100.76	2.89	3.80
2006	515.18	176.89	692.07	18303.58	2.81	3.78
2007	575.46	385.49	960.95	23572.62	2.44	4.08
2008	680.34	816.90	1497.24	28649.79	2.37	5.23
2009	803.64	920.97	1724.62	32602.59	2.46	5.29
2010	894.06	1004.01	1898.07	40613.04	2.20	4.67
2011	1102.36	1222.26	2324.62	52547.11	2.10	4.42
2012	1372.49	1541.72	2914.21	61077	2.25	4.77

Sources of data: the data from 1994 to 2011 are from "Tax Year Book of China" (1995-2012) and "Finance Year Book of China" (1995-2012). The data of 2012 is collected and organised from the relevant information on the website of Ministry of Finance of China.

It can be seen from Table 2 that the total taxation revenues from real estate tax has grown rapidly, from 6.451 billion in 1994 to 137.249 billion in 2012, with a yearly growth rate at 26.52% in average. Nevertheless the share of revenues from real estate tax in local public financial revenues has not been increasing, despite of the rising price of housing properties and prosperity of the real estate market. The collection of real estate tax had fallen from a historical peak to a current low, especially since housing properties were privatised in 1998. From 1998 to 2004, revenues from real estate tax accounted for more than 3 percent of local public financial revenues, and were the most important component of revenues from real estate taxes. Since 2005, the share of revenues from real estate tax in local public

financial revenues was below 3 percent. Especially since 2007, the share of revenues from real estate tax declined in both local public financial revenues and real estate tax revenues. This shows that the financial functionality of real estate tax had not been effective. Thus this situation is in contrary to the current development of the real estate market in China as well as the intrinsic financial function of real estate tax.

3. Analysis of the local fiscal functions of real estate tax

From the perspective of public finance, real estate tax has an "intrinsic function" of becoming an important category of local tax. Given the location fixity of real estates, local governments have better understanding of the regional characteristics such as the local property market, the historical development, practical and housing needs, and preferences of public services of local residents in its region than the central government. This arrangement is to grant the local governments rights to collect real estate tax, as well as let them to undertake the responsibility to provide local public goods. The real estate tax will become a major tax category for major local tax revenue, and such arrangement accords to the feature of real estate tax that "benefits correspond to costs". For this reason, despite that the real estate tax regimes in different countries are heterogeneous, they have homogeneity as major tax revenues for local governments granting local governments with more autonomy in taxation. At present, under the backdrop of 'VAT in lieu of BT' in China, localizing real estate tax not only accords with the intrinsic attributes of real estate tax, but also has practical importance in solving the problem of lacking major local tax categories in the current tax-sharing system.

The history of property sales shows that real estate tax has economic basis of becoming an important category of local taxes. Real estate tax revenue sources from the stable housing supply. The measure of the ownerships of properties and its growth rate follows in parallel with the rapidly growing economy of China. The growth of property sales is demonstrated in Table 3.

Table 3 Sales of commodity housing according to purposes of use in 1998-2012

Unit: 10,000 m²

Year	Area of commodity housing sold	Residential	Office Building	Commercial	Others	Proportion of residential properties in commodity housing (%)
1998	12185.30	10827.10	400.60	810.80	146.80	88.85
1999	14556.53	12997.87	403.43	1003.17	152.06	89.29
2000	18637.13	16570.28	436.98	1399.31	230.56	88.91

2001	22411.90	19938.75	502.57	1696.15	274.44	88.96
2002	26808.29	23702.31	538.92	2218.58	348.47	88.41
2003	33717.63	29778.85	630.49	2833.10	475.19	88.32
2004	38231.64	33819.89	692.84	3100.29	618.62	88.46
2005	55486.22	49587.83	1096.23	4081.38	720.78	89.37
2006	61857.07	55422.95	1231.04	4337.79	865.29	89.60
2007	77354.72	70135.88	1465.23	4644.61	1109.01	90.67
2008	65969.83	59280.35	1157.05	4206.06	1326.37	89.86
2009	94755.00	86184.89	1544.43	5328.03	1697.65	90.95
2010	104764.65	93376.60	1889.97	6994.84	2503.24	89.13
2011	109366.75	96528.41	2004.97	7868.65	2964.71	88.26
2012	111304	98468	2254	7759	-	88.47

Sources: Statistics of 1998-2011 are sourced from 'The Year Book of statistics' (2012). Statistics of 2012 are sourced from website of National Bureau of Statistics.

Table 3 show that since the reform of housing regime in 1998, the commodity housing sales in China increased from 121.853 million square meters to 1,113.04 million square meters in 2012, which is 9.13 times of that in 1998 with an average annual growth rate of 17.12 %. The large number of listings serves as a huge reservoir for tax revenues. According to the current real estate tax system in China, real estate tax is mainly levied on corporate properties in the region. Properties owned by natural persons except for those used for trading or leasing purposes are excluded from real estate tax. According to statistics in Table 3, in residential property sales (in area) consistently accounts for over 88% of that of commodity housing. Given the considerable volume of residential properties, however, most of them are not within the scope of real estate tax. Hence, if the application of real estate tax is expanded, the abundant existing housing listings will provide a practical economic basis for making real estate tax a major source tax revenues of local governments.

4. Design of essential elements of real estate tax regime

Amid alarming social-economic conflicts, the public overestimates the ability of real estate tax reform. However, these expectations contradict with each other. This clash of values will translate into difficulties of crystallising real estate tax regulations. The challenge in real estate tax reform is to meet the legal needs of different entities that have been adjusted in the conflicts of various functions in different periods.² Solving this problem requires good assessment of the current social and economic situations. The gradual reform of real estate tax encompasses effective choices among balancing different values and functions, paying attention to the interests of disadvantaged groups, achieving the goal of fair and justice as well as effectively meeting the market needs. The design of essential elements of real estate tax regime should on one hand consider the needs of tax entities from a macro perspective that real estate tax should be collected for a legitimate purpose. On the other hand, it should investigate the affordability and political acceptance of the tax paying entities from a micro perspective. For taxpayers, the tax should be paid for values. The real estate tax reform can only proceed smoothly if the political acceptance of real estate tax is increased. In the current socio-economic situation, the real estate tax reform should exert greater influence in ‘restructuring major tax categories in local tax system’ in order to redress the unbalance fiscal rights between local and central governments, which is caused by lacking major local tax categories after the implementation of ‘VAT in lieu of BT’ policy.

(A) Double expansion of real estate tax on taxpayers and levied targets

According to the relevant provisions in current real estate taxation laws in China, real estate tax payers are basically limited to corporate taxpayers. Only a small amount of natural persons pay real estate tax. The reason is that personal property for non-commercial use is exempt from real estate tax as tax incentives. Personal property holdings are not subject to real estate tax as long as the properties are not leased or used for trade. It is regardless of the nature of properties as whether they are owner-occupied, for investment or speculative. Also, it is regardless of the size of properties or quantity of properties. This leads to the situation where personal property holdings are basically tax-free. Along with the housing reform in China, the real estate market has continued its rapid growth over ten years. As a result of structural change in sales of commodity housing, individual residents have become the major buyers in real estate market. Real estates have become important assets and financial tools for residents. Therefore, the core issue of real estate tax reform is to expand its scope. Firstly, the scope of taxpayers should be expanded. Natural persons should be included to pay real estate tax and bear the same legal obligations as corporate taxpayers. Secondly, the scope of leviable targets should be expanded. Personal properties for non-commercial use should generally be levied, which will

² Edgar Bodenheimer, 郑正来 (译) [Translated by Zheng Zhenglai] 《法理学、法律哲学与法律方法》 [Jurisprudence: The Philosophy and Method of the Law] (中国政法大学出版社 [China University of Political Science and Law Press], 2001), 298.

increase the tax burden on property holdings. Since the expansion of the scope of taxpayers will effect a large number of individual taxpayers giving rise to “infringement” upon personal properties, focus should be given to the legal expectation and recognition of the taxpayers, and the expansion should be implemented gradually. Such detailed measures can be learned from the model of the pilot scheme in Shanghai, where real estate tax is applicable to new properties bought by families already own a property of residence and by families without residency status in the city. Secondly, learning from the Chongqing model, real estate tax should be applicable to houses, luxury properties and investment properties. While ensuring that the housing needs of residents are met on one hand, collecting tax on properties that are bought for investment purposes, in vacancy or exceed the standards, exhibits the balancing function of real estate tax and promotes social fairness. Finally, real estate tax should be applicable to all types of properties, including both incremental properties and stock listings. According to trend in real estate development in China, the current property market is still dominated by the incremental properties. With the decrease of the land recourses and the improvement of the matching of stock listings and the population, stock listings will gradually come to dominance. Only Properties include stock listings reflect the total value of wealth of individual or family. Therefore, applying real estate tax to both stock listings and incremental properties will truly reflect the fair and equitable ethical characteristics of taxation. Of course, this requires a relatively long and gradual process. In addition, housings for domestic, investment and trade purposes should be defined scientifically from an institutional perspective. While properties for domestic purpose should be exempt from tax, tax is applicable to properties that exceed standards regardless of whether they are used for domestic, investment or trading purposes, also regardless of whether they are new housings or stock housings. The public should be guided to reasonably consume properties and urged to make rational decisions in the property trading market. Real estate market can be adjusted through real estate tax resulting in promoting the best use of housing and profit maximization of the land.

(B) Design of tax rate and appropriate discretion of local governments

Given disparities in the nature of property holdings, post-reform real estate tax should adopt proportional tax rates with different amplitude. The general real estate tax rate in developing countries around the world is 1%.³ In the real estate tax pilot scheme in Shanghai, the confirmed tax rate is at 0.4%-0.6%. In the pilot scheme in Chongqing, the confirmed tax rate is 0.5%-1.2%. According to international experience coupled with considerations of the residents’ ability to pay real estate tax in China and the impact of tax rate in the pilot schemes, the proportional tax rates with amplitude of real estate tax are designed as follows: rate for common residential property is 0.5%-1%; the rate can increase by 1.5% to 2% if the property is a house, luxury apartment or vacant property due to the owner has multiple properties. For vacant land that is not developed within the time limit according to regulations, real estate tax is collected at 3% on top of collection of the vacant land levy. Under a

³Stated by Roy Bah and Sally Wallace from Andrew Young School of Political Studies in Georgia State University in the study of property tax in developing countries.

nationwide unified regime of proportional tax rates with amplitude, local government is allowed discretion to adjust the rate according to local economic development conditions, developing goals of property industry, standards of tax evaluation of property as well as supply and demand of public products or a combination of different factors.

