Overview

In contrast to most OECD countries, China does not levy a recurrent tax on residential property. Recurrent property taxes are growth-friendly and versatile, and they are especially valuable for raising revenues at the local level, notably to foster economic development. Despite these benefits, recurrent taxes on immovable property are among the most challenging taxes to administer, primary due to the need to revalue properties frequently. In addition, reforms to recurrent taxes on immovable property are difficult due to the tax's frequent unpopularity as well as its interactions with intergovernmental fiscal frameworks. Nevertheless, many successful recurrent property tax reforms have been implemented by OECD and partner countries in recent decades, especially following the Global Financial Crisis. The aim of this book is to draw on these examples to provide recommendations for the introduction of a recurrent levy on residential properties in China.

China is one of the few countries that does not levy a wide-base recurrent tax on residential properties, despite its rapid urbanisation in recent decades. Chinese municipal governments suffer from a relative scarcity of revenue sources to finance needed spending and they do not have autonomy over any major tax. A main source of revenues for Chinese municipal governments is public land leasing fees (OECD, 2017[1]). Nevertheless, due to the irregular and scarce nature of this source of revenue, it may not be sustainable to rely substantially on this revenue stream (Brys et al., 2013[2]). While the number of urban residents rises, the stock of available land for leasing decreases, shrinking the fiscal capacity of local governments to provide the level of public services that urbanisation demands. A recurrent tax on residential properties could be an alternative source of revenue that has the potential to overcome these difficulties, since it is regular, tends to grow with urbanisation and provides the necessary resources to finance local public services. According to the OECD *Revenue Statistics* and OECD Fiscal Decentralisation database, all OECD countries obtain some portion of their revenues from recurrent taxes on immovable properties, and on average, 88% of this revenue accrues to local governments. This revenue stream represents, on average, 40% of local government total consolidated revenues, usually covering more than all expenditure on housing and community amenities and public order and safety.

Aside from the benefits of increasing government funding, recurrent taxes on immovable property have additional features and purposes that set them apart from other taxes, which could benefit the Chinese tax system in many different ways. More specifically, recurrent taxes on immovable property are a versatile policy instrument that can have a role in the three main functions of the government: attainment of a less unequal distribution of income, maintenance of a stable economy and an efficient allocation of resources. First, due to property taxes' relative inelasticity – taxpayers usually only modestly react to changes in tax policy because their tax base is immovable – they are considered to be relatively efficient and among the taxes that are least detrimental to economic growth, especially when levied on households (OECD, 2021[3]). Second, in the case of residential taxation, there is a close link between taxes paid and public services received, which follows from the benefit principle of taxation in public finance. Third, they are one of the taxes least prone to tax competition, since their burden can be capitalised in house prices. Fourth, they can be used as a policy instrument for property price stabilisation since they tend to reduce the volatility of house prices. Fifth and lastly, it is a relatively transparent tax, potentially improving government accountability, contrasting with land concession revenues, which is a source of revenue that is defined outside the process of establishing a budget.

It is common for property tax reforms to be accompanied by more encompassing reforms of the fiscal system and inter-governmental relations, such as changes on the size and distribution criteria of fiscal equalisation funds. That is because the introduction of a new local tax in the absence of changes in the inter-governmental transfer system is likely to exacerbate existing fiscal disparities. China is among the most decentralised countries in the world from an expenditure perspective and also among the ones with the largest vertical fiscal gaps (i.e. the difference between local spending and local own revenues). At a minimum, the introduction of recurrent taxes on immovable property may narrow the vertical fiscal gap and provide more fiscal autonomy to local jurisdictions.

