Capital gains tax to curb property speculation in selected places

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1. Introduction

1.1 The sustained low interest rate environment, coupled with other related factors such as population and income growth, has fuelled much of the recent surge in housing prices around the world. The rally has attracted speculators into the property market, driving housing prices even higher. In developed economies, demand-side measures have been introduced to prevent further market exuberance which may pose significant risks to macroeconomic and financial stability. These measures include caps on banks' lending to home buyers, taxes on flat ownership and transactions, and curtailment of mortgage interest deduction. Some developed economies have also made use of capital gains tax ("CGT") to curb speculative behaviours such as house flipping, ownership of multiple properties, and purchases by foreign investors.

1.2 In Hong Kong, the Government has since 2010 implemented demand-side management[1] and macro-prudential measures[2] to dampen investment, speculative and non-local demand. Their implementation has helped reduce the number of short-term sales and purchases by non-local individuals/companies[3]. Nevertheless, flat prices have seen almost uninterrupted increase between 2010 and 2020,[4] as evidenced by the doubling of the residential property price index over the period.[5] This has given rise to discussions about whether additional demand-side tools – such as CGT on the sale of properties[6] – should be introduced to disincentivize speculation in the housing market. At the request of Hon CHEUNG Kwok-kwan, the Research Office has completed a research task on the adoption of CGT measures to curb property speculation in Canada, New Zealand, South Korea, Taiwan and the United Kingdom ("UK"). The relevant documents are set out in an information pack with findings outlined below and in **Table**.

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1 These include (a) Special Stamp Duty ("SSD") since November 2010 to curb short-term speculation in residential properties; (b) Buyer's Stamp Duty since October 2012 to suppress the investment demand of non-Hong Kong permanent residents; and (c) increasing the rate of ad valorem Stamp Duty since February 2013 to target buyers of multiple residential properties.

2 The Hong Kong Monetary Authority has put in place macro-prudential tools, such as limits on loan-to-value and debt-servicing ratios, to reign in housing prices through the control of credit conditions and household leverage.

3 The number of short-term resales remained low at 47 cases per month or 0.9% of total transactions in 2020. The corresponding figures for purchases by non-local individuals/companies also stayed low at 16 and 0.3%.

4 Amid the Coronavirus Disease 2019, the Hong Kong economy registered a contraction for the second consecutive year in 2020. Yet, flat price in December 2020 were on average broadly the same as in December 2019.

5 On annual average increase basis, flat prices increased by 9.7% per year between 2010 and 2020.

6 The existing SSD targets short-term speculation of residential properties which are resold within 36 months after their acquisition. It has been suggested that CGT may replace SSD as it would enable (a) taxing of gains but not losses from the sale or transfer of property; and (b) taxing of gains on properties held for more than 36 months which are not currently covered by SSD.

2. Taxation of capital gains from the sale of properties

2.1 The net capital gains[7] realized from the sale of designated properties are taxable in the places studied. In New Zealand and Taiwan, CGT is used as **the only tax measure** to deter property speculation, with rules to ensure that properties purchased and sold within a specified time period are subject to tax. In contrast, CGT is used as **a supplementary tax measure** in Canada, South Korea, and the UK – alongside stamp duty and/or property tax – to combat speculative activities. Reflecting the need to balance between deterring speculation and supporting owner-occupiers, gains from primary residences are generally exempt from tax.[8]

2.2 The taxation of capital gains on properties can be used to target specific speculative behaviours depending on particular policy needs. For instance, South Korea and Taiwan deter short-term housing flipping with **tapered tax rates** corresponding to the holding period, i.e. the shorter the property is held before disposal, the higher the tax rate. South Korea also imposes a tax surcharge on properties in cities designated as speculative areas, whereas Taiwan has a more stringent tax schedule for non-resident investors. On the other hand, Canada, New Zealand and the UK impose **progressive tax rates** on gains from the sale of properties, meaning that an investor who make more gains on properties are subject to a heavier tax burden.