(C) Gradual implementation of market-oriented tax calculation

In theory, real estate tax rate should be based on the evaluation of the property. However, due to the constraints on the information of real estate property, evaluation techniques, rating agencies and other aspects, marketization of taxation calculation also requires gradual implementations. In the early stage of real estate tax reform, areas of pilot schemes should be expanded. In the expanded areas of pilot scheme, referring to the Shanghai and Chongqing model, the tax calculation should be based on a certain percentage of the transaction price. By doing that, experiences of the reform, understandings and support of the people can be gained, which leads to improving public acceptance of real estate tax reform. Subsequently, provinces and cities that choose to trial assessment of real estate tax need to summarize their experience in the assessment arrangements, the collection, recording and approval of the data, as well as development of software system for tax assessment. They also need to adopt a tax calculation method based on evaluation, which is providing foundation of evaluation nationwide. When it is the proper time, the evaluation-based tax calculation method can be applied generally across the whole country.

(D) Tax benefits

Real estate tax incentives should have clear indication and operability in order to protect the housing needs of ordinary people. Benefits should be focused on the urban families receiving allowance for minimum living standards, the disabled, urban residents with low-income, rural residents and other disadvantaged groups. Benefits should also be limited to meet people's basic survival needs and existing average housing conditions. In addition, benefit policies should be applicable to the properties used by public utilities that provide public products by exempting schools, public parks and religious entities from real estate tax. Given the dichotomy of urban and rural economies in China, lands used for agricultural production, rural residents' homestead and residence can be exempt from real estate tax. Land used for non-agricultural production in rural areas may be temporarily exempt from real estate tax. Taxes may be collected in the future when conditions are met.

Real estate tax reform is a long and gradual process. Although real estate tax can have some fiscal functions in the local tax system, such functions cannot be fully exercised in the short term. For these functions to be fully exercised requires good design of essential elements in the regime, follow-up of ancillary facilities and social recognition. The tax arrangement and the speed of the reform should be corresponding to a range of factors. These include the original regime such as land letting fees, the rate of income growth of residents, the affordability of taxpayers as well as the general reform of national taxation system and the national level of taxation. In addition, the ultimate goal of reform should be protection of basis human rights of taxpayers, as it is the only way to reduce resistance to reform and gradually perfect the reform of real estate tax

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Influence of Property Tax on Household Consumption - Based on Calculation of Property Tax Burden [☆]

Wei qun XI^{☆☆}

Abstract: Property tax is a crucial part of tax policy, and it also plays an important role in regulating household consumption. In order to objectively evaluate the impact of property tax on household consumption, this paper redefines the statistical measures of residents' burden of property tax, and calculates the property tax burden of Chinese residents using a statistical approach to analyse flow of funds. It is concluded that real estate tax have a certain impact on household asset choice and consumption. Based on this conclusion and the long-term effect of taxation, a series of proposals of establishing a proper property tax scheme are put forward in this paper.

Keywords: Household Consumption; Property Tax; Tax Effect

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1. Introduction

China's economy has advanced remarkably since the implementation of the reform and opening-up policy in 1978, with an average annual growth rate of 9.75%¹. However, a consumption-driven growth scheme has not yet been formed, as China's economic growth is still highly dependent on investment. According to the data of the State Statistical Bureau, the contribution rate of consumption to economic growth was 62.9% from 1978 to 1990, which dropped to 56.6% between 1990 and 2000, then further declined to a record low of 35.79% from 65.1% in the period from 2000 to 2003, before bouncing back to 55.55% in 2011. During the same period, the contribution rate of investment to economic growth increased from 30.3% to 36.1%, then further rose to 63.21%, before falling back to 48.77% in 2011. Although the growth rate of consumption in China showed some positive changes in 2012, the country is still highly investment-driven, and the final consumption rate is still relatively low compared to previous periods. The consumption rate was 62.1% in 1978, 58.1% in 1995, 52.9 % in 2005, 48% in 2009, and 49.08% in 2011. The low final consumption is primarily caused by the long-standing depression of the household consumption rate. The household consumption rate was 48.79% in 1978, and the figure fluctuated around 50% in the 1980s before beginning to decline since 1990s, then dropped to 35.42% in 2011, showing a 14.99% drop compared to 1978. Meanwhile, the government consumption rate, on the other hand, has remained at 13%.

During the same period, the investment rate nevertheless showed a generally upward trend, rising from 38.2% in 1978 to 40.3% in 1995, then further increased from 41.6% in 2005 to 47.7% in 2009, and reached 48.31% in 2011. The function of investment has been further emphasized, especially since the financial crisis, which had a significant strike on net export rate.

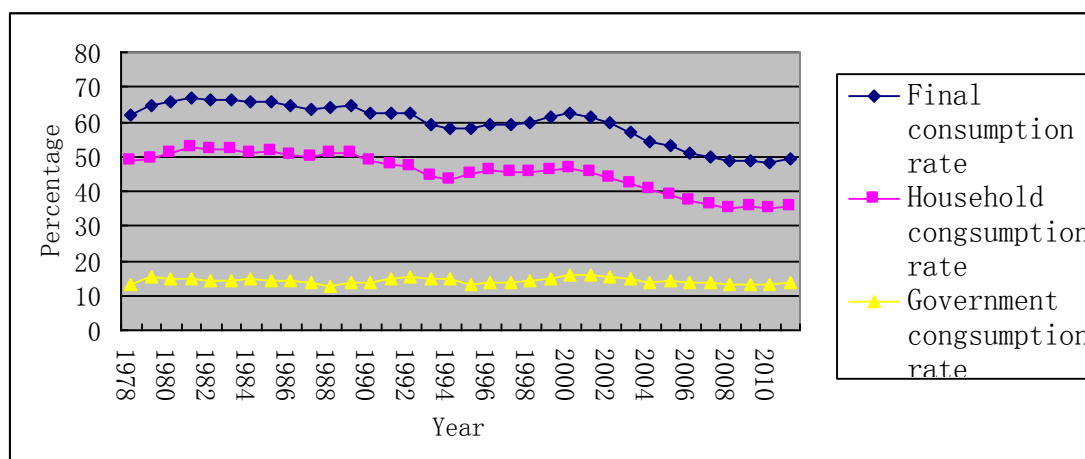


Figure 1 China Consumption Trend

Date sources: China Statistical yearbooks

¹Pei Changhong. Analysis on Direction and Growth Idea of Future Economic Development Economic Perspectives. (2013)2, *Economic Perspectives*, 4-8.

Such consuming patterns, on the one hand, were caused by the lack of stamina of the sustainable development of economic growth, resulting in the increasing dependence of economy on the demand of export and, in particular, investment. On the other hand, this consuming patterns also negated the improvements in Chinese residents' life quality and increases in household consumption level for a long period of time. Therefore, only by establishing investment on effective demand of consumption market could the domestic demand be substantially stimulated. This is the main reason why the "Twelfth Five-Year Plan and the Eighteenth Conference of the Communist Party of China both proposed that the strategy of expanding domestic demand should be adhered to, in order to release the consumption potential of urban and rural household, and improve household consumption rate.

As macro-control tools, flexible and effective tax policy is a powerful measure to stimulate consumer demand, and solve the problem of inadequate consumption and weak economic-growth. Property tax is an important part of the tax policy and plays an important role in the regulation of household consumption. In fact, the policy related to property tax has been adjusted to expand domestic demand in recent years. Some scholars have used different research methods to explore the effects of property tax on the household consumption. Based on data from 1994 to 2010, Xu (2013) made use of co-integration analysis and found out that the impact of real estate transaction income tax (tax on capital gains) on household consumption was insignificant in the short term, but household consumption rate would be reduced by 0.32% in the long-term when the proportion of real estate transaction tax increased 1%. However, the analysis of this policy by Chu and Yan (2012) used a dynamic panel data model reached a different conclusion, that the property tax actually has a promoting effect on consumption. More specifically, Chu and Yan stated that consumer spending would increase by 0.1271% for every 1% increase in the average individual property tax. In addition, some other scholars also believed that property tax affects household consumption, and suggested that real estate tax (property tax) as well as inheritance and gift tax should be levied to adjust income distribution and stimulate the potential of consumption (Tan, 2009; Jia, 2010; Wang 2012).

However, it should be noted that the statistical measure as analysed by Xu (2013), Chu and Yan (2012) of property tax is rather broad because it included building tax, urban land-used tax, farmland conversion tax, vehicle and vessel tax, deed tax and land value-added tax, etc. But the payers of these property tax are primarily enterprises and companies rather than residents², so it is inaccurate to simply use the logarithm to analyse the influence of property tax on household consumption. This paper therefore intends to redefine the statistical measure of residential property tax, and analyse its impact on the household consumption on this basis.

²Building tax was chosen to make test in Shanghai and Chongqing on January 28, 2011, some people beard building tax.

2. The functioning mechanism of property tax on household consumption

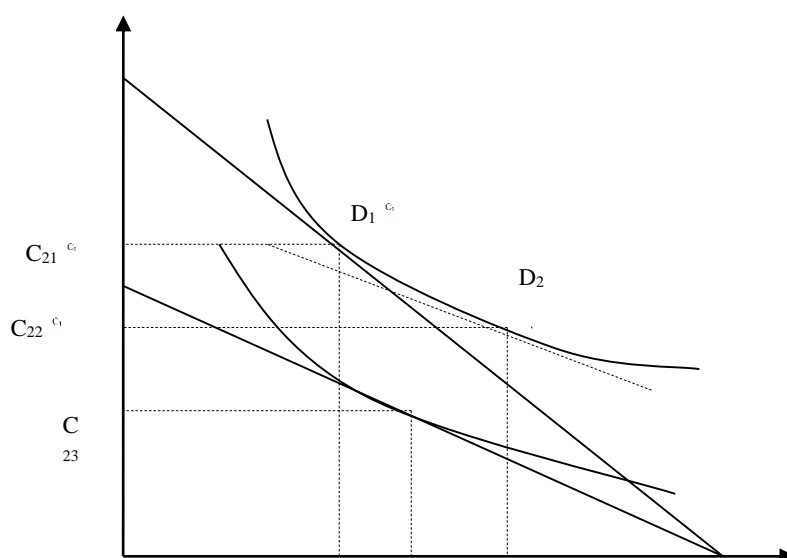
In China, urban residents' consumption accounts for a large proportion of the national household consumption. Therefore, according to the regression analysis regarding urban residents' annual expenditure per capita and their disposable income from 1989 to 2011, disposable income was positively correlated with expenditure, suggesting that when disposable income increased 1 yuan, 0.708253 yuan would be used for consumption, meaning that the marginal propensity to consume was 0.708253³. Therefore, compared to the lifetime consumption theory, Keynes' Absolute Income Hypothesis of Consumption may be more suitable for China's situation.

