

Land-transferring Fee and Property Tax Reform in China

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Abstract: This paper analyzes the possible proposal of the land-transferring fee into property tax. We clarify the purpose and the program of China property tax reform. Based on the view of local finance, this paper looks into inadequate local financial resources caused by the current tax-sharing system. Discussion is focused on whether should Land-transferring Fee is integrated into property tax. The proposal property tax system would avoid the drawbacks of land finance; provide local governments a potential, steady and sustainable source of revenue.

Keyword: Local Public Finance; Property Tax; Land-transferring Fee

1 . Introduction

Currently, Chinese government is implementing a pilot property tax reform. And, the reform has been a hot debate among scholars, real estate developers, housing buyers and local governments. Especially, along with the roaring housing price, its impact on real estate market has been discussing a lot. Since the current house and land taxation and all kinds of Charges and fees result in imbalance of the tax burden among different stages of land acquisition and real estate development, selling and house tenure, the mission of the reform at the beginning is to set up a tenure tax after the acquisition of a house, scholars argued that property taxation would improve real estate retain link's tax system, help to further implementation of the principle of reasonable, affordable and fair taxation. And, it's conducive to the healthy and steady development of China's real estate market. What's important, it is hoped to have some efficiency on

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housing price regulation, or to curb the increasing housing price within the affordability of an ordinary household.

However, when we look into the real estate market and its tax system, or the property tax reform, there is a crucial fact that they are all so related to China's land leasing system. And so, the land-transferring fee charged for the land use right in several decades, as a large ratio of local government revenue and as a cost of land acquisition finally calculated into housing price, also has been a focus of the framework of the property tax.

In accordance with the foreign experience, property tax is an important source of local revenue, and it's an important breakthrough if local governments will participate in the reform. Since the Central-local Tax Sharing System started in 1994, local governments are increasingly tending to land-transferring fee to financing for local infrastructure and public service. Because of the instability of this extra-budget, actually, some scholars argued that property tax is not only reform in real estate tax system, but also an important step to deepen the tax sharing system between central and local governments. So it's the purpose of this paper to provide another perspective by looking into the performance of land-transferring in local public finance and the potential impact of property tax reform in China. From the perspective of local government finance, based on the problem of inadequate local financial resources under the current tax system since 1994, the paper will clarify the goal of China's property tax reform and discuss the potential program, mainly make a demonstration for the need to include land transferring fees into property tax.

The rest of the paper is organized into five parts. The following section is a brief introduction to China's property tax reform. The third section presents the current tax-sharing system in China and insufficient tax revenue of local governments, and the fourth section discusses the problem that land-transferring fee is important to property tax reform in China. And the final section is the conclusion.

2 . Brief Introduction to China's Property Tax Reform

The Path of China's Property Tax Reform

In 2003, it was put forward in third session of the 16th CPC Central Committee that there is a need to levy property tax. And Eleventh Five Year Plan also explicitly asked for "the steady implementation of property tax". At the same time, "Property Law" provides a legal basis for property tax introduction. It's supposed that China's property tax reform is a major step to improve China's tax system. Property tax levy can improve real estate retain link's tax system, helps to further implementation of the principle of reasonable, affordable and fair taxation. And, it's conducive to the healthy and steady development of China's real estate market. At the

same time, it will be helpful to rationalize the relationship between central and local governments to establish a stable place source of fiscal revenue, expanding the size of local tax revenue.

Since 2006, property tax reform has been carried out in various districts of the two batches of experiments, the first six pilots include Beijing, Liaoning, Jiangsu, Shenzhen, Ningxia and Chongqing; In early 2008, another four pilots were also launched, they are Anhui, Henan, Fujian, and Tianjin. On May 25th 2009, the State Council stressed that “deepening the real estate tax reform, research and try to start the property tax”. Then, from June 2009 to June 2010 Shenzhen was selected as the first city to try to get the system ready to actually levy this tax, with a total investment 9.1 million Yuan. However, a year later Shenzhen failed to levy the property tax.

In fact, at the beginning of 2011, Shanghai and Chongqing promulgated *Private House Property Tax Rules* and actually started the tax. But the tax item was changed, regardless of the land system in China and its severe Land Finance Problem with the local government, only aimed to fight against real estate speculation and to reduce to the price of private house property. There is a great gap between the desire at beginning and now.