2.3 Nevertheless, the implementation of CGT might have unintended consequences on the property market. CGT might affect **housing liquidity** insofar as investors are induced to hold longer onto their appreciated properties to avoid paying CGT.[9] In addition, investors might **evade tax liability** by holding properties through corporate entities, which has prompted South Korea and Taiwan to align more closely the individual and corporate tax rates on the sale of properties.

2.4 Overseas experience also suggests that CGT has achieved **mixed results** as a demand-side measure to curb property speculation. In South Korea and Taiwan, the imposition of more stringent CGT arrangements has resulted in a more subdued growth in housing prices (**Figure**). Yet, residential property prices in Canada and New Zealand have been on a visible rising trend in recent years notwithstanding the introduction of CGT. The anti-property speculation effect of tax has been offset somewhat by factors such as

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7 The net value applies as CGT allows for deductions on the amount paid to acquire, maintain or dispose of the property. These may include costs (a) incurred in improving/enhancing the property; and (b) directly connected to the disposal of the property (e.g. legal fees and property agents' commission).

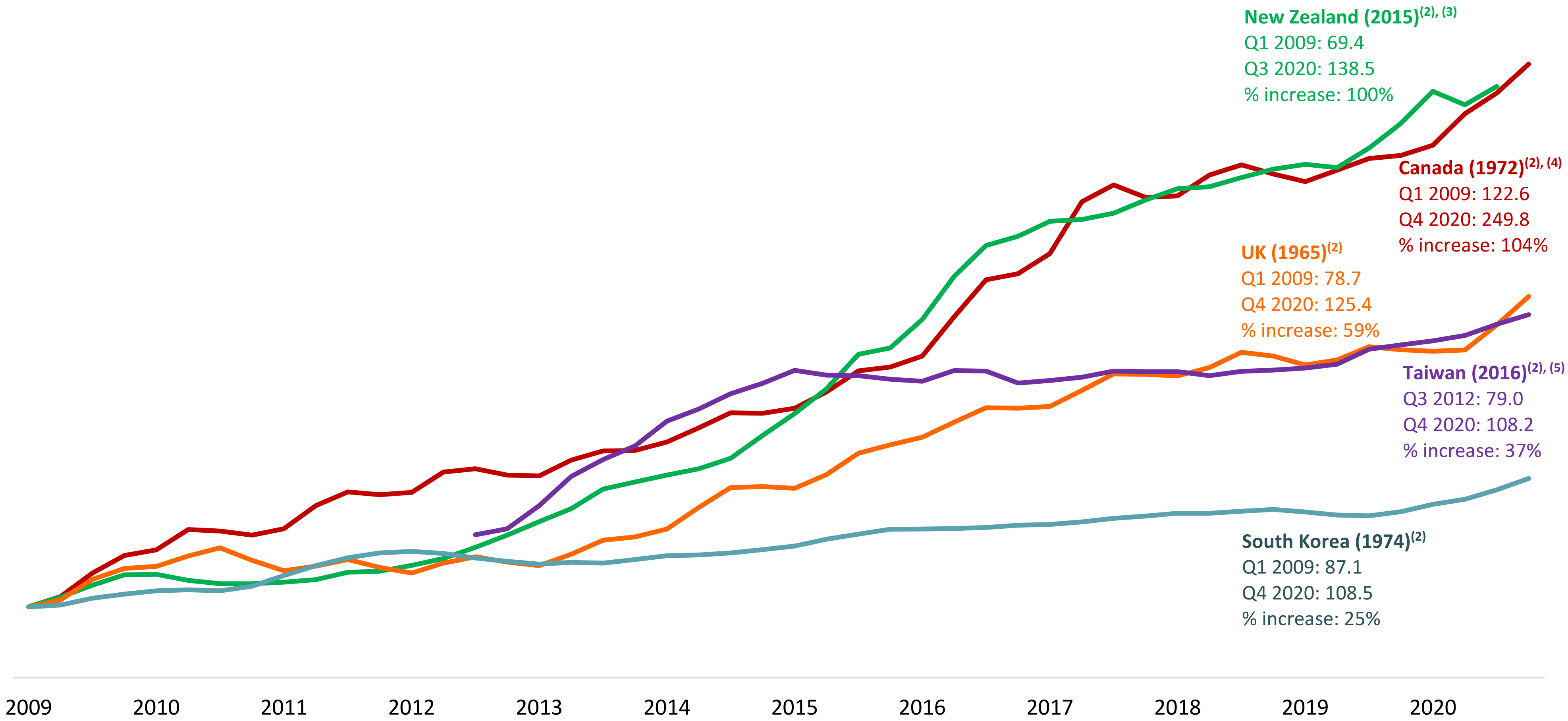
8 Taiwan is an exception as it charges a 10% tax rate on the gains from the sale of primary residences over and above NT$4 million (HK$1.04 million).