Based on this premise, assume that household income would only be used for current consumption or saved for future consumption. Under this assumption, after levying real estate tax, the net earnings of property owners would decrease, which would lead to the increasing price of current consumption because of the accumulated property through saving. Rational consumers would increase the current consumption level while reducing savings; consequently, the substitution effect would occur between the purchase of property and current consumption. According to Figure 2, D_1 , which is the equilibrium point before levying property tax, indicates that resident consuming C_1 on goods would be OC_{11} while savings C_2 becomes OC_{21} . After the government levied property tax on the benefits generated by property possessions or transitions, the savings related to current consumption would become more expensive, and the budget line of resident revenue would turn from AB to BD , which would touch the indifference curve U_2 at the point D_3 . At the new equilibrium point D_3 , taxpayers' current consumption and savings would be OC_{13} and OC_{23} respectively. Compared with pre-property tax, current consumption would increase $C_{13}-C_{11}$ whereas savings would reduce $C_{21}-C_{23}$.

However, it is also necessary to note that property tax creates not only a substitution effect but also an income effect. Because of real estate tax, residents increase savings and buy more property in order to prevent the reduction of the governable property. As a result, savings would increase to C_{22} while consumption would increase to C_{12} , therefore, income effect would be $C_{22}-C_{23}$, and substitution effect would be $C_{12}-C_{11}$. The total effect would be $C_{21}-C_{23}$.

³Xi Weiqun. Society Insurance Payable Have Generated "Crowding Out Effect" To Resident Consumption? (2012)2, *Academia Bimestris*, 38-42.

Figure 2 Function mechanism of property tax on household consumption



3. Effect Analysis of property tax on household consumption

Because the Chinese Tax Yearbook shows only taxes by business types not those taxes levied on residents, in the paper we used the data about taxes on "self-employed" business as shown in the Chinese Tax Yearbook and worked out data regarding residential property tax, and business tax and individual income tax relating to property between 2000 and 2011 (see Tables 1 and 2 below).

Table 1 Residential property tax in 2000~2011

Unit: hundred million

Year	Building tax and urban real estate tax ^①	Urban land-used tax	Land valued-added tax	Vehicle and vessel tax ^②	Vehicle purchase tax ^③	Total ^④
2000	9.83	1.86	0.45	12.21	-	24.35
2001	10.04	1.95	0.58	12.76	-	25.33
2002	-	-	-	-	-	-
2003	17.26	3.42	2.01	15.85	-	38.54
2004	21.42	4.03	3.05	16.9	-	45.4
2005	26.68	5.44	4.72	17.38	-	54.22
2006	33.1	7	8.27	23.17	-	71.54
2007	39.15	10.61	13.41	26.5	-	89.67
2008	43.92	18.89	15.83	37.82	838.36	954.85
2009	47.66	22.85	17.3	39.12	848.7	975.63

2010	55.08	24.27	33.42	43.91	1315.92	1472.6
2011	68.84	30.08	57.29	47.53	1529.47	1733.21

Date sources: China tax yearbooks

①From 1 January 2009, urban real estate tax was incorporated into property tax.

②From 1 January 2007, vehicle and vessel license tax was incorporated into vehicle and vessel tax.

③Vehicle purchase tax has been levied since 1 January 2001, but no data before 2008 was included in the yearbooks.

④In addition, there are stamp duties and deed taxes levied in the course of property transactions, but since the yearbooks include no data on these two taxes, tables in this paper do not include stamp duties and deed taxes.

Table 2 Business tax and individual income tax which residential property be referred in 2000~2011^①

Unit: hundred million

Year	Business tax			Individual income tax			Total
	House rent	Transfer land right to use	Sale real estate	Income of property lease	Income of property transfer	Among: Income of building transfer	
2000	-	0.39	3.51	2.02	0.92	-	6.84
2001	-	0.57	4.62	1.98	1.7	-	8.87
2002	-	0.88	6.57	1.94	1.74	-	11.13
2003	1.95	1.03	9.06	2.67	4.28	-	18.99
2004	3.31	1.58	14.43	3.64	5.52	-	28.48
2005	4.67	2.1	28.46	4.27	9.92	-	49.42
2006	7.24	4.06	63.05	5.79	32.97	-	113.11
2007	9.7	6.77	97.96	7.6	72.81	-	194.84
2008	6.43	3.99	96.33	9.61	98.47	-	214.83
2009	10.85	4.57	90.73	11.12	167.26	79.39	284.53
2010	13.55	6.67	155.88	14.17	255.78	79.55	446.05
2011	17.68	7.9	212.53	19.8	464.25	114.85	722.16

Date sources: China Tax Yearbooks

①China's individual income tax includes individuals as well as individual business establishments, partnership businesses, individual industrial and commercial units; as such this table data cannot be interpreted as tax shouldered by the individual, which corresponds with Table 1.

②—means no subsection date in yearbooks.

Firstly, according to the current practice, the calculation method of the property tax burden is property tax divided by residents' disposable income; therefore, the statistical data of residents' disposable income are needed. Because there was no direct data in the China Tax Yearbook, this paper was based on the date in the Yearbook in terms of the Real Trade Flows Funds and calculated resident disposable

income⁴ during 2000 to 2009, as can be seen in the Table 3. The results of this calculating discovered that the proportion of residential real estate tax in residents' disposable income is imperceptible. Even when business tax and personal income tax are added to personal property, the tax bearing rate is still very low. For example, the highest percentage was only 0.63 % in 2008, as can be seen in Table 4. But it must be noted that the ratio of real estate tax accounted for between 0.04% and 0.06% of residents' disposable income from 2000 to 2007, and it soared to 0.51% in 2008. The reason of the increase is that the data of vehicle purchase tax had only been recorded since 2008. Therefore, based on the data above, it is difficult to draw the conclusion that real estate tax have significant influence on household consumption. Furthermore, residents' disposable income can take various forms, such as salary, transferring income, property income, and so forth. Households usually spend most of their income on consumption, and the rest of the income is transformed to residential properties through saving. Therefore, the residential tax burden is not accurately revealed by simply dividing residential property tax by disposable income. Instead, it is only accurate if the residential tax burden equals the property tax divided by property value.

Table 3 Residents' Proportion of primary distribution and redistribution in flow of funds table⁵

Year	Primary distribution			Redistribution		
	General income of primary distribution(hundred million yuan)	Among: Resident's income(hundred million yuan)	Portion (%)	Disposable income(hundred million yuan)	Among: Resident's disposable income(hundred million yuan)	Portion (%)
1992	26651.84	18307.94	68.69	26707.04	18488.73	69.23
1993	34560.49	23412.15	67.74	34765.18	23557.96	67.76
1994	46670.13	31586.51	67.68	47087.41	31453.31	66.80
1995	57494.88	39526.44	68.75	57814.7	39277.75	67.94

⁴ There have only date during 1992~2009 in real trade flows of funds table of China statistical yearbook

⁵ The paper did not take into account the inter-department usualness transfer at home and abroad to analyzing effect of taxation on household consumption. Therefore, that is regarded as general redistribution income be equal to general income of primary distribution, and it have tiny difference than flow of fund table.

1996	66850.57	44946.63	67.23	67028.4	46442.9	69.29
1997	73142.02	48061.36	65.71	73568.0	50121.3	68.13
1998	76967.31	50495.15	65.61	77321.8	52688.6	68.14
1999	80579.22	52360.74	64.98	80988.5	54354.0	67.11
2000	88288.62	52826.77	59.83	98000.5	65811.0	67.15
2001	95726.93	60814.03	63.53	108771.1	71865.3	66.07
2002	103936.03	67844.99	65.28	119095.7	76801.6	64.49
2003	116741.97	73780.81	63.20	136421.2	87268.4	63.97
2004	159587.11	92045.56	57.68	159453.6	97489.7	61.14
2005	184088.66	109698.09	59.59	183617.4	112517.1	61.28
2006	215904.4	131114.9	60.73	218141.8	131426.4	60.25
2007	266422.0	158805.3	59.61	269243.2	158558.6	58.89
2008	316030.3	185395.4	58.66	319027.5	185926.3	58.28
2009	340320.0	206544.0	60.69	340320.0	206544.0	60.69

Date sources: China tax yearbooks in 1993~2010

Table 4 Ratio of tax related to resident's property account for disposable income in 2000 - 2009

Unit:%

Year	Property tax ÷ disposable income	Business tax and individual income tax ÷ disposable income	Total
2000	0.04	0.01	0.05
2001	0.04	0.01	0.05
2002	-	0.01	-
2003	0.04	0.02	0.07
2004	0.05	0.03	0.08
2005	0.05	0.04	0.09
2006	0.05	0.09	0.14
2007	0.06	0.12	0.18
2008	0.51	0.12	0.63
2009	0.47	0.14	0.61

Because the China Statistical Yearbook does not include the data of household property value either, this paper analysed the data of financial transaction flow of funds in the statistical Yearbook in order to ascertain household property value. During the period of 2000 to 2009, China's household wealth included deposits, bonds, stocks, and fixed asset formation. The proportion of fixed asset (property, vehicles) accounted for more than one third of the total resident wealth, and the figure was at its lowest at 34% in 2008, and highest at 54% in 2005 (see Figure 2). Table 1 and Table 2 reflect the taxes that are relevant to residents' property and vehicles, so the accurate property tax burden should be property tax divided by resident total fixed assets (see Table 5).