The Goal(s) of China's Property Tax Reform and Its Framework

Taxation is an important means to carry out national macroeconomic regulation and control. And for the real estate market, it's the property tax. The majority of countries and regions all over the world levy tax during real estate holding. There are more than 70 countries and territories levy a property tax (real estate taxes, property taxes). In fact, different countries have different property tax system. When we look into the purposes and financial functions of different property tax system, there are basically two types: First, it's provided as financial resources of local governments and aimed to financing for local public service, like United States and Canada; Second, it's mainly an instrument to improve land use efficiency of real estate (land and house), preventing all kinds of speculation, such as South Korea and France. There are also examples taking into account both aspects above, like Japan. The objectives of Property tax policy in many countries are based on clear and specialized aim. In harmony with the overall national taxes, property tax is set to play a multiple roles, raising local revenues, regulating land resource use efficiency and promoting the development of real estate market.

Since 1990s, a series of reforms happen to China's real estate industry, represented by housing commodification and land market-oriented reform, real estate market has been greatly developing. As a result, a substantial increase in real estate owned by individuals¹⁾ provides a strong economic base for China's property tax levy. Meanwhile, more and more investment tends to real estate market, and under the land use leasing system, land-transferring fee became one important revenue resource of local public finance. In contrast, although the real estate industry

1) It's reported that the urban residential privatization rate reached as high as 81.62%. Resource: China's Ministry of Construction, Urban House Statistical Bulletin in 2005. P2

is growing with a high speed, the tax revenue increases with a low growth rate and a low share in local public revenue. And one of the problems related to current land leasing system and the land finance is that land price is increasing too fast and finally makes the housing price roaring. So, it's hoped that China's property tax reform is a multi-objective system engineering: 1). To establish a property tax system which can solve the imbalance tax burden among different links of housing; 2). Through the taxation lever, to control the housing price, crack down on property speculation and finally improve the development of the industry; 3). To find a stable revenue resource of local governments, or to improve the central-local relationship, hoping to carry out a comprehensive fiscal reform with property tax reform as a breakthrough point. Therefore, Chinese government is planning to put forward property tax reform, through property tax, promoting the healthy development of the real estate industry, increasing revenues, and regulating the allocation of the national economy, thus as the breakthrough point, the China's property tax reform will help to put forward an in-depth reform of fiscal and taxation system in China. And, the ultimate goal is the last one.

As to the framework of the property tax reform, scholars discuss a lot. Basically, it's to set up a property tenure tax levied every year after the acquisition of a house. One of the possible proposals is to integrate several tax items, including house property tax, land appreciation tax, land-transferring fee and so on, into a unified property tenure tax. From the experiments in more than ten pilots, we can find it's not happening like the framework. The experiments in Shanghai and Chongqing, in which the only aim to strike speculation by levying residential house tax which has been exempted from house property tax, imply that it's different to take so huge a step toward such a ultimate policy goal. Studies also give the evidence that there are resistance from local government, because for a long time they collect land-transferring fee to fund local economy, and the possible revenue gap makes local government reluctant to move forward.

In terms of land-transferring fee, it's the unique thing all over the world. According to China's Land Administration Law, the owner of all urban land is stipulated to be the State Council. This ownership designation is obviously nominal because land management is actually handled by local governments (Deng, 2005). Further, the revenue from land use leasing is at the disposal of local government. Whether it's feasible to make it a part of property tenure tax? It's a complicated problem. The opponents discuss from the conception. He (2004) argued that tax and price is two different categories in economy and they have different non-substitutable capability, property tax is a tax imposed on house or land, while land-transferring fee is the price to get the use right of a parcel of land. Wu (2005) also pointed out that there are no theoretical basis and lack of maneuverability, this will increase the risk in real estate industry, reduce efficiency of land resources allocation, and lead to corruption. Based on the nature of land-transferring fee and the

land use leasing system, Bai (2007) showed an analysis that it's unfeasible to merge land-transferring fee into property tax, only the differential land rent can be a part of the new tax.