Despite these benefits, introducing a recurrent property tax system is challenging, given that for a number of reasons recurrent property taxation is among the most unpopular type of taxes. First, the transparency and inelasticity of recurrent property taxes, while they improve accountability and efficiency, make the tax salient and difficult to avoid. Second, the presumptive nature of property taxes makes it prone to unfair value assessments, particularly when revaluations are rare, potentially leading to abrupt and substantially higher obligations. Third, different from most taxes, recurrent property taxes are not levied on income flows, but rather on a stock of a relatively illiquid asset and, thus, can generate liquidity problems for households facing financial difficulties, in particular for asset-rich income-poor households, which are common in rapidly developing economies and regions. Fourth, the redistributive effect of recurrent property taxation hinges on various factors, but overall such taxes are typically less progressive than the personal income tax, inheritance tax and wealth tax. For these reasons, recurrent property reforms may face especially strong public opposition, adding to the typical difficulties of reforming tax systems (e.g. transitional costs, timing, impact on different levels of government, etc.).

Recurrent property taxes are considered among the most challenging taxes to administer, and require a well-functioning property valuation, billing and appeal system. The way that these processes are managed can have a significant impact on administration costs, which can be, as a share of tax revenues, as high as 10% (Almy, 2014[4]) or as low as 1% or less (e.g. in some US states).[1] Moreover, since recurrent property taxes are commonly managed at the local level, multiple jurisdictions may administer these taxes differently and sometimes inconsistently, especially because of asymmetries in local administrative capacity, creating horizontal distortions. China is a large and heterogeneous country and might be prone to this risk.

Although there are major challenges in designing, reforming and managing a recurrent property tax system, it is possible to overcome these in a manner that allows society to reap benefits in terms of a better allocation of resources, more stable house prices and a fairer income distribution. Many successful recurrent property tax reforms were implemented by OECD and partner countries in the last decades, especially after the 2008-09 Global Financial Crisis. This report highlights many of these cases. Some reforms were more comprehensive and disruptive, involving the introduction of new recurrent property tax systems nearly from scratch, whereas others were more incremental, approaching specific features of ownership classification, valuation methods or local government autonomy issues (see Box 0.1 for a sample of the most recent property tax reforms).

Box 0.1. Recent recurrent property tax reforms in OECD countries

In the last five years, recurrent property tax reforms were motivated by very different objectives in OECD countries. Some countries aimed at improving the progressivity of their recurrent property tax system by either giving tax reliefs for low-income households and/or increasing tax rates applied to high-income households. Other countries focused on property revaluation in order to reduce horizontal inequalities, increase fairness and/or tax revenues. In some cases tax rates were increased and/or the tax base was widened so as to boost tax revenues or to curb rapidly increasing housing prices. Temporary exemptions were also given to promote investments.

In **Chile**, a new progressive surcharge applies to taxpayers whose combined real estate fiscal value in Chile exceeds CLP 400 million (regardless of Chilean tax residency). The surcharge rate schedule is as follows: 0.075% for the part of the combined fiscal value of real estate properties that ranges between approximately USD 485 000 and USD 846 000; 0.15% for the part of the combined fiscal value that ranges from approximately USD 846 000 to USD 1 088 000; and 0.275% for the part of the combined fiscal value of real estate above USD 1 088 000. This tax entered into force on 1 April 2020 and is added to the ordinary real estate tax that is payable on a quarterly basis.

Denmark also introduced important changes to housing taxation. From 2021 onwards, housing taxes – including both the property tax and the land tax – will reflect market values, thereby ending the property valuation freeze in place since 2002, which has led to falling effective tax rates for homes experiencing increases in value. This reform will increase cadastral values for many properties. Tax rates will be lowered, however, and homeowners whose overall housing taxes increase with the new system will be compensated through a tax rebate. In an effort to protect homeowners from tax increases while they occupy their home, the payment of tax increases after 2021 will also be deferred until the home is sold.

Finland introduced an increase in recurrent real estate tax rates in 2017 to boost municipalities' revenues. In 2018, for general charges, and in 2019, for residential buildings, the maximum tax rates were raised again.

France’s progressive repeal of the dwelling tax for 80% of households is one of the most notable property tax reforms in the last five years. The dwelling tax (*taxe d’habitation*) is due annually by owners or tenants that occupy a dwelling. The repeal has been phased in over three years for a group of households (based on annual income thresholds) with the tax reduction amounting to 30% in 2018, 65% in 2019 and 100% in 2020. For the rest of households, the tax will be gradually removed between 2021 and 2023. The dwelling tax has largely been perceived as unfair because effective tax rates vary widely across municipalities and because the notional rental values upon which the tax is based have not been updated since the 1970s. It should be mentioned that France’s reform does not affect the *taxe foncière,* which will continue to be levied on the owners of immovable property.