Figure 3 The Formation of Resident wealth, 2000~2009

Data sources: China tax yearbooks in 2001~2010

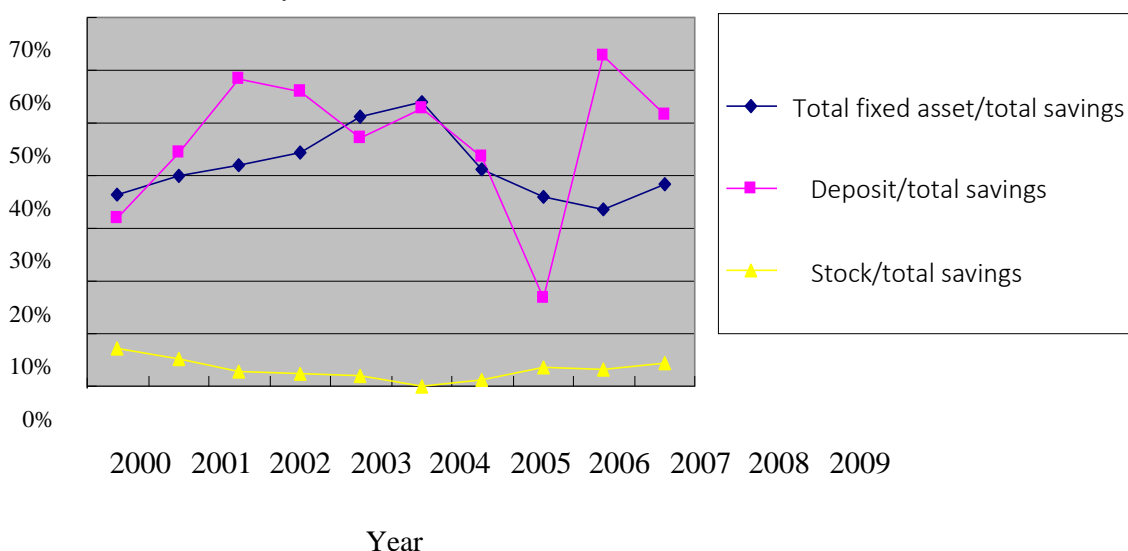
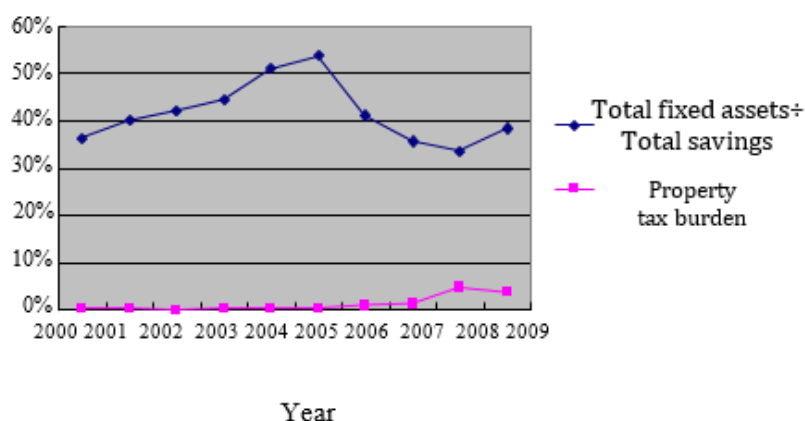


Table 5 Residents' property tax burden

Year	General fixed capital formation (hundred million yuan)	Property tax/ general fixed capital formation (%)	Business tax and individual income tax/ general fixed capital formation (%)	Total (%)
2000	7493.4	0.33	0.09	0.42
2001	9015.3	0.28	0.1	0.38
2002	10264.3	-	0.11	-
2003	13189.3	0.29	0.14	0.43
2004	17021.4	0.27	0.17	0.44
2005	21504.6	0.25	0.23	0.48
2006	20117.4	0.36	0.56	0.92
2007	22280.1	0.4	0.87	1.27
2008	24918.4	3.83	0.86	4.69
2009	32039.8	3.05	0.89	3.94

According to the data in Table 5, we find that residents' real estate tax burden was no longer imperceptible. Although the overall tax burden (including business tax and individual income tax) was still low, (specifically, the highest point was 4.69% in 2008), the tax burden increased five to six times compared with the data in the Table 4, which would certainly create an effect on households. As shown in Figure 3, the tendency of the property tax burden was the opposite of that of total fixed assets. Since 2007, the proportion of residents' fixed assets have declined, and the ratio of general fixed assets to general savings reached its lowest point at 54% in 2008; whereas the amount of savings represented a significantly growth⁶. Correspondingly, the property tax burden increased significantly in 2007 and peaked in 2008, but then fell in 2009 due to the adjustment of tax policy. On the contrary, the ratio of general resident fixed assets to general savings increased

Figure 4 Residents' property tax burden and ratio of fixed assets in 2000~2009

⁶ The interest income tax was levied on saving deposits at 5% from 15 August 2007. However, from 9 October 2008, the interest income tax was exempted, which stimulated increases in saving deposits and thus has a short-term effect on wealth accumulation.

To conclude, although it is difficult to do a regression analysis for want of sufficient statistic data, the analysis above indicates that real estate tax do have some effects on residents' choices of household wealth. However, the exact degree of the impact is unclear. When property tax increases, people are less likely to purchase property and vehicles, and vice versa. With the change of disposable income used for accumulating, consumption behaviours are also changed. When people scrape together money for property purchase, current consumption would be largely restrained.

4. Suggestions

The most important asset for ordinary people is real estate, followed by savings, and stock is only minor. Therefore, real estate should be emphasized during the process of constructing property tax. While the government has launched a number of tax policies to stimulate consumption in recent years, including the reduction of 5% and 7.5% of vehicle purchase tax on the purchase of small displacement passenger car, and the preferential policy on stamp tax, deed tax and land valued-added tax in order to encourage property purchase,, these policies can only affect the market in a short period, and lack long-term effects. Taking vehicle purchase tax for an example, the preferential tax rate for passenger vehicles with a 1.6 litre capacity and below changed three times in three years. In 2009 it was 5%, increasing to 7.5% in 2010, but the overall tax was then returned to 10% in 2011. These changes in tax policy led to severe fluctuation on the numbers of the sale of 1.6 litre and below passenger cars. The number of 1.6 litre and below passenger cars sold was 4.2 million in 2008, accounting for 62.19% of the total sales of passenger cars. This figure soared 71.2% to 7.2 million in 2009, accounting for 70% of all; then it was 9.46 million in 2010, accounting for 69% of the total: the growth rate dropping to 31.48%. After that, the total sales were 9.85 million in 2011 with a growth rate of only 4.06%, and the market share dropped to 68%⁷. Considering the new "Five Rules" issued by the State Council as another example, individual housing transferring income has been restricted by the levying of a personal income tax of 20%. These rules actually reiterates individual income tax should not be levied on 1% of the assessed property price; rather, the individual income tax should be levied at 20% of the proceeds from the transfer. Yet this policy still unexpectedly caused a mass reaction in the market. Consequently, with the exception of Beijing, none of other cities issued the regulations for the implementation of the "Five Rules", exposing the short-sightedness of levying tax policy. Therefore, if we want property tax to have a long-term influence on household consumption, the policy should be reconstructed.

4.1 Reform real estate tax to increase holding cost of house property

The procedure of reforming real estate tax duty was detailed in the conference of the Third Session of the 16th Congress held in the end of the 2003. The conference announced the "Decisions on the Improvement of the System of Market Economy by CPC Central Committee". The announcement emphasised that urban construction taxes and charges should be reformed, and that standardized property tax should be

⁷ Date source: China automobile industry yearbook in 2009~2012.

levied on real estate uniformly. After that, some cities were chosen by the government to implement idling test on property tax levying, yet because the reform was too intensive, the reform was adjusted after a few years to levy property tax on individual owners and transformed into a pilot program in two different cities -- Shanghai and Chongqing. However, after a period of time, the public generally believed that the effect of the pilot property tax on the real estate market was limited. In other words, the property tax had no obvious effect on adjusting the market prices of housing.

Theoretically, the first step to achieve the goal is to position the tax policy on a functional orientation while promoting real estate tax. The functions of the real estate tax can be theoretically summarized as raising fiscal revenue, adjusting wealth distribution, optimizing resources allocation, and realizing economic macro-control, and so forth. From current research, there is a lack of scholarly consensus on this matter, generating some controversy. This paper insists that orientation of the real estate tax should be adjusted accordingly to the different stages of development. In the short term, the real estate tax reform in China should be guided by residents' ability to pay, in which the function of tax should be positioned so as "to play a regulatory role". This means that the goal would be determined by the regulation of income distribution with the consideration of the conservancy of land resources conservancy and the guidance of local governments' operations. In the long-term, the real estate tax should be levied based on the benefit theory, and the tax function would be positioned as "the main tax category of local governments". Improvements will be made to the local tax systems for the primary purpose of raising fiscal revenue for the local governments and meanwhile regulating local income distribution.

The real estate tax reform in China should therefore be carried out step by step, to reform the system gradually, and realise fairness and efficiency by designing reasonable real estate tax scheme. In the short term, we should primarily focus on perfecting and promoting the building tax, making amendment based on Shanghai and Chongqing program, then select some typical cities to carry out a pilot program, before launching the program on a national level. In the medium and long term, we should re-establish the real estate tax scheme, incorporating the building tax and urban land usage tax into the real estate tax, reforming the land value increment tax, and merging and adjusting the stamp tax and deed tax.

At the same time, we should stabilize the tax policy regarding the business and individual income tax in real estate transaction, in order to reduce the impact of policy changes on people's consumption behaviours.

4.2 Imposing inheritance and gift tax to reduce saving and stimulate consumption

With the development of China's economy, the number of privately owned properties is consistently increasing, and people are calling for the imposition of inheritance and gift tax. But there are two primary problems about levying inheritance and gift tax in China. Firstly, taxpayers would hesitate or even resent accepting such a tax. Secondly, the personal disposable income of the majority of residents is still relatively low judging from the current income level, and inheritance tax is only payable by a few people, while the cost of collection is expected to be

high due to the imperfect system and limited administration ability. Therefore, such a policy might result in low tax revenue and high collection cost. Based on the above mentioned reasons and the prime purpose of collecting such taxes, that is, to improve the tax system in China, the inheritance tax scheme should be levied on the principles of fairness, distinction and convenience without too much emphasis on income. Likewise, the gift tax scheme should emphasize cooperation rather than income. These taxes are imposed in order to reduce high incomers' inclination to accumulate wealth, reduce the gap between the rich and poor, and increase overall consumption level. Currently, we should be focusing on the preparation job of collecting inheritance tax, such as establishing and perfecting citizen's death reporting system, personal income declaration, personal property registration system, assessment system, as well as personal property notarization system and related legal regulations, to create necessary condition for the collection of the inheritance and gift tax.

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The Practical Choice for Real Property Tax Reform

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Abstract: Defining the functions of real property tax (“RPT”), levying RPT fairly, and legislating RPT democratically are the three core issues of the current RPT reform, which are addressed in this paper. Firstly, even when granted the capacity, RPT cannot solely fulfil the function of controlling the real property market. With regard to the second issue, abolishing the tax exemption for personal non-commercial housing coincides with the principle of tax equity. Tax equity is enhanced by considering the size of residential area in addition to current value assessment when calculating tax payable. Finally, pilot programs of real property reform within the present tax legislation do not violate the principle of legality. The desire to realize the “ideal type” of such principle in theory cannot outweigh the necessity of those pilots.

Key words: Real Property Tax; Tax Control; Tax Fairness; Legislative Taxation

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Recent RPT reform, namely expanding RPT with respect to residential housing, involves interest game between different interest groups as well as the macro-control by the State over the real property market, and even influences the process of legalizing taxation in China. Hence, not only do the public and the press follow this reform closely, but academics in taxation and tax law also express their opinions and suggestions. Though there are diverse and sometimes contrary ideas about real property reform, they all boil down to three issues: defining the functions of RPT, levying RPT fairly, and legislating RPT democratically. These are the core issues at the centre of most controversy. Therefore, substantial discussion of these three issues is necessary for improving the RPT reform before this reform is implemented.