On the other hand, there are some studies showing evidence of the necessity to make such an institutional reform. Wu (2008) argued that fiscal power and administrative authority of local governments are unbalanced under the current land use leasing system, so that local governments take land finance as an important revenue resource, and there's necessity to adjust central-local relationship through property tax reform. Some scholars estimated the potential impact of the reform on local finance, Fu (2006) calculated that its share of local revenue would reach 23.9%-71.4%; Macro Group, CCER (2006) found that it will not always cause fiscal gaps, and the amount may be 10%-20% of local revenue at city level, and the effect differs among areas with economic development.

3 . Inadequate Local Financial Resources under Tax-sharing System since 1994

Since 1970s, there's an unprecedented fiscal decentralization reform all over the world, which has an important meaning in developing countries and countries in transition, because these countries' authoritarian system is not able to provide better public services. Political commitment, administrative and fiscal decentralization can strengthen representative democracy, increase the overall efficiency of the public sector and improve those countries' social and economic well-being. Most importantly, the government will be more accountable and be able to meet people's needs. At the same time, theoretical research generally believed that only local governments have considerable autonomy and decision-making power to raise local revenue, the responsibilities associated with the decentralization can be implemented. In terms of international experience, property tax is a stable source of local government's revenue, thus it is an important breakthrough in tax reform in the world, and an ideal kind of tax in local fiscal decentralization reform.

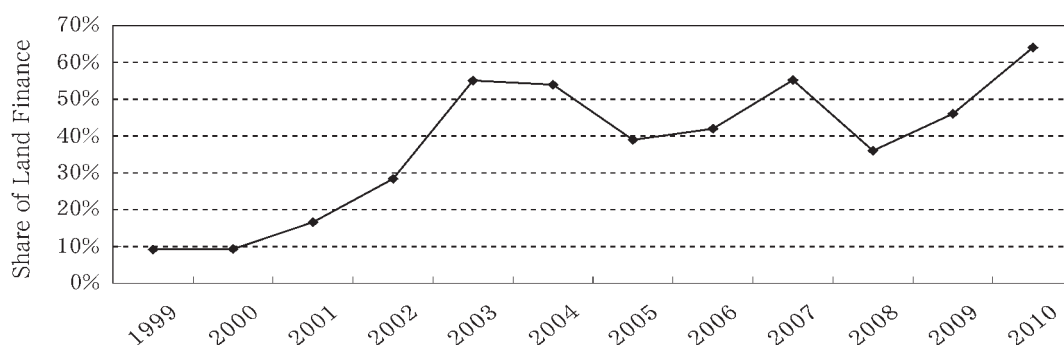
China also has been making effort in tax-sharing system since 1994. As a result, the tax right is allocated between center government and local government, the items with scattered tax base

2) Central taxes (or "central fixed incomes") include customs duties, the consumption tax, VAT revenues collected by customs, income taxes from central enterprises, banks and nonbank financial intermediaries; the remitted profits, income taxes, business taxes, and urban construction and maintenance taxes of the railroad, bank headquarters and insurance companies; and resource taxes on offshore oil extraction. Local taxes (or "local fixed incomes") consist of business taxes (excluding those named above as central fixed incomes), income taxes and profit remittances of local enterprises, urban land use taxes, personal income taxes, the fixed asset investment orientation tax, urban construction and maintenance tax, real estate taxes, vehicle utilization tax, the stamp tax, animal slaughter tax, agricultural taxes, title tax, capital gains tax on land, state land sales revenues, resource taxes derived from land-based resources, and the securities trading tax. Only the VAT is shared, at the fixed rate of 75 percent for the central government, and 25 percent for local governments. See Wong (2000).

and sporadic revenue is levied by local governments, while categories of taxes easy to collect are endowed as central government's tax²⁾. But it's not the same like the fiscal decentralization in other countries, and it's even criticized as Re-Centralization (Wong, 2000). This reform set up a new fiscal pattern between central and local government, and in the new divisions land finance is more and more relied by local governments to fund for public services.

