China:
Shanghai and Chongqing implement trial real property tax policies

The municipal governments in both Shanghai and Chongqing have released interim measures relating to the real property tax on residential property owned by individuals, which means that the long-awaited trial reform of the real property tax finally has been launched. The interim measures are effective as from 28 January 2011. The taxation of residential property is expected to eventually expand nationwide.

Background

In 2010, the Chinese central government and the local governments at all levels introduced a series of measures that impose limits on the purchase of real property in order to crack down on property speculation and rein in spiraling property prices. The People’s Bank of China has raised the interest rate three times since October 2010 to tighten credit and curb inflation, which, to some extent, will create cash flow pressures for companies in the real estate sector. However, none of these measures has resulted in a discernible change in the exorbitantly high property prices in the country. The government has been expected to adopt more tax policies to adjust and control the real estate market – and the trial programs in Chongqing and Shanghai that levy real estate tax on residential property make that expectation a reality.

Although the real estate tax is not a new tax in China, under current regulations, residential housing normally is exempt. The key feature of the real estate tax reform is to broaden the taxable base to include certain personal residential property with a view to regulating and guiding market demand for housing consumption.

Comparison of Shanghai and Chongqing policies

The following chart sets out the trial real estate tax policies applicable to residential housing in Shanghai and Chongqing:

<table>
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<th>Scope of trial</th>
<th>Shanghai municipal administrative area</th>
<th>Nine central districts of Chongqing City</th>
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| Taxable target       | • Newly purchased second and subsequent residential property by a Shanghai resident family  
• Newly purchased residential property by a non-Shanghai resident family | • Villas owned by individuals  
• Newly purchased high-end residential property by individuals where the price per gross floor area (GFA) is two times or above the average GFA price in the previous two years of all newly constructed commercial property in the nine central districts  
• Second and subsequent ordinary residential property that is newly purchased by non-Chongqing resident individuals who do not work or operate a company in Chongqing |
<p>| Taxpayer             | Owner of residential property          | Owner of residential property          |
| Tax base             | 70% of transaction price of residential property (provisionally adopted) | Transaction price of property; however, once a villa or high-end residential property qualifies as a taxable target, the tax base remains regardless of any subsequent change in ownership (provided no new rules stipulate otherwise) |
| Tax rate             | 0.4%, 0.6%                             | 0.5%, 1%, 1.2%                         |</p>
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<tr>
<th>Preferential policies</th>
<th>Shanghai</th>
<th>Chongqing</th>
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<td>• The first 60 square meters of family per capita floor space of all residential property, including existing and newly purchased property, are exempt. Adult children without their own residential property can be treated as family members</td>
<td>• Each family is entitled to a deduction for only one taxable residential property. For villas before the trial policy, the first 180 square meters are exempt, and for newly purchased villas and high-end residential property, the first 100 square meters are exempt</td>
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<td>• A family of Shanghai residents that purchases new residential property (as their second property) and then sells the original residence within one year may obtain a refund of the real estate tax paid on the newly purchased residence</td>
<td>• Other preferential policies for peasant workers</td>
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<td>• Where an adult child purchases residential property for marriage purposes or a qualified non-Shanghai resident family purchases new residential property, a provisional exemption will be available as long as the property is the sole family residential property</td>
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It appears that the trial in Shanghai applies only to residential property purchased after the trial was announced and excludes the first residential property of a Shanghai resident family from the scope of the tax. Therefore, the main objective of the trial in Shanghai is to control the demand for real estate for investment. The Chongqing trial, on the other hand, focuses more on curbing the market demand for high-end housing.

**Comments**

The trial programs in Shanghai and Chongqing will increase the cost of owning a residence in the two municipalities, but it is hoped that the new rules will temper the market demand for housing. However, it is commonly believed that these trial policies are moderate and their long-term implications for the real estate market and investors are unclear. Notably, although both the Shanghai and Chongqing trials initially use the transaction price as the tax base, they will consider turning to real estate valuation prices in the future. It is likely that the tax authorities will improve the tax collection and management system and release specific measures for collecting information on personal residences and valuing the price of residential property.

The competent authorities (i.e. the Ministry of Finance, State Administration of Taxation and Ministry of Housing and Urban-Rural Development) have announced that they intend to collect real estate tax on all individually owned residences throughout the country, taking into account the need for an exemption for basic living requirements. Therefore, the results of the trials in Shanghai and Chongqing could become the blueprint for the levy of the real estate tax in other provinces and, ultimately, nationwide.

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