1. Defining the Functions of RPT

Currently, as in the past, tax has an inherent function as a tool to raise revenue. However, in modern times, the notion of tax neutrality—the essential idea that tax ought not to affect how the economy operates—has changed. With the rise of governmental intervention in the market, tax has developed other functions. *The Fiscal Code of Germany*, for example, has an explicit provision that the raising of revenue may be a secondary objective.¹ In theory, tax is divided into revenue tax and regulation tax. Correspondently, tax law is also divided into revenue tax law and regulation tax law. The regulatory function decides that tax law has always been recognized as one type of economic law.

The function of RPT also relates to the raising of revenue and controlling the market. However, scholars have different understandings of the function of RPT. There is no denying that RPT helps raise revenue as one category of tax, however there is no academic consensus as to whether increasing revenue by expanding the application of RPT should be the main motivation of this reform and the relationship between such expansion and the decrease of related levies.² These discussions have their theoretical and practical significance, however it is unlikely that they will affect the implementation of RPT reform. Firstly, regardless of whether raising revenue is the main or secondary motivation of RPT reform, it will have a certain influence over revenue actually raised, as well as over the real property market. In other words, there is no necessary correlation between the subjective motivation and the objective influence: they are not the same matter. Secondly, the expansion of RPT will enhance the function of raising revenue. However, it does not necessarily mean that other taxes and fees related to real property will definitely decrease, or should decrease simultaneously. There are some academics who expect the RPT reform can integrate various taxes and fees. Taxes such as land use fees, land capital gain tax, urban land use tax, stamp duty, deed tax, and business tax can be reduced to some extent or even removed. Obviously, such expectation no longer attempts to define the functions of RPT, but instead tries to optimise the real real estate tax and fees regime. Following this argument, RPT reform should also consider the optimisation of the national tax system as a whole, as the RPT exists within this system. If so, the reform of one single category of tax will need substantial knowledge and resources, and may

¹ *Abgabenordnung* (Fiscal Code) [Germany] §3

² 徐阳安[Xu Yang'an], 《房地产税制改革的立法考量》[Legislative Consideration for Real Property Tax Reform] (2011) 4, 税务研究 *Taxation Research*.

eventually be indefinitely delayed due to the broad range of seemingly endless discussions. The importance of optimising the tax system cannot be ignored, but such discussion does not have a compelling connection with the issue of defining RPT's functions. In other words, the implementation of RPT reform will not exclude later discussion of this topic. Similarly, the proposition that restructuring the state revenue-sharing system and other related systems as the prerequisite to RPT reform is also questionable.³

Regulating the function of RPT has been most controversial in the discussion of RPT reform. Scholars favouring this reform generally recognize the regulation function believed to be the main purpose of the reform. Expansion of RPT will increase the cost to hold real properties, which in turn will curb enthusiasm for investment housing and eventually affect the total demand on the real property market, fulfilling the goal to cool down the market. However, academics opposing the reform either do not agree that RPT has an inherently regulating function, or emphasise the complexity of factors determining the trend in the real property market and neglect the realistic possibility of regulating the market via RPT.⁴ Regarding the first supposition, the regulating function cannot be denied as long as tax has an objective influence on how people operate in their social and economic lives. In a sense, the regulating function is the source of the objective influence that tax has over taxpayer transactions and arrangements. In other words, tax has the attribute of being regulatory by nature. On the assumption that taxpayers have every freedom in their social and economic life, any tiny variation in tax will stimulate taxpayer to respond with rational decisions to maximize personal interest. Among these, some decisions meet the expectation of tax legislator, while some do not. The regulating function reflects the correlation between the objective regulatory nature of RPT and the subjective expectation of the legislator. It is a feature of the regulating function that the subjective and the objective are intertwined. Such a feature means different classes of tax will not necessarily be deprived of the regulating function simply because they are categorised as one specific kind of tax according to some theories. Thus, to deny the regulating function of RPT is to deny the objective influence of RPT on the market. However, the objective influence of a particular RPT regime over the real property market is in reality quite observable. For example, it cannot be said that the provision about exemption of personal non-commercial housing in *Temporary Regulations on Real Property Tax* has no impact whatsoever on the investment choices made by taxpayers between commercial and non-commercial housing.

The inherent regulating function possessed by RPT is not equivalent to realising the expectation of regulating the market in real life, and the extent to which the expectation is realized. Therefore, these should be treated separately. Whether the goal of controlling the market will be met ultimately is decided by various factors.⁵ In modern society, economic, social, political and cultural elements correlate more

³ 陈小安 [Chen Xiaolan], 《房产税的功能、作用与制度设计框架》 [Real Property Tax's Functions, Roles and Framework] (2011) 4, 税务研究 *Taxation Research*.

⁴ 熊伟 [Xiong Wei], 《房地产税改革的法律逻辑》 [Real Property Tax Reform's legal logics] (2011) 4, 税务研究 *Taxation Research*.

⁵ 夏商末 [Xia Shangmo], 《房产税：能够调节收入分配不公和抑制房价上涨吗》 [Will Real Property Tax adjust unfair income distribution and rein in housing price] (2011) 4, 税务研究 *Taxation Research*.

closely and grow in complexity. Most of the time, they intertwine when affecting everyday transactions and economic activities. In terms of causation, it is difficult to discern a clear one-cause-for-one-effect relation in decision-making, but rather multicausal-multieffect complex relations. In this context, realising the control effect will not rely on RPT reform alone. A multi-faceted approach is desirable in the process of regulating real property market. Consequently, the ultimate effect decided by multi-causes to deny the regulating function of RPT should not be used, nor should the possibility that RPT reform can serve the purpose of regulating the market by being one of a multi-pronged approach be neglected.

2. Levying RPT Fairly

Levying RPT fairly is a compulsory requirement, and reflection, of the principle of tax equity. It has been generally agreed that tax equity is measured by taxpayers' actual affordability in achieving horizontal and vertical equity. Horizontal equity proposes that taxpayers of equal affordability should bear equal amount of tax, while vertical equity refers to the notion that taxpayers of different affordability should be taxed to a different amount. Tax equity requires the cooperation of the three branches of government: the legislature, the judiciary and the executive. As far as the legislature is concerned, the principle of tax equity requires various structural elements of the tax system to treat taxpayers' affordability equitably from the very beginning. The legislature's concern in equitably reforming the RPT emphasises the expansion of the application of the RPT and choices of tax basis after this expansion.

A large number of scholars disagree regarding the expansion of RPT to personal noncommercial housing. However, when viewed through the lens of fairly levying the RPT, it is not difficult to find that the provision on the exemption of such housing in the *Temporary Regulations on Real Property Tax* is against the principle of tax equity. This is because the idea of exemptibility is not the same as non-taxability, which is distinct from the former in terms of taxability. Exemptibility refers to the principle that some tax objects are exempted out of policy consideration: for example, the prizes received by individuals as provincial scientific, educational, cultural and health awards are exempt from individual income tax⁶. On the contrary, non-taxability relates to objects that do not have taxability: for example, the living expenses of RMB 3,500 that are deducted when calculating the income taxable. Those expenses are not possibly taxable as a part of the individual income, and a certain standard deduction is applied in all countries' individual income tax law. The distinction between exemptibility and non-taxability indicates that tax objects are exempted by tax law for the purpose of regulating and controlling transactions and activities at the expense of tax equity. If tested by the principle of tax equity, the exemption provision concerning non-commercial properties actually treats commercial and non-commercial properties inequitably differently. Unless it can be established that the policy considerations for the exemption of non-commercial housing still exist today after the *Temporary Regulations on Real Property Tax* have been enacted for over twenty years, there are simply insufficient reasons to suggest that the reform has violated the principle of tax equity because it has abolished the

⁶ 《中华人民共和国个人所得税法》 [Individual Income Tax Law of People's Republic of China] (People's Republic of China) National People's Congress, 10 September 1980. Art.4

exemption. It remains, however, that the privatization of housing had commenced shortly before the enactment of the *Temporary Regulations on Real Property Tax*, and the exemption exists to guarantee that the residential housing market remains free from intervention. After twenty years, and in a climate where the demand for investment housing is rising to the point that the healthy development of the real property market is impaired, it is questionable whether there is any justification for maintaining the exemption provision infringing on tax equity.

In the expansion of RPT's application, the tax equity principle also has requirements for tax bases, namely which tax basis can fulfil tax equity to the largest extent. A large variety of options have been suggested, including property size⁷, purchase price (which has already been used in the pilot programs of RPT reform in Chongqing and Shanghai), and current assessed value.⁸ The choice of tax basis is a technical issue. The final choice on the tax basis for the RPT is the implementation of the tax law principles and policy considerations contemplated in the design of RPT. In this sense, RPT's tax basis ought to consider the balance between the objective attributes of real property and the measurement of taxpayers' affordability. The tax basis should be determined by combining the property size and currently assessed value. On one hand, a property's ultimate value in use is to provide accommodation. A minimum size is required by everybody to meet his or her basic living requirement, no matter how much a property's exchange value can be. Therefore, basic living requirements are inelastic, which is also within the scope of fundamental living security. From position that no tax should be levied against fundamental living security, the residential area that meets such requirement is not taxable and should be deducted when calculating RPT, regardless its economic value. On the other hand, it should be noted that the measuring standard of taxpayers' affordability tends to be monetised. It is, however, possible to measure taxpayers' affordability by the economic value of all kinds of resources held by them. Thus, the remaining part following the subtraction of the basic living area should be taxed on the basis of its economic value. Considering the durability of real property, its economic value will vary over the time. Therefore, the assessed present value, rather than the original purchase price, should be used.

It is worth noticing that when deciding the tax basis on the ground of tax equity, all real properties owned by a taxpayer, apart from the necessary living area, are subject to RPT on their present value, no matter whether they are stock housing or newly-constructed, or whether the taxpayer owns one or more houses. This means that the RPT achieves a fair levy among taxpayers. As a matter of course, a deduction more than the sum of two single people's basic living areas may be applied to married couples, given that familial life needs more space. This bypasses the potential of worrying that people will fake divorces for the sake of avoiding RPT. Furthermore, considering that there is no positive correlation between a property's basic living function and economic value, and that taxpayers have the freedom to use their

⁷ 周文 [Zhou Wen], 《专家：房产税可按面积实行等级征税》 [Experts: Real Property Tax May Be Taxed on the Basis of the Classification of Property Size], <http://news.hexun.com/2010-06-02/123865425.html>.

⁸ 《税总官员称房产税将扩大试点，相关制度全国实施》 [Officials at State Tax Bureau Claim that Real Property Tax Will Pilots Will Be Expanded to the Whole State], http://news.xinhuanet.com/house/2012-09/22/c_123747820.htm.

properties as they like, a deduction of basic living area may be applied against the property with the highest value assessed if a taxpayer has more than one property.