Many studies carried out research on the relationship between land finance and local economic development, it's suggested that local fiscal and economy are closely related to land-transferring fee. As it is showed in Table 1 and Graph 1, From 2003, land-transferring fee accounts for the proportion of local fiscal revenue as high as 50%-60%, and the share is keeping a surprising increasing with a growth rate, especially, climbing up to 64.02% in 2010. While, land-transferring fee experienced minus growth rate in 2005 and 2008, down to -8.24% and -16.02%. The possible expiations are severe land market regulation in 2004 and 2005 and financial crisis in 2008. From 2004, China takes a series measures in the regulation of land use in national-level development zones, and in 2005 land use illegal cases were up to 80427, in which 79763 were settled, and 6992.87 hectares of the land were taken back.³⁾

What's worse, the land-transferring fee is not included in the budget of local finance, which causes the unsustainable of local fiscal revenue. As a whole, it has been fluctuating wildly that the growth rate ranges widely from -16.02% to 124.32%, and it's increasing faster in provincial capital cities or southern coastal cities, especially, the highest growth rate approached nearly 400% in Foshan, Chengdu in 2009⁴⁾. In one word, under the current land use leasing system, land-transferring fee is not a stable financial resource although it has been taken as an important method to finance for local development, and further, its nature of extra-budget will lead to abuse, corruption, and its fluctuations of the land price even will cause local public financial risk.



Graph 1 Share of Land Finance in Local Public Revenue (1999-2010)

3) See China Land and Resource Statistics Bulletin in 2005.

4) See China Real Estate Index System.

Table 1 Land-transferring Fee, Local Public Revenue and the Share of Land Finance (1999-2010)

Year	Land-transferring Fee	Growth Rate	Local Public Revenue	Growth Rate	100 million Yuan; % Share of Land Finance
1999	514.33	—	5594.87	—	9.19%
2000	595.58	15.80%	6406.10	14.50%	9.30%
2001	1295.89	117.58%	7803.30	21.81%	16.61%
2002	2416.79	86.50%	8515.00	9.12%	28.38%
2003	5421.31	124.32%	9849.98	15.68%	55.04%
2004	6412.18	18.28%	11893.37	20.75%	53.91%
2005	5883.82	-8.24%	15100.76	26.97%	38.96%
2006	8077.64	37.29%	18280.85	21.06%	44.19%
2007	12216.72	51.24%	23565.04	28.91%	51.84%
2008	10259.80	-16.02%	28644.90	21.56%	35.82%
2009	17179.53	67.45%	32580.74	13.74%	52.73%
2010	26000.00	51.34%	40613.04	24.65%	64.02%

Resource: China Statistical Yearbook; China Land and Resource Yearbook.

Land-transferring Fee of 2010 is from China Land and Resource Statistics Bulletin.

4 . Land-transferring Fee into property tax?

4.1 Property Taxes' Performance in Local Finance

As we know, most of countries all over the world are levying some items of taxes on real estate (land, house, or attachment). And, property tax plays an important role in the local finance in these countries, with a large share of their fiscal account, and it's a significant revenue source for local governments. Roy Bahl (2006) pointed out that reliance on the property tax comes with economic development, and that some OECD countries make especially heavy use of property tax, like Canada with a share of 4% of GDP and US 3%. In contrast, developing (with only 0.6% of GDP) and transition countries do not use property tax so intensely as OECD countries, but the fact is that they would appear to rely more heavily on property tax to finance local governments' expenditure.

When we look into China's property taxation, we would find out that till the beginning of 2000's, property tax revenues only raised less than 1% of GDP. The reason is that the real estate industry in China was just started from the housing reform in 1998, and exemptions have been widely used for residential and non-profit houses. With the development of China's real estate industry, the share is increasing, and till 2010, it reached 2.06%.

However, from Table 3, we would find that the local governments have a strong reliance on property taxation, till 2010 its share of local public revenue climbing up to 20.35%. But land finance accounts for as much as 64.02% of local public revenue, while it's not tax revenue nor

included into general budget of local government, but also comes out of land. In World Bank's analysis (1993), it was clearly cautioned against setting the goal of raising substantial public funds through land contracting. Meanwhile, Hong (1996) studied public land leasing in Hong Kong, and suggested that it can be an important source of public funds.