Greece reduced its property tax (ENFIA) by providing a progressive tax rebate. This rebate ranges from 10% to 30% in a progressive manner – properties valued below EUR 60 000 received a 30% tax rebate while properties exceeding EUR 1 million received a 10% rebate. In addition, in 2018 there was a re-adjustment in real estate taxable values and an increase in the threshold of the supplementary tax – from EUR 200 000 to EUR 250 000. At the same time, the government abolished a property tax cut that was introduced by the previous administration and benefited property owners whose tax liability was below EUR 700.

Germany legislated an overhaul of its property valuation rules to comply with the requirements of the Federal Constitutional Court. In its ruling dated 10 April 2018, the Federal Constitutional Court declared the way in which properties are valued for the purposes of real property tax to be unconstitutional, as the tax is calculated on the basis of property values that are decades old. The values determined in accordance with the new law will be used to calculate charges from 2025 onwards. Overall, the reform is expected to be revenue neutral.

Israel, in order to lower the demand for housing investments and cool the property market, introduced a new tax, which became effective on 1 January 2017. Owners of three or more apartments or houses are now subject to a 1% tax on the value of those properties.

Italy unified its local property taxes, by abolishing the municipal service tax TASI (“*Tributo Servizi Indivisibili*”) and merging it with the IMU (“*Imposta Municipale Propria*”) local property tax. The sum of TASI and IMU rates will remain the same. Moreover, the IMU deduction from business income taxation has been increased up to 100% as for 2022 (instead of 70%). Italy also introduced an annual property tax on marine platforms for the extraction of hydrocarbons.

In **Korea**, the comprehensive real estate tax, which is a national tax levied on the owners of multiple properties and expensive real estate, was raised as part of an attempt to curb rapidly increasing housing prices.

Lithuania is increasing effective rates of its recurrent property tax by reducing the tax-exempt threshold for non-commercial property from EUR 220 000 to EUR 150 000. It also has increased the minimum tax rates for immovable property used for commercial purposes from 0.3% to 0.5%.

Portugal introduced a new municipal property tax surcharge of 0.7%, 1% and 1.5% on real estates of total taxable values above EUR 600 000, EUR 1 000 000 and EUR 2 000 000, respectively. This surcharge replaces the stamp duty on residential urban properties and on land for construction of a taxable value above EUR 1 million. This reform also introduced a single rate of 0.4% levied on companies’ total real estate.

Turkey reformed two elements of its recurrent property tax system. First, it implemented an additional levy on residential houses that are valued above TRY 5 million. The tax rates are progressive (between 0.3% and 1%) depending on the value of the residence. Second, it introduced a five-year exemption from real estate taxation for buildings constructed within the scope of the investment incentive.

Sources: OECD (2016[5]), OECD (2017[6]), OECD (2018[7]), OECD (2019[8]), OECD (2020[9]) and OECD (2021[10]).

This report presents a set of good principles and options for reforming recurrent taxes on immovable property based on the latest experience of property tax reforms around the world that are particularly relevant to the Chinese context. Although these good principles are mostly general, meaning that they can apply to almost any country, the report makes specific points tailored to the Chinese case. The report is divided into four chapters. The first chapter focuses on the role of property taxes in OECD countries; the second chapter discusses good principles for recurrent property tax design; the third discusses good practices on recurrent property taxes administration. Together, the second and third chapters provide the ‘end-goal’ of a reform, covering topics such as its integration into the tax system, tax rate, scope, valuation of properties and fiscal cadastre management. The fourth and last chapter provides principles to lay out a reform that can successfully overcome the general difficulties in any tax reform, such as transitional costs and communication issues, and the specific difficulties in property tax reforms, such as how to deal with its salience, liquidity constraints, perceived regressivity, inherently arbitrary tax base and lack of sensitivity to economic activity. Box 0.2, below, provides a summary of the main findings.