3. Legislating RPT Democratically

Democratic legislation of RPT is the core issue receiving most attention from the tax law community. Tax law academics generally connect the democratic legislation issue of RPT with the principle of legality and further substitute the question of democratic legislation of RPT with the question of whether RPT reform is in line with the principle of legality. The maxim “no taxation without representation” has been cited to simplify the democratic legislation of RPT reform issue into the notion that the reform must take the form of legislation by the NPR because it fulfils the principle of legality. Otherwise RPT reform lacks democratic legitimacy. Such an argument can be found in the criticisms of the legitimacy of the pilot programs in Shanghai and Chongqing.⁹

There is no doubt that the principle of legality is one of the fundamental principles in contemporary tax law. It is a longstanding accomplishment, achieved through the development of democracy and the rule of law following the Bourgeois Revolution in the eighteenth century. It is universally recognized in the tax law community that the principle of legality incorporates the idea that taxation elements must be legislated by law in express and unambiguous words, and that tax must be collected through legal process. Representative institutions (like the National Peoples’ Congress in China) must legislate taxation elements via legislation. The extreme variation of this theory excludes the possibility of delegating the power of making laws with respect to taxation by the NPC to other State organs.¹⁰ However, with the increasing complexity of social and economic life and its growing relevance to taxation activities, tax law has gradually specialised, which makes it impossible for representative institutions to entirely legislate tax law. In addition, the introduction of uncertain legal terms into the language of tax law in order to prevent tax evasion also jeopardies its certainty. Consequently, not only does tax legislation demonstrate the trend of delegation of legislative powers, but tax and judicial authorities also have an increasingly significant role in the development of democracy and rule of law with respect to taxation. In essence, the intrinsic requirement of the principle of legality is to place the power to levy taxes under the control of people. In early modern society, the principle of legality was reflected only by legislating procedures to ensure democracy and rule of law. A result of the complexity of contemporary economic life is that pure legislating procedures will no longer suffice; instead, the collaboration of the legislature, judiciary and executive is required. That is, the principle of legality is not a static and rigid doctrine that has a universal application. As long as the powers belong to the people, it is an evolving and adapting doctrine.

⁹ 《法律专家称沪渝试点房产税存合法性不足问题》 [Experts Claim That Real Property Tax Pilot Programs in Shanghai and Chongqing Lack Legitimacy], <http://news.sina.com.cn/c/2011-02-13/035521945340.shtml>.

¹⁰ 王鸿貌 [Wang Hongmao], 《税收法定原则之再研究》 [Restudy of the Principle of Legality in Tax] (2004) 3, 法学评论 *Law Review*

There are both positive and negative opinions regarding whether taxation activities now have established the principle of legality.¹¹ Interestingly, among scholars opposing the RPT reform there are those holding positive as well as negative opinions as to the establishment of this principle.¹² Apparently, they overlook the legislative system established by the Constitution and the *Legislation Law of the People's Republic of China* (“*Legislation Law*”) and the regulative characteristics of the reform. The *Legislation Law*, reflective of the legislative directions given by the NPC, underpins the principle of legality in the legislative process, as required by the Constitution, by providing that the basic systems of finance and taxation shall be governed by law only. Yet the *Legislation Law* has not gone to the extreme, rather providing that the NPC or its Standing Committee may authorize the State Council to formulate administrative regulations according to actual need of tax reform, subject to the ultimate supervision of the legislature in accordance with the Constitution and *Legislation Law*. It can be concluded that neither the contestation that the principle of legality has not been established in taxation activities in China, nor the dogmatic opinion that taxation shall be regulated only in the form of law, should be adopted. RPT reform pilot programs are conducted within the tax legislative system. Furthermore, ongoing reform pilots concerning resources tax and business tax are also following the principle of legality.

In conclusion, the principle of legality exists to guarantee democracy and rule of law in taxation. However, the way by which these goals are achieved is not fixed. Though the taxation legislative system is not set in stone, and the application of the principle to every step of rule of tax law is quite comprehensive, it is worth noting that the urgency and necessity to implement RPT reform are realistic at this special time of systematic transition and the development of democracy and rule of law. In theory, we are in pursuit of the ideal that taxation shall only be governed by law, while in practice this is not an adequate reason to impede RPT reform.

4. The Practical Choice for RPT Reform

The reformed RPT will inevitably help raise revenue and regulate the market, but whether the reform will reconcile existing taxes and fees or achieve the targeted regulatory results should not be used to suspend or delay RPT reform. Furthermore, there is no so-called legitimacy crisis involving pilot programs violating the principle of legality. An idealised type of such a principle should not hinder the reform process. Therefore, the real choice confronted by the reform is how to design a set of tax bases which not only provide the living spaces required, but also levy RPT fairly. This paper recommends that the basis for calculating the RPT for all taxpayers be

¹¹ Positive opinions see, 刘剑文, 熊伟 [Liu Jianwen, Xiong Wei], 《税法基础理论》 [Basic Theories of Tax Law] (北京大学出版社 [Peking University Press], 2004), 108-109; Negative opinions see, 李刚, 周俊琪 [Li Gang, Zhou Junqi], 《从法解释的角度看我国<宪法>第56条与税收法定主义——与刘剑文、熊伟二学者商榷》 [Article 56 of the Constitution and the Principle of Legality from the Perspective of Legislative Interpretation – discussion with Liu Jianwen and Xiong Wei] (2006) 9, 税务研究 *Taxation Research*.

¹² 熊伟 [Xiong Wei] ed, 《税法解释与判例评注》 [Tax Law Interpretation and Case Commentaries] (法律出版社 [Law Press China], 2011) Vol. 2, 20-27.

the present value assessed of the total areas of all properties after deducting the basic living areas.

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China and the Coming of the Property Tax

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Life is full of daily rituals - be it going onto Facebook, the first thing each morning - which I ceased doing in December, 2010, after viewing 'The Social Network' (hey, it's nice to discover that I am anti-social – and like it!); or going into the kitchen to retrieve that freshly brewed cup of coffee that the night before was automatically set to the time you would be getting up; or reading Google news' daily accumulation of Asia-based tax articles, which it seems I've been doing forever and ever and ever - and will likely continue as ritual as long as I live. From Google, I venture on to 7-10 daily newspapers which provide the bulk of information from which I extract various and sundry items that I eventually weave into either a Tax Analysts or Tax India International article. I'm honoured to be asked to take some of my writings and expand upon them for the international tax conference this December.

The 'real world' of news that I read starts with the China Daily. No, China Daily is by no means the best source for news about what is going on in the world but it is by far the best choice if you want to find out in English what the government wants you to know, be it official pronouncements or the so-called 'trial balloon' (i.e.: 'run it up the flagpole and see who salutes' variety - this was once known as 'Let 100 flowers bloom', in China and those who volunteered their flowers got their political stems cut off, fast!). Obviously, tax articles attract most of my attention....and after 11 years writing the Asian Tax Review, the daily research, followed by writing, has become a satisfying incurable addiction!

Are there 'run it up the flagpole' articles about taxation? Plenty, if you consider the fact that it is going to cost a small fortune to finance the government's urbanization goals. The problem the government seems to be discovering is that no one has quite figured out how it will be funded. Thus, the number two banner headline on page 1 of the July 15 China Daily, "Local governments face financing woes", was one that was worth my interest and it turned out to be one containing some surprising, in-depth statistics as well as some political commentary about how divisive an area this just might be within the country's confines of power.

Some statistics: year-on-year fiscal revenue growth for China was 24.8 percent for 2011 (over 2010). For 2012, growth rate took a very drastic drop to 12.7 percent. For the first five months of 2013? 6.7 percent.

Now, now, there are many of you, readers out there, located in jurisdictions where recession-like (depression-like, too) percentages make you ask why anyone is fretting about 6.7 percent year on growth for the first five months of 2013 but remember, so much of China's population lives in rural poverty that it was easy to forget about this population segment and the harsh statistics showing that their year-on-year growth percentage is definitely lower and while final amounts have not been published, might actually be showing an economic decline. To try to reduce rural dwellers, bring them from the countryside to the city, making them urban dwellers

is current policy: 'Likenomics', given that name because of Premier Li Keqiang, who is, for all intents and purposes, the current economic czar. One other year-on-year/five month 2013 number re-affirms urbanization policy: while the country's growth was but 6.7 percent through the end of May, urban year-on-year growth through May, 2013 was 13.4 percent.

But why is urban fiscal growth twice that of rural China (if not more - I do not have the raw, statistical data available but my gut reaction is that I will be able to find the statistics to support that urban growth is more than twice that of rural China)? Land sales - primarily - that's why! According to China Daily, revenues from selling land during the first half of 2013 went up by 60 percent, to 1.13 trillion RMB. How does this impact the entire socio-economic strata of those living in the cities? And what happens when the cities run out of land to sell?

The cities have to put their urban dwellers to work. There might no longer be SOEs, the danwei and the iron rice bowl to cover the costs of people's lives and one result has been local investment in industry providing mass local hire. The plight of China's cities is exacerbated by the fact that over the years, cities of China have heavily invested in industries geared to outside demand which is no longer there. As a result, there is either overcapacity of unsold production or current cessation of business activity, causing both over-demand for current local social insurance resources and, perhaps, more importantly, a drop in tax revenues (which supports the social welfare system) because of the disappearance of the export market. Hey, what do you expect: you earn less, you pay less tax and obviously there is less for government to spend.....only governments have not stopped spending? Are government-owned companies in China 'too big to fail'? Are cities, themselves, too big to fail? The cities are pressuring the central government to bail them out - again. Will it happen? Probably - but I'd wager that it will be a 'selective' bail out - there'll be some failures in China.....enough for many who will feel the pain while the others get the message - but not enough to cause any social unrest. If there is a leader out there who can correctly forecast and implement that system of pain and pull it off with social stability, that leader deserves to be at the top of the heap - the 'supreme laoban'. Alas, I do not think anyone can fully pull it off. Bo Xilai tried this - we all know the results. Xi Jinping, Li Keqiang and five others compose the standing committee of the Politburo and assuming that these gentlemen wish to start upon a 'legacy' then look to what will be announced in November. Their program is based upon increased urbanization of China.

Current Beijing long-term policy plans call for 70 percent of the population of the country to be living in cities (both established and newly developed) by 2030. That's really not far away. Tom Holland discusses this in his South China Morning Post column of 14 August 2013. How are you going to transfer the rights and privileges of hukou (the local registration system) for approximately 230 million farmers and 250 million rural hukou holders to the cities? Where is the money going to come from to pay for schooling, medical care, etc.? The cities can't afford any additional burden now, so how will these goals be financed to fruition - especially since it has been widely estimated that it will cost approximately 48 trillion RMB between now and 2030: more than 5 percent of the country's current GDP? Tax is obviously the answer.