The fact is that local governments do not have enough revenue sources since tax-sharing reform, and land-transferring fee is used intensively to narrow the financial gap at provincial local level. Because of large scale exemption in property taxation, its revenue is not growing with the pace of the industry, but its performance is getting better in financing local expenditure (in table 3, the ratio reached over 20% at the end of 2010). As to House Property tax, its share of local public revenue is even getting reduced these years. Actually, it's one of the only two property tenure tax items in China's property tax system, while the other is called Urban Land Use Tax levied based on the area of a parcel. And both of the two taxes funds little for local finance, since there are large exemptions. At the beginning, these exemptions were set up solve the housing problems and real industry market development. But now, the situation is different, China's property tax system is on the edge of reform, especially the property tenure taxes. Compared to OECD countries, China's property taxes funding so little in local infrastructure, while so high a share of its reliance on its land finance. As a result of low revenue from property taxes, local governments' reliance on land finance is increasing, even though it's extra-budget and of volatility. So, it's implied that property taxation should be strengthened to provide local governments a productive revenue source, or even, the land leasing system also should be re-examined together.

Table 2 A Comparison of Property Tax Revenues among OECD, Developing and Transition Countries

	Property Tax Revenues as a Share of GDP (%)				Property Tax Revenues as a Share of Total Sub-national Government Expenditure (%)			
	1970's	1980's	1990's	2000's	1970's	1980's	1990's	2000's
OECD	1.24	1.31	1.44	2.12	9.7	9.88	13.65	12.4
Developing	0.42	0.36	0.42	0.6	18.65	15.97	13.49	18.37
Transition	0.34	0.36	0.54	0.68	3.67	4.92	7.75	9.43
All	0.77	0.73	0.75	1.04	14.49	12.89	11.63	13.4

Resource: Roy Bahl and Jorge Martinez-Vazquez: The Property Tax in Developing Countries: Current Practice and Prospects.

Data of 2000's only includes 2000 and 2001.

Table 3 Property Tax Revenues as a Share of GDP and Local Public Revenue in China (1999-2010)
100 million Yuan; %

Items	Total Revenues of Property taxes(A)	HPT	GDP	A/GDP	Local Public Revenue (B)	A/B	HPT/B
1999	690.79	183.36	89,677.05	0.77%	5,594.87	12.35%	3.28%
2000	797.89	209.38	99,214.55	0.80%	6,406.10	12.46%	3.27%
2001	880.93	228.42	109,655.17	0.80%	7,803.30	11.29%	2.93%
2002	1,143.24	282.38	120,332.69	0.95%	8,515.00	13.43%	3.32%
2003	1,447.37	323.86	135,822.76	1.07%	9,849.98	14.69%	3.29%
2004	1,877.52	366.32	159,878.34	1.17%	11,893.37	15.79%	3.08%
2005	2,381.62	435.96	184,937.37	1.29%	15,100.76	15.77%	2.89%
2006	2,895.35	514.85	216,314.43	1.34%	18,280.85	15.84%	2.82%
2007	3,904.04	575.46	265,810.31	1.47%	23,565.04	16.57%	2.44%
2008	4,992.92	680.34	314,045.43	1.59%	28,644.90	17.43%	2.38%
2009	6,232.24	803.66	340,902.81	1.83%	32,580.74	19.13%	2.47%
2010	8,266.13	894.07	401,202.03	2.06%	40,613.04	20.35%	2.20%

Resource: China Statistical Yearbook (2000-2011)

In the table, A includes 6 items of property taxes, such as, CMCT= City Maintenance and Construction Tax, LAT= Land Appreciation Tax, FOT= Farmland Occupation Tax, DT= Deed Tax, HPT= House Property Tax, ULUT= Urban Land Use Tax.

4.2 Is China's property tax to integrate Land-transferring Fee into it?

Till now, China's still working on its property tax reform, and doing experiments in local cities. At the beginning of 2011, its new pilots in Shanghai and Chongqing started. They just ignored the awkward problems associated with the current public land use leasing system and land-transferring fee. It's targeted only to curb the climbing housing price through levying private house tenure tax after acquisition. It's argued that this experiment will reduce the profit of housing speculation, and finally ended in a relatively lower housing price. When we look into the detail in the two cities, it's kind of enlarge the tax base of existing house property tax by including high leveled residential houses which is villa or with a high price. In the past one year, its revenue just accounts about 20,000 million Yuan⁵⁾ in Shanghai, it means that the property revenue can be increased by enlarging the tax scale or eliminating the exemptions; meanwhile, it seemed that the new tax did not have some impact on housing price⁶⁾, although China's central government put forward a set of regulation policies to control real estate market last year.