9 Concerns over the lock-in effect of CGT mainly apply to places with tapered tax rates, such as South Korea and Taiwan. There are also similar concerns in New Zealand as residential properties sold within the prescribed period are subject to CGT.

(a) less stringent tax net or inclusion rate[10] on capital gains; (b) demand-supply imbalances and the resulting housing shortages in urban areas; and (c) relatively higher loan-to-value mortgages for home buyers. In the UK, CGT has helped moderate the rising trend in housing prices following the introduction of targeted measures in April 2016, notwithstanding the high demand and record shortage of homes for sale.

[10] Inclusion rate refers to the prescribed percentage of net capital gains that are included and taxed. In Canada for instance, only 50% of net capital gains are included as taxable gains.

Figure – Quarterly housing price index[1] in Canada, New Zealand, South Korea, Taiwan and the United Kingdom, 2009-2020



Notes: (1) The housing price indices were indexed to the same base in 2009.
(2) The year in bracket refers to the year when CGT on the sale of properties was first introduced.
(3) The housing price index for New Zealand is updated up to the third quarter of 2020.
(4) The housing price index for Canada is a composite figure from 11 metropolitan areas including Vancouver, Toronto, Ottawa, Montreal and Halifax.
(5) The Taiwan government has only begun compiling the housing price index since the third quarter of 2012.

Sources: National Bank of Canada (2021), Organisation for Economic Co-operation and Development (2021) and 內政部不動產資訊平台 (2021).

Table – Taxation of capital gains from the sale of properties in Canada, New Zealand, South Korea, Taiwan and the United Kingdom