Box 0.2. Summary of practices

1. Role of recurrent taxes on immovable property

- Recurrent taxes on immovable property often are the most important tax in terms of revenue raising capacity at the local level, although they are only the fourth most important type of tax in terms of overall tax revenue.
- Recurrent taxes on immovable property are the taxes over which subnational governments (SNGs) have most discretion and, thus, have a key role in increasing subnational autonomy and reducing the vertical fiscal gap
- Recurrent property taxes revenues are often enough to supply various public goods commonly assigned to local governments such as housing and community amenities and public order and safety, but usually cannot finance the entirety of local expenditure on education, health or social protection.
- The reliance on recurrent taxes on immovable property is correlated with a country’s level of development – not only developed countries tend to rely more on immovable property taxation, but also the more a country develops, the more it tends to increase its reliance on these taxes. Some OECD countries have reformed their property tax system in order to increase the role of recurrent taxes on immovable property while reducing the role of transaction taxes. This can be justified by the fact that a revenue-neutral shift toward a well-designed recurrent tax on immovable property has the potential to minimise economic distortions and increase growth.

2. Tax Design

- The tax base of recurrent taxes on immovable property is typically wide, covering land and improvements, business and residential households, as well as owner-occupied and rented properties. Wide tax bases allow governments to increase tax revenues while minimising allocative distortions.
- The same recurrent property tax usually applies to all types of property and tax bases, and typically tax rates vary little across property types, which minimises distortions and reduces tax avoidance.
- Despite having distortionary effects, property tax reliefs and exemptions are employed to achieve a myriad of policy objectives such as preservation of agricultural land, promotion of business and urban development, increased tax progressivity, reduced salience of the tax, among others.

- The most common measure to increase tax progressivity is to provide tax reliefs to low-income earners. Although progressive rates are employed in some countries, their effect on the progressivity of the tax system depends on the distribution of house ownership.
- Programmes aimed at providing tax benefits to business come in various forms: property tax abatement programmes, firm-specific property taxes, earmarked tax revenues to the development of a specific region and enterprise zones, among others. Despite the use of multiple types of programmes, evidence is unclear about their effect in promoting business.
- Countries often use recurrent property taxation as a tool to reduce housing price volatility. Evidence points to a small but significant effect of these taxes on housing prices. Nevertheless, ultimately, this reduction depends on the incidence of the tax, which is defined by the supply and demand elasticities of housing as well as the frequency of reassessment.
- Owner-occupied housing is commonly taxed at concessionary rates due to lack of imputed rent taxes and capital gains tax exemptions or reliefs. Further concessions are often provided to debt-financed investments in owner-occupied housing through mortgage interest relief. As a result, the tax system often favours housing investments, potentially in a distortionary manner.
- OECD countries often mitigate tax distortions that tend to benefit housing investment in detriment of other investments by levying recurrent taxes on immovable property, capping deductions or providing tax credit when granting tax reliefs for mortgage interest, and capping the value of owner-occupied houses that benefits from exemption from taxation capital gains.
- Designing recurrent property taxes to promote green investments and sustainable land use have become increasingly popular across OECD and partner countries.
- Evidence suggests that property taxes are effective in reducing urban sprawl when designed specifically for that purpose. A more general measure to achieve this objective is the imposition of higher tax levies on land in comparison to buildings (i.e. split-rate taxation). Other measures involve the penalisation of under-used land that was zoned for development and of new developments through fees.

