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The People's Republic of China needs to step up property and income tax reforms

Increasing the use of property and income taxes in the People's Republic of China won't be popular, but it is necessary. Relying more on property and income tax will not only help the China government balance its budget but could smooth income inequality and limit unrestrained urban expansion.

As countries develop, they tend to keep balance between indirect taxes such as a levy on goods and services and direct taxes on incomes and property. That allows the government to use tax policy to meet social or fiscal goals while raising money to invest in a social safety net.

In China, direct taxes account for a much smaller percentage of total tax revenue than in member countries of the Organisation for Economic Co-operation and Development. In 2014, China raised 9.5% of its revenue through direct taxes, compared with 20.3% on average in OECD countries.

Indirect taxes could be subject to swings in the amount collected as economic growth speeds or slows. The year-on-year growth rate of taxes collected from indirect sources in China declined to 1.0% in 2016 from 10.3% in 2012, for example.

The burden of goods and services taxes are often seen as falling disproportionately on lower-income people, since more of their total income is spent on goods and services than those higher up the income ladder. Indirect taxes cannot be shaped to spread the tax load like income taxes can be, an important consideration in a country like China where income disparity has been growing fast.

The Gini coefficient, a measure of income inequality, hovered around the 0.30 level in the 1980s but rose to 0.49 in 2008 and has remained at about 0.46 over recent years. A higher ratio indicates greater disparity. Current tax policy in China seems to do little to offset that disparity, since the coefficient remains around the same level when the effect of removing taxes is calculated.

China has been working to reform its property and income tax systems but change has been slow so far.

Only 3% of the population paid income tax in 2016 and only 20% of all workers were liable to pay personal income tax.

The government started two pilot programs to study property taxes in 2011, in Shanghai and Chongqing. Both projects have been slow to develop and as yet their examples have not made significant progress toward the ultimate goal of rolling out property taxes nationwide. Both cities opted to levy property tax rates at low levels and left room for many exemptions. Chongqing opted to use the property tax for luxury units while Shanghai limited it to new purchases. Neither city was making more than 1% of its revenues from property taxes a year after the projects began.

China's local governments should be allowed to tax properties and spend the money raised for their own purposes. Currently, much of their revenue comes from borrowing from the markets or from selling or leasing land. That gives them an incentive to allow relatively unrestrained urban sprawl, which causes environmental problems and relies on ever-increasing investments in infrastructure.

Property taxes would lead to less sprawl and would also lower the amount of speculation that has often contributed to overly frothy property markets in China.

Taxes could be shaped to accomplish a number of goals which could include lowering speculation and promoting home ownership.

At the start, new properties could be taxed followed by taxing the second property purchased by an owner. Eventually, all properties should be included in the tax system. Taxes could take into account incomes of the buyers, and lower-income customers might be made exempt at the start of the program.

To get going on a property tax system, China needs to build a nationwide property registration system. Although a new registration system was introduced for real estate transactions in 2015, it is expected to take at least 3 years before information on the existing stock of properties is added.

The government needs to prepare a system to value property and train appraisers to run a property valuation database. Efforts are underway in both areas.

This podcast is based on a chapter of the Asian Development Bank Institute book, *Tax and Development: Challenges in Asia and the Pacific*. The chapter, Ongoing Fiscal and Tax Reforms in the People's Republic of China, was written by Jürgen Conrad, who headed the Asian Development Bank's economics team in Beijing, and Jian Zhuang, an economist at ADB's Resident Mission in Beijing.

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