Form the experiment, we can find that the goal to control housing price is difficult if only by

5) <http://business.sohu.com/20110128/n279128744.shtml>

6) According to Statistical Bulletin of National Economic and Social Development in Shanghai (2011), the consumers housing price index is 105.4.

extending the house property tax base. As is known, the land-transferring fee is a large pre-paid cost for house tenure, and its revenue is selected by local governments to fund for public infrastructure, to some extent, it's kind of tax (collecting revenue for local development). It seems impossible to ignore the important but tricky problems with land-transferring fee or even the public land leasing system. And it's argued that in some sense, land leasing is an approximate form of property tax under special institutional environment, and that it's also like an excise tax included into local public finance; Because of the difficulty with tax collection, in 1980s and 1990s public land leasing but not property tax was the first choice for Chinese local governments; and further, with the gradual dilution of public landownership, property tax may become more and more attractive (Deng, 2005).

In fact, the reliance on land finance lasts till now. And the local government fiscal risk is approaching that the land-transferring fee experienced minus increasing in Shanghai in 2008 and 2011⁷⁾. Because of the lump-sum land-transferring fee, local government can get huge amount local revenue, but if the macro-economy is performing not so well, the land market would go down and result in insufficient land finance. Some studies tried to put forward a property tax reform by integrate land-transferring fee into it. Macro Group, CCER (2006) calculates the potential property tax revenue by making the land leasing cost, which will be collected every year instead of lump-sum for 70 years, into property tax. The result implies that local governments will gain revenue in small and medium cities, while a little revenue gap would happen in several big cities. It's also argued that the reform will greatly influence local public finance as well as local governments' behavior, to change from production-oriented to service-oriented.

When we look into these problems, such as housing price, local finance, and property tax reform, the land-transferring fee is an inevitable key word. Or even worse things happen that the rural landownership is becoming quasi-private, by illegal developed skip the land leasing and expensive land-transferring fee, and the residential houses is call small (or uncompleted) right houses. This kind of house is very common in countryside and suburbs.

However, it's just some proposal to integrate land-transferring fee into property tax, one of the reasons is that all urban land belongs to the public according to the Constitution of PRC, and it's not so easy to amend it. After more than 6 years pilots, afraid of possible fiscal trouble, local governments are still not willing to carry out it. But it's obvious that land finance problem, increasing housing price and illegal residential house construction are all related to the land-transferring fee and the property tax. It's necessary to set up a new system to make the property tax really work.

This paper also argues that the land-transferring fee should be re-examined when considering

7) <http://www.ewise.com.cn/Industry/201201/fdc111456.htm>

property tax. To the ultimate goal of the property tax reform, it's an important step in central-local finance reform. And if integrated into property tax, lump-sum land cost will be cut down and the housing price will reduce. Further, as a local tax, the future property tax will be a potential and steady revenue source for local public infrastructure, avoiding the weakness of land finance, and an incentive for local governments to provide public service.

5 . Conclusion

China's property tax is multi-target, establishing a property tax system to solve the imbalance tax burden among different links of housing, controlling the housing price by crack down on property speculation and finally improve the development of the industry, providing a potential and steady revenue resource for local governments, and finally help to put forward an in-depth reform of fiscal and taxation system in China.

This paper discusses the framework of property tax reform based on local finance viewpoint. Since tax-sharing reform, local governments suffer insufficient tax revenue resources, and land-transferring fee is selected by local governments under the public land leasing system to fund for local public infrastructure. Although land-transferring fee makes housing price increasing as a large cost of land use right, to some extent, it takes some role of property tax and has a good performance in local revenue. However, because of its volatility, it may cause local finance risk in future. If integrated into property tax, local governments will have a sustainable revenue source, and willing to improve local services.

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