	Canada	New Zealand	South Korea	Taiwan	United Kingdom ("UK")
a. Policy background					
Inception of CGT	• Broad-based CGT regime was introduced in 1972.	• The bright-line rule which taxes gains on the sale of designated residential properties was introduced in October 2015.[1]	• The Real Estate Speculation Control Tax first came into effect in 1968, but it was replaced by a broader CGT regime in 1974.	• The House and Land Transactions Income Tax (房地合一稅) came into effect in 2016.[2]	• Broad-based CGT regime was introduced in 1965.
Average housing price increase[3]	• 5.9% per annum ("p.a.").	• 6.4% p.a.	• 1.6% p.a.	• 3.9% p.a.	• 3.7% p.a.
Macro-prudential measures to tighten mortgage lending	• The loan-to-value ratio ("LVR") is set at 80% for conventional mortgage loans and 65% for non-conforming mortgage loans.[4] Nevertheless, the LVR cap can be exceeded with the appropriate mortgage insurance.	• The Reserve Bank places the following restrictions on banks' extension of mortgage loans: (a) no more than 20% of the loans to **owner-occupier mortgages** with LVR > 80%; and (b) no more than 5% of the loans to **property investor mortgages** with LVR > 70%.	• South Korea has imposed limits on mortgage loans since 2002, with the government progressively tightening LVR to as low as 40% for designated areas such as Seoul and Sejong.	• The Central Bank has imposed LVR limit of between 40% and 55% for those who purchase multiple and/or high-value residential properties.	• Since 2014, mortgage lenders[5] are not allowed to extend more than 15% of their total number of new residential mortgages with loan-to-income ratios ≥ 4.5.
Any tax measures other than CGT to curb speculation	• Yes, for some provinces/territories. For example, Ontario taxes non-residents who purchase or acquire residential properties in designated areas, at 15% of the property value. • Separately, British Columbia levies a speculation tax in designated areas, targeting (a) properties owned by non-residents; and (b) vacant properties owned by local residents.[6]	• No.	• Yes. In order to stabilize the housing market, the South Korean government has also introduced anti-speculation measures targeting owners of multiple properties who are subject to higher acquisition and real estate holding taxes.	• No.	• Yes. Transfers of property are subject to the Stamp Duty Land Tax. For residential properties, the tax is levied at progressive rates on the value of the property. Higher rates apply for foreigners and/or owners of multiple properties.
b. Taxation of capital gains from the sale of properties					
Scope	• Under Canada's broad-based CGT regime, net capital gains from the sale or transfer of properties are taxed as individual/corporate income.	• Net capital gains from the sale of properties are taxed as individual/corporate income if they fall under the: (a) **bright-line rule** – residential properties acquired on or after October 2015 and sold within the prescribed "speculative period";[7] or (b) **intention test** – properties that (i) have been bought with a firm intention to sell; (ii) the owner has a prior record of buying and selling; or (iii) the owner is associated to a land dealer, developer or builder.	• Net capital gains from the transfer of properties are taxable. Individuals are taxed under a separate schedule, with higher tax rates for the sale of residential properties held for less than two years.	• Net capital gains from the sale of properties acquired since January 2016 are taxable. Individuals are taxed under a separate schedule, with higher tax rates for the sale of properties held under 10 years.	• Net capital gains on the sale, transfer or disposal of assets are taxable under a progressive tax schedule. This applies to most types of properties in the UK, including buy-to-let properties and business premises.

1 Prior to the introduction of the bright-line rule, capital gains on the sale of properties were only taxable if they fell within the intention test. See the row "Scope" in the table for further details about the bright-line rule and intention test.
2 The House and Land Transactions Income Tax replaced the Specifically Selected Goods and Services Tax (特種貨物及勞務稅). The latter was introduced in 2011 and imposed a 10%/15% tax on the value of a property held for two years or less.
3 The figure represents the average annual increase in residential property price indices from Q1 2009 to Q1 2020, with the exception of Taiwan which is between Q3 2012 and Q3 2020.
4 Non-conforming mortgage loans are those that have higher-risk attributes or deficiencies, such as insufficient income verification.
5 In the UK, mortgage lenders mainly include banks and building societies.
6 The Speculation and Vacancy Tax is levied at 0.5% or 2% of the assessed value of residential properties.
7 The period is set at two years for properties acquired between 1 October 2015 and 28 March 2018, five years for those acquired between 29 March 2018 and 26 March 2021, and 10 years for those acquired after 26 March 2021.

Table – Taxation of capital gains from the sale of properties in Canada, New Zealand, South Korea, Taiwan and the United Kingdom (cont'd)