In 1979 when Deng Xiaoping, after consolidating his power base, started upon market economy reforms, the urban population of China was 19 percent. It was not much more, a half-decade later, when I first visited the country. Now? 51 percent of China's population is 'urban'. This is a remarkable, peaceful migration from the countryside to the city for a country with 23 percent of the world's population. I'm not sure it can adequately be described, either through pictures or by written word. I was here and experienced the flight to the cities which experienced sustained, long-term double digit annual growth over close to a 30 year period. Shenzhen now is home, arguably, to 14 million people. I was there when barely 300,000 people resided there, and I started living there when the population had expanded to 750,000. But for the future? How do you go from 51 percent to 70 percent during the next 20 years without sustained, double-digit growth in a country that is home to so many people? Damned if I know.....Lots a luck, guys!

Xi and Li propose a new form of urbanization for the future: Chengzhenhua, urbanization with emphasis upon building of new towns, rather than expansion of the current cities. Can it be done? The prior 'model' worked brilliantly for some locations (Shenzhen) while doing nothing for others (Shantou). This subject is covered in depth in a brilliant academic article by Gabriele Battaglia, "Beijing Ready for new Urbanization", in Asia Times Online. Current 'control' by the Central Government is limited, resulting in rampant municipal overbuilding at all costs and going far beyond the fiscal capabilities. Can these excesses be reined in? Alas, no. Financial reporting in China still leaves much to be desired. The accounting profession has been 'separated' from the tax profession, with the Ministry of Finance creating the Certified Tax Agent in China because they could control from the start - and hopefully maintain a better semblance of transparency in tax, if not accounting - professional actions and ethics. Ethics be damned when you are the accountant auditing the local township company that employs virtually all of your town. Are you seriously going to consider accounting ethics if it is going to end any hope of employment in your area? Can new towns be subject to new, enforced taxation and procedures that cannot currently be enforced elsewhere? It is definitely worth a try, as are all proposals worthy of consideration if you want to do something that no one else has ever done while figuring out a way to finance it. China has 31 provinces, 333 prefectures, 2,858 counties, 40,858 townships and 'an unknown number of villages' according to Ms. Battaglia. Surely some have been already overbuilt with housing, infrastructure, market facilities, etc., which the government will use as part of incepting new towns. All of this is a lofty plan but, once again, how will it be financed?

Battaglia quotes Ou Ning, a writer heading the Anhui Province based Bishan Commune, a social experiment linked with China's newly revived 'rural reconstruction movement'. Ou states:

The aims of chengzhenhua are good, however ... given that the peasants are a weak class, they should be helped by public sources. A report of the Ministry of Finance says that in order to transform the peasants into citizens you need to find resources of 1.8 trillion yuan. That's an astronomical figure. Where will this money come from?

On 14 August, Zhu Zhongyi, Vice President of the China Real Estate Industry Association, at the Bo'ao Real Estate Forum in Sanya (on Hainan Island, the Chinese Hawaii) stated that before the year is out - most likely at the annual Beijing Party Conference in November - the government will introduce 'long-term mechanisms' to stabilize (i.e., deflate, rather than burst, the real estate bubble) Chinese real estate. "The mechanism will not only adopt economic means such as taxation and credit policies to regulate the market, but it will also create policies to improve the housing and land supply systems."

Current methods of real estate price stabilization, including the 'so-called' real estate tax of Shanghai and Chongqing, have not curtailed speculation. A long-range, long-term, urban financing, tax and fiscal policy plan must be started if the massive migration to existing cities or becoming a pioneer of a 'new town' is to become a reality over the next generation.

Zhu stated in his opening remarks at the Forum that issues regarding municipal fund raising (i.e. taxation alternatives to selling land or expecting over-production industries to be able to finance local government and its programs), supervision (an anti-corruption/due diligence mechanism had better become part of this or it simply will not work), planning, construction, quality-control and distribution of low income housing to those for whom there is no current housing (you want to bring in half a billion people to the cities as legitimate residents - then you've got to do something about housing them), will be part of the upcoming 'official announcements' but that the country had better realize that establishment of these 'mechanisms' will take years. That final statement, concerning 'years', is the most refreshingly truthful foresight mentioned in any of the press about these -matters. Things will happen here in the development of taxation to meet the needs of an urban China - but it's going to take some time...

While I expect an initial 'framework' regarding the reformation of the tax system to be announced this year, I also expect that the 18 June South China Morning Post article suggesting that there will be some form of property tax - presumably similar to those in place in Shanghai and Chongqing (which will likely be renewed and become an annual excise tax-like assessment) - introduced in Beijing, Hangzhou and Guangzhou, this year.- This is not because these municipalities are bankrupt, but instead because the real estate bubbles in these cities are starting to get 'beyond control' and tax is once again seen as a way to slow things down. And insofar as those cities that have run out of land to sell (i.e. Shenzhen) expect some serious tax experimentation to take place a whole lot sooner than anyone would imagine. If the central government deems Shenzhen too big to fail, it really had better start some more tax 'experimentation' there, soon!

Tax reform in November....

Writing culture in journalism can be so different between neighbouring cultures. The press in India often publishes short, one-paragraph articles in areas where one would hope for in-depth coverage. The English language Chinese press generates 'complete' articles - that one paragraph article in China is rare, indeed! The press in China, when there is in-depth coverage, generally serves as a spokesperson for the government. Thus, the 7 page China Daily article entitled 'China banking on tax returns to help

transform its economy' was, in fact (although one can't truly 'prove' it), the government telling us what it wanted us to know.

In March, when the new cabinet was introduced, three areas of focus were announced as its agenda. First on that list was tax reform. Taxation in the PRC came into being after the Cultural Revolution. In 1978 the country made its entrance into the national problems of revenue and expenditure, setting up a system of delegating taxation powers to the lower levels of government, receiving negotiated amounts from the provinces (which, in turn, got its coffers filled from the local governments within the province), in order to conduct the necessary affairs of the central government. The local governments had autonomy over virtually everything else. How much did Beijing get from this trickle-up system of finance, without any 'controls'? It simply boggles the imagination to think of all that money siphoned off to corrupt beneficiaries before getting to Beijing. Now, of course, the funds are trickling down...

Things changed dramatically at the end of 1993 with the introduction (effective, January 1, 1994) of what was, in essence, the first national tax act of the People's Republic of China: a six page document, upon which volumes of rules, amendments and regulations have been added over the past 19 years.

The 1994 tax act clearly delineated the division of responsibilities. Local governments were now responsible for provincial and municipal-level infrastructure, development, urban constructions, and local cultural, education and healthcare programs.

A dozen taxes - tariffs, consumption and VAT, enterprise income tax amongst them - were all now part of the national tax collection process. Conversely, approximately 20 tax items, including business tax, individual income tax, urban land use, vehicle and stamp tax, were the responsibility of the local governments to collect and spend. There was only one major problem with this division: the central government was now taking in 60 percent of the revenue, while the local governments were spending 60 percent of all expenses. A system of transfer payments had to be instituted.

Why now?

As per China Daily's in-depth article: "To accelerate the transformation of its economic growth model away from a reliance on exports and investment and toward consumption, local governments must have a motive to do so, and reforming the tax system could do the trick. In other words, the present tax system is no longer able to provide enough impetus for economic development." In 1993, before the national tax act, local governments collected 78 percent of all tax revenue and spent 72 percent of all tax expenses. Then came the tax act and now, prior to the national VAT replacing the local business tax, China is facing a scenario where local governments take in only 52 percent of all tax revenue but are responsible for 85 percent of all tax expenses.

The 18th Central Committee of the Communist Party of China will hold its Third Plenary Session in November, after the 'mini-mass-migration' of people visiting their home towns during the National Day (1 October) holiday week festivities has subsided and life returns to 'normal'. China is 'closed' this first week of October. It

is a perfect time for people to travel back to their homes: perfect weather, with high speed rail drastically reducing travel time. The housing complex where we reside in Guangzhou is so quiet and tranquil right now, as I write this, because of the holiday – I love it!

The Central Committee meetings come right after the Bo Xilai 'theatre-absurd' trial and the new leaders not only have to re-structure the tax system for the future, but also set the mechanisms in place for greater transparency. The cities are in trouble - they've spent what they don't have. Will they be bailed out? Will there be a selective bail out, saving some while letting others fail? Zhang Guangtong, Vice-Dean of the School of Taxation, Central University of Finance and Economics, is quoted in the article: "The bankruptcy of Detroit is a lesson for the Central Government. During the country's stage of rapid development, serious bubbles emerged in the economy in the form of real estate, surplus capacity and local government debts. Once any of the bubbles burst, the results would be catastrophic, Tax reforms are needed to contain such bubbles." Some jurisdictions, some SOEs are going to have to fail, if for no other reason than setting up a 'new policy' of no more bail outs in the future will likely mean that there'll be 'permitted' failures and selective bailouts just to get things started.

There will have to be changes in the distribution of tax revenues and expenditures between central and local governments. Controls are needed to prevent rampant abuse in those faraway places that would otherwise escape the current levels of scrutiny coming from Beijing. This will need to be combined with determining how to develop new local taxes while reducing local reliance upon selling of land use rights. Can the Xi regime make a viable start toward this lofty goal? While I'm sure that I'll be able to give you an answer, face-to-face, at the conference in December, I think that Xi will be effective. He's consolidated power, bringing party elders to his side in the Bo Xilai case. Was Bo any more corrupt than any of the top echelon in China? Probably not. Hu Jintao was squeaky clean but Wen Jiabao's family, if you read the New York Times (not China Daily in cases like this), has amassed a fortune.

Xi and Li? Who knows? Yet I find that irrelevant. It took princelings (sons of the party elders) to get rid of princeling Bo. It was all about politics and control. Xi apparently has that control and is using it. Zhou Yongkang, 'retired' Politburo standing committee member, mentor of Bo Xilai, is now being investigated. Zhou's other 'protégés' are being investigated, too. This is a show of political force. Why? Because Xi has the power and the political acumen to gather support to do this - primarily as a message to those below. Inroads against corruption must be made and transparency of new tax reforms must be enforced to prevent the current degree of corruption. If Xi and Li are to have a successful decade of leadership and leave a legacy of change, then no one will question the legitimacy of single party rule. If not? Who knows??? Hu knows!

China Daily, on September 25, in a brief article, called for introduction of unified real estate registration in China. This is important! It would be the first step in developing national standards for a location valuation tax, i.e., a property tax. It would be a major step towards limiting commodity speculation involving multiple home purchases throughout the country. At a conference held in Beijing at the end of September, attended by approximately 100 real estate academicians and

professionals, government spokespersons for the first time officially called for a national registration system to protect property rights. Currently, real estate, including land and resources, housing, urban-rural development, agriculture and forestry, is registered through a multitude of national and municipal departments, with absolutely no coordinated control. Is this a pre-cursor to future implementation of a national property tax system to control resources? Has this concept even been thought out?