3. Tax Administration

- Administration of a recurrent property tax system can be very costly as a proportion to tax revenues. Nevertheless, many OECD countries employ methods that can significantly reduce these costs, notably computer-assisted mass appraisal systems.
- OECD countries commonly use fiscal cadastres not only as a tool for calculating property tax obligations but also as a tool to support the achievement of other policy goals such as urban, transport and environmental and social policy.
- In decentralised countries, horizontal and vertical co-ordination arrangements are sometimes used to overcome challenges related to the lack of scale that some local governments might have to efficiently administer fiscal cadastres and property valuation systems.
- Capital values are by and large the most used property value basis for recurrent taxes on immovable property in emerging economies, since: 1) there is sufficient sales data; 2) capital values can be used as a basis for other taxes; and 3) they are partially correlated with economic activity.
- The sales comparison approach is the most used method for property valuation across OECD countries. Other methods are particularly employed to appraise properties that lack sales data, such as the cost and the income approach.
- Many OECD economies maintain a frequent revaluation schedule (at least once every six years). Countries that do not maintain a frequent schedule can become prone to distortions that cause horizontal inequities, harming good properties of recurrent taxes on immovable property.
- It is common for upper levels of government to define general guidelines and oversee valuation assessments performed by lower levels of government. This can be justified by the fact that

having some uniformity in the valuation method and basis is important to maintain effective tax rates similar across jurisdictions, reducing horizontal inequities.

- Local governments in most OECD countries can set tax rates within limits set by upper levels of government and cannot define tax bases and/or grant exemptions that are not in the upper level of government law. In that manner local governments have sufficient autonomy to be held accountable for their fiscal policies and, at the same time, cannot create major horizontal distortions across jurisdictions, such as by exporting taxes.
- Most tax administrations grant to taxpayers a right to challenge assessments. Commonly: 1) independent institutions are involved in the judgment of appeals; 2) instructions on how to appeal are available in websites and/or in valuation notices; 3) taxpayer information on how their properties were appraised is provided when requested; and 4) no fee, a small fee or a progressive fee is levied for appeals, allowing low-income taxpayers to appeal.
- OECD countries often try to make tax payments convenient, and allay liquidity challenges as much as possible by allowing tax payments to be in multiple instalments and/or in a joint manner with other payments such as mortgages or utilities. Taxpayer convenience can reduce delinquency.
- Countries carefully choose the text to be sent to taxpayers in bills. Multiple studies have found that a significant increase in tax compliance can be achieved through the disclosure of some type of information such as the compliance rate, a clear explanation of the tax system, the public goods that are funded with the tax and sanctions.
- Internet websites are widely used as a tool to increase transparency. Countries or states usually have websites that centralise information regarding the tax system of local governments. These websites often provide a wide range of information with regards to rates system, valuation, rate setting and the appeal process.

4. Tax Reform

- Payment in instalments, withholding tax at source, allowing payments to be made in conjunction with other payments, tax deferrals for seniors, tax reliefs for low-income households, taxpayer education and consultation, accessible appeal processes, frequent reassessments, phased increases and indexing are among the most promising and widely used approaches to deal with unpopular features of recurrent taxes on immovable property.
- Bundling is an effective strategy that is commonly employed in recurrent property tax reforms as a way to overcome political resistance through losers' compensation and improvements in distributional effects. Often, property tax reforms are bundled with inter-governmental fiscal relations reforms to alleviate problems related to the distribution of revenue across and within levels of government or through the reduction of other taxes to avoid increasing the tax burden.
- Engaging a wide range of stakeholders, obtaining a consensus on a reform's broad long-term goals and focusing the discussions on the systematic rather than individual impact of the reform are all effective communication strategies. In this way, undesired impacts of the reform can be put into a larger/systemic perspective and be communicated in a manner that is more palatable for some actors.
- Transitional measures are typically introduced to alleviate short-term effects of tax hikes. For that purpose, temporary reduction in tax rates, tax credits, tax deferrals or tax reliefs are commonly employed. Nevertheless, reformers need to design and implement these measures in a manner that the full implementation of the reform is secured so the reform can achieve their initial goals.
- Most property tax reforms are made during economic upswings since governments tend to be in a better financial situation to compensate losers and since a potential reduction in housing prices will tend to lead to a stabilisation rather than an attenuation of housing price movements.

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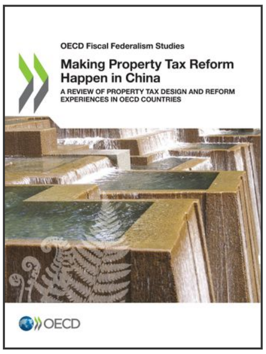
Note

[1] For more, see Walters and IAAO Research Committee (2014).



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