	Canada	New Zealand	South Korea	Taiwan	United Kingdom ("UK")
b. Taxation of capital gains from the sale of properties (cont'd)					
Any tapering[8] of CGT rates	• No.	• No.	• Yes. The CGT rate is tapered according to the length with which properties are held.	• Yes. The CGT rate is tapered according to the length with which properties are held.	• No.
Tax rate for individuals[9]	• 50% of a net gain from the sale of a property constitutes a taxable gain, and is subject to progressive federal income tax rates ranging from 15% to 33%.[10]	• Net gains from the sale of residential properties are subject to progressive income tax rates ranging from 10.5% to 39%.	• Net gains from the sale of properties are subject to tapered tax rates ranging from 6% to 50%: (a) 50% for properties held < one year; (b) 40% for those held ≥ one year but < two years; and (c) basic tax rate [11] for those held ≥ two years. • A tax surcharge may also be applied to multi-property owners and properties situated in designated areas (e.g. Seoul).	• Net gains from the sale of properties by **local residents** are subject to tapered tax rates ranging from: (a) 45% for properties held ≤ a year; (b) 35% for those held > a year but ≤ two years; (c) 20% for those held > two years but ≤ 10 years; and (d) 15% for those held > 10 years. • Net gains made by **non-residents** from the sale of properties are subject to more stringent tax rates ranging from: (a) 45% for properties held ≤ a year; and (b) 35% for those held > a year. • The tapered tax schedules will be adjusted with effect from July 2021.[12]	• Net gains from the sale of non-residential properties are subject to progressive CGT rates of 10% (basic rate payers) or 20% (higher rate payers). • Disposal of residential properties are subject to a further eight percentage point tax surcharge (i.e. 18% or 28%).
Tax rate for corporate entities[13]	• 50% of a net gain from the sale of a property constitutes a taxable gain, and is subject to the federal corporate tax rate of 15%.[14]	• Corporate income – including net gains from the disposal of residential properties – is taxed at a flat rate of 28%.	• Corporate income is subject to progressive tax rates ranging from 10% to 25%. There is also an additional tax surcharge of 10 percentage points for net gains from the disposal of non-business related properties.[15]	• For **resident companies**, net gains from the sale of properties are taxable as corporate income at a flat rate of 20%. The tax rates for **non-resident companies** are the same as that levied on non-resident individuals. • With effect from July 2021, net gains made by resident companies from the sale of properties will also be subject to tapered tax rates of: (a) 45% for properties held ≤ two years; (b) 35% for those held > two years but ≤ five years; and (c) 20% for those held > five years.	• Corporate income – including net gains from the disposal of properties – is taxed at a flat rate of 19%.

8 Tapering refers to the incremental decrease in CGT rates as the holding period of a property increases.
9 Unless otherwise specified, the tax rate is applicable to both residents and non-residents.
10 In Canada, taxpayers pay income tax to the federal government and to the government of the province/territory where they reside.
11 The basic tax rate is a progressive tax schedule which ranges from 6% to 42%. However, properties held outside of speculative areas may enjoy deductions for long-term holding of three years or more.
12 With effect from July 2021, the net gains made by local residents from the sale of properties will be taxed at: (a) 45% for properties held ≤ two years; (b) 35% for those held > two years but ≤ five years; (c) 20% for those held > five years but ≤ 10 years; and (d) 15% for those held > 10 years. The net gains made by non-resident individuals/companies from the sale of properties will be taxed at: (a) 45% for properties held ≤ two years; and (b) 35% for those held > two years.
13 Unless otherwise specified, the tax rate is applicable to both resident and non-resident companies.
14 In Canada, corporations are taxed by the federal government and by one or more provinces or territories.
15 According to Pulse (2020), the additional tax surcharge was reportedly increased to 20 percentage points in January 2021. As such, the CGT rates for corporate entities would be in line with those for individuals, thereby disincentivizing those people who have set up corporate entities to purchase multiple properties. However, there is no official English publication of such tax change available in the public domain.

Table – Taxation of capital gains from the sale of properties in Canada, New Zealand, South Korea, Taiwan and the United Kingdom (cont'd)