Zhao Xiaoqian, director of the China Law Counsel Center, stated that a system of registration would safeguard transactions and improve credibility. A Vice minister of Land and Resources (unnamed but referred to in China Daily) stated that China would resolve real estate registration rules by June, 2014. Although it is far easier said than done, the fact that this concept is finally being discussed is a step in the right direction.

Real estate in China is rapidly on the rise. Is it truly a bubble? Is it a hybrid of speculation plus true demand for residence? How different is real estate in China than elsewhere? Let us simply assume that it is a hybrid of all of the above and that whatever measures have been implemented during the past couple of years seem to have generated little impact. Hong Kong has impact with its stamp duty: while prices have not dropped (the mentality of housing commodity traders seems to be that prices may never go up but they will not go down, either). Yet official statistics (as per the 18 September FT) show that residential property prices in the three biggest cities (Beijing, Shanghai and Guangzhou) have jumped 20 percent, year-on-year for the month of August in spite of current restrictions on speculative buyers.

We know that developers are buying land contracts and are stockpiling their holdings - as long as their financial backers are not worried about holding this non-producing 'inventory' and there is no annual tax on these stockpiles, then the developers are not concerned. How long will this last? Speculators in the country, while still in the luxury market, are turning to the mass market residential properties and churning prices for these properties, creating a bubble for this type of property as well as the luxury market. And when restrictions are enacted in the tier one cities, the speculators have not hesitated to trickle on down, and now turn to the fourth and fifth tier cities for short term investment. Who's to stop them when there is no method of tracking who is buying what, thereby negating the one (or two) home ownership policy?

Come November, when the CCP meets and more specifically lists not only its short term goals but the initial methodology of implementation, property is going to be a very big issue. Social, political and economic stability remains the emphasis of keeping people satisfied - at least, this is what the governmental hierarchy feels. Maintaining stability will rest primarily on the new policies of November. These may be 'broad' policies, but they will nonetheless be an outline for implementation.

Yet national registration simply is not going to come about without a really big fight - and it is going on as you read this. National registration will not develop without a fight, and this is happening right now. There is substantial local opposition to either registration or a 'real' property tax. Yet the pressure from above, coming from Xi, Li and the remaining 5 on the standing committee of the Politburo, I believe, will be

‘triumphant’ in bringing about tax change: there is basically no alternative. In May, according to the Wall Street Journal (25 June 2013) 69 of 70 cities showed substantial year-on-year market price increases. 66 of the 70 showed increases in August....price curtailment? Ha! Maintaining an affordable level of housing prices in China is an essential aspect of maintaining the fabric of social stability which the rulers of the country so desperately need – especially after the Bo Xilai ‘incidents’.

Dragonomics, in a 26 September feature article by Tom Miller, ‘What Happens When the Land Runs Out?’ emphasizes redevelopment of rural construction land within the cities as the ‘favored’ local alternative to the national policy, instead of development of property taxation as an alternative. This is, in essence, no change from current policies of selling land leases, but it won’t work in the long run. As the cities have expanded, they have surrounded villages, changing the face of that village to ‘blending in’ with the neighboring, all-encompassing city. In the past, municipalities in China simply expropriated, auctioned and developed without any form of plan or goal: medium or long term municipal planning was not on the agenda. This is no longer feasible as China, with more than 20 percent of the world’s population, cannot go below a minimum of 120 million hectares of land to cultivate the food necessary to feed its population and maintain self-sufficiency. How much of this village land is still agricultural? How effective are the controls currently in place to maintain agricultural acreage? In 2011, 323,000 hectares of cultivated land were lost to urban construction, bringing the national area of cultivated land to 121.7 million hectares.

‘Pure’ rural land cannot be part of the growth equation because it is needed for food. Yet already ‘urbanized’ land within the cities that are still ‘villages’ can be redeveloped. Miller makes the point of emphasizing new policies (incentives?) necessary to persuade urban villagers to leave their homes for redevelopment. How do you legislate fair market value without adequate enforcement measures, including appeal procedures that work? What about granting urban hukou as an additional enticement. And where will you displace those who have to move in order to have urban redevelopment? What will be future policy in this area - will it be announced in November?

When you’ve got a city like Shenzhen where urban villages make up more than 40 percent of the built up area, urban redevelopment of villages within is obviously feasible. However, once again, this is something far more easily said than done. Until such time as villagers are assured of receiving their fair market value (which still does not happen ‘frequently enough’ to pacify villager fears of being robbed), there will be a hesitancy to sell. Then there is the fact that many of Shenzhen’s villages consist of densely packed, 10-15 storey housing complexes already housing both migrant workers and dwellers who paid for their apartments, albeit in a grey market area. This market area is ‘grey’ because ownership is of questionable legality. Where do you re-house these potential victims of urban redevelopment? Shenzhen has problems of developed areas that are more than the shanty towns of other cities which fall within the concept of urban redevelopment. Baishizhou, in the middle of an upper middle class area of Shenzhen, has an estimated 140,000 residents of which only 20,000 hold hukou and even more astounding, only 2,000 are actual members of the original village collective. While Baishizhou’s housing is not up to the standards of the surrounding community, neither is it ‘slum dwelling’, and if those

2,000 village owners are to get their fair market value upon sale, then how will Shenzhen get adequate revenue from land sales? While alternative sources of rural redevelopment and construction land will undoubtedly be one aspect of municipal revenue, it alone will not be sufficient for the future. China's property developers already hold substantial land they've leased but have not yet developed. While the developers will fight it, at some stage, this undeveloped property is going to be taxed.

So, where are we now? To summarize this essay, thus far: the traditional methods of raising revenue in order that the city support itself will not be the same in the future. Municipal industry is costing the cities, now, because of the worldwide depression. And yet, the only certain revenue tool, the one to overcome municipal industrial loss, has been the sale of land leases. But what happens when the land runs out? Rural redevelopment within the cities will provide construction jobs, but will this bring in municipal revenue?

Premier Li Keqiang's urbanization policies envision growing new cities as well as expanding and regenerating old ones. It is based upon the premise that maintaining stability in an urban area is easier than doing so in the countryside, where all 'successful' revolts in Chinese history have been incubated. To keep city dwellers happy, both urban services must be provided, and housing--the Chinese dream--must be attainable to the urban resident.

In other words, housing policy and tax policy not only have to be developed, but also implemented. So what is the government's housing policy? Roselea Yao is the Dragonomics PRC housing specialist. Her 18 September Dragonomics essay covers the options open to the central government.

Over the past decade housing supply in China could not keep up with demand. Now, overall, 'reliable' statistical information suggests that it is approaching balance and is in potential danger of turning to oversupply. Well my friends, long ago and far, far away, when I was a university student (over a half century ago!), the most useful text I had was 'How to Lie with Statistics'. Statistically, there may very well be a current total housing construction in the country equal to current demand for housing but I maintain that when you enter both dwelling size and quality of construction into the equation, the cost of buying an apartment is simply inaccessible to the urban middle class and that migrant workers coming to the cities cannot even afford the sub-standard rental housing available to them.

Last night, my wife and I dined, outdoors, at a new restaurant within a new development in Guangzhou. The food was great, the October, autumn night was 'sublime'. We inquired about the costs of a dwelling there (as we, too, would be interested in upgrading, if we could afford it - after 23 years of living in China, my dream is the Chinese dream, too - and why shouldn't I have upgrade aspirations??!). We were told that the cost would be RMB100,000 per square meter!!! We were also told that there are very few owners in residence but that those units rented were available at 'bargain rental prices'. No, I am not doing investigative journalism - I don't care who purchased these units but the cynic in me wonders just how legal the money used to purchase these units really is?

Guangzhou is a tier one city. True, tier four and five cities will not have those RMB100,000 per square meter units for sale but I'd bet they already have an oversupply of high priced, empty dwellings available for which there are non-performing loans on bank records. There is current housing supply in China - at a price. There is housing demand in China, too: are migrant workers and middle class housing aspirations being met? Sadly, no. Thus, as Ms. Yao states, the central government has its present conundrum: "The government can either redouble its efforts to meet demand for low-income housing through direct public-sector provision of subsidized housing, find a new way of incentivizing private-sector developers to provide this housing, or abandon its high-profile campaign to suppress upgrading demand." What about taking over and administering much of the overbuilding after the bank loans have been called in?

It is not going to be a choice as much as a hybrid of options presented. I believe that government policy, which will be announced a month from now, 'interpreted' through the end of the year (I expect to find a lot of 'interpreting' at the mid-December conference in Xiamen!), and implemented over a long period of time is what we will be discussing in Xiamen. Some long term planning is called for, now. True, it will be embellished in the future, yet a basic framework is called for and is going to be announced.

And an urban tax that has impact? It will take time. A generation or two of tax and housing policy changes in China is not even a blip on the radar screen of Chinese civilization. Long term policy will be set by the central government in spite of local resistance.

I expect to see a national land registration in China announced in November. I'd be surprised if it were not announced. While I never expect to see a change in culture away from treating land as a commodity to be bought and sold with speculation frenzy, new limitations will also be announced. Shanghai and Chongqing, with their limited wealth tax upon expensive property, will be joined by other cities. Only what will be incepted elsewhere will not be an exact duplication of the taxes imposed in Shanghai and Chongqing on property. There'll be limited derivations of a location value tax (aka property tax) elsewhere in China, with successful new tax programs eventually adopted on a national basis (not to mention the local head of government who thought of and implemented the successful new tax from rising rapidly within the national Party hierarchy!).

While pressure from local government and regional interests, combined with the politicking of developers to keep their inventory of undeveloped land off of the future roster of property subject to tax, is strong at the moment, over a period of time the political pendulum will swing in the opposite direction (with a faster swinging if the urban middle class gets frustrated too fast, about having the ability to buy a home) and the landlord of the future will not be deposed/executed, yet at some point, he'll pay real estate tax. I truly believe that a far more encompassing property tax, closer to a true location value tax than elsewhere, will come to China during the next half century. Merryn Somerset Webb, in an essay about this 'perfect tax' in the 27 September 2013 FT, said: "Once the initial valuations have been done, it is phenomenally easy to collect and all but impossible to avoid. It also discourages

speculation and stops in its tracks the endless cycle of investment in land and property purely to rent it out."

National registration comes first. I fearlessly predict it to be mentioned in November, and I will either gloat about this prediction or wipe egg off of my face in Xiamen!

There will be a 'real' property tax in China in the not too distant future for no other reason than the pure and simple fact that the cities need money and there will ultimately no other alternative for them. Urban land redevelopment can only last so long before those funds run out, too. Will I be correct? Ask me later: I certainly hope to be around over the next 50 years to see what happens next - and what happens after that!