	Canada	New Zealand	South Korea	Taiwan	United Kingdom ("UK")
b. Taxation of capital gains from the sale of properties (cont'd)					
Relief/ exemption for main residences	• The principal residence exemption applies to a property which has been: (a) ordinarily inhabited by the taxpayer and/or family members; and (b) designated as the sole principal residence by the taxpayer and any member of his or her family unit.	• The primary residence is generally excluded from tax as long as more than 50% of its area has been used as the main home.[16] • Under the change-of-use rules,[17] a main home which has been converted for non-residential use for more than 12 months is taxable on the amount of gains apportioned to the post-conversion period.	• Each household can claim tax exemption for a single residence provided that it: (a) has been held for two or more years; and (b) is worth not more than 900 million won (HK$5.94 million).	• A property qualifies as primary residence if: (a) the owner/family has lived there continuously for six years; (b) the property was not rented or used for business in the six years prior; and (c) the owner/family has not claimed the relief in the six years prior. • Primary residences are charged a 10% tax rate on gains over and above NT$4 million (HK$1.04 million).	• The Private Residence Relief applies to a property which: (a) has served as the main home for all the time that it is owned; (b) has not been let out; (c) has not been used exclusively for business purposes – whether in part or in whole; (d) is less than 5 000 square metres; and (e) was not bought just for a gain.
Recent developments	• In response to concerns over the emergence of a housing bubble, some have suggested the government to impose a stricter CGT regime by (a) increasing the inclusion rate on real estate; or (b) removing the exemption for principal residences.	• The renewed increase in housing prices has prompted the government to extend the bright-line period from five years to 10 years on 27 March 2021 for properties acquired on or after that date (excluding new builds).	• The South Korean government has since 2017 imposed stricter CGT rates to stabilize the housing market. With the latest round of measures scheduled to come into effect in June 2021, the top marginal CGT rate will be increased from 50% to 70% on the sale of residential properties held for less than two years.	• The House and Land Transactions Income Tax regime has recently been amended to include (a) higher tax rates for the sale of properties held for less than 10 years; (b) harmonized tax rates for individuals and companies; and (c) expanded tax coverage.[18] The changes will come into effect in July 2021.	• The CGT regime has remained virtually unchanged since the introduction of tax surcharge on residential properties on 6 April 2016.
c. Effect on housing market					
Effect on housing market	• Housing prices in Canada has seen relatively strong growth in the last two decades. This may be due to its more relaxed LVR limits and less stringent CGT regime (including a 50% inclusion rate for all capital gains since 2001).[19]	• While housing price growth in New Zealand decelerated following introduction of the bright-line rule, housing prices have been gaining upward momentum again since 2019 amid favourable market fundamentals such as strong economic growth, low interest rates and limited supply.	• Housing prices in South Korea have seen relatively modest growth in the last decade. Yet, in spite of the government's cooling measures since 2017, housing prices have seen accelerating growth driven mainly by population increases and housing shortages in urban areas such as Seoul.	• Housing prices have remained stable following implementation of the House and Land Transactions Income Tax in January 2016. While there was a visible decrease in transaction volume initially, housing liquidity has stabilized in the ensuing months.	• The introduction of targeted CGT and stamp duty measures in April 2016 has helped moderate the rising trend in house prices in recent years.
Other related issues	• In its 2021 Budget, the federal government announced its plans to implement a national speculation tax on residential properties owned by non-residents. The proposed tax is similar to that implemented in British Columbia.	• Extension of the bright-line period should exert downward pressure on housing prices in the short-to-medium term. Yet, it may also result in lock-in effects and put upward pressure on rents as fewer flats are put up for sale and end-users resort to the leasing market for their housing needs.	• The renewed rise in housing prices has been attributed to, among others, the demand-supply imbalance in urban areas. This has given rise to suggestions that the government's policy goal should focus more on increasing housing supply instead.	• There are suggestions that other tax measures – e.g. taxation on the holding of properties – should be introduced to supplement the existing CGT arrangements.	• In the UK, CGT on the sale of properties is complemented by other tax measures such as stamp duty to provide more targeted measures against speculation by non-residents and multi-property owners.

[16] The main home exclusion can only be used twice over any two-year period.

[17] The change-of-use rule was recently introduced and only applies to main homes acquired on or after 27 March 2021.

[18] With effect from July 2021, the tax regime will also cover the gains from the disposal of (a) pre-sale flats; and (b) majority stock holdings in a company where over 50% of its asset value comprises of real properties in Taiwan.

[19] The inclusion rate for capital gains was previously set at 75% from 1990 to 1999. In 2000, there was a transitional period which saw the inclusion rate decreasing from 75% to 66.6% and finally to 50%.

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Hong Kong

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