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Beijing Tax Step Rattles Developers

Levy on Profits Wallops Stocks
But May Not Cool Property Prices
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SHANGHAI, China -- China took another step that could weaken investment in its booming property sector, announcing a profit tax on real-estate developers that will likely hit both domestic and foreign companies. But analysts said the move, which hammered property stocks, might do little to reduce the soaring property prices that officials worry are causing problems for the world's fourth-biggest economy.

Property developers' stock prices fell nearly 10% yesterday after China's State Administration of Taxation said Tuesday that it plans to levy a tax starting Feb. 1 of as much as 60% on the profit builders earn from real-estate projects. While the tax bureau said the measure is meant to boost its revenue, analysts said it is likely also aimed at reducing the attractiveness of property investing by local and foreign developers alike.

The move, which revives a previous rule that hadn't been enforced, comes amid concern among China's top leaders about the risks of soaring property prices. The government worries that China's masses are being priced out of booming housing markets, that banks could be saddled with bad loans if prices fall and that real-estate investment has fueled overly rapid economic growth. But so far the government has had limited success in efforts it began in 2003 to cap prices with a mix of property taxes, restrictions on ownership and requests for banks to control their lending.

The announcement spooked stock-market investors, who worried the tax will erode profit margins for China's real-estate developers. "The days for windfall profits are gone," said Theodore Justin Novak, a senior advisor at real-estate firm DTZ Debenham Tie Leung in Shanghai. Mr. Novak said, the tax could push prices of new properties higher, because the prospect of a smaller margin could encourage developers to try to nudge up sales prices.

An index of Shanghai real-estate stocks plunged 9.3% yesterday -- although profit taking partly explained the drop, as the property index jumped 159% in 2006, beating the 130% rise in the Shanghai Composite Index. Among the biggest losers yesterday were shares in residential builder Vanke Co., which fell 10% -- the limit for Chinese stocks -- to end at 17.28 yuan, or about $2.22, in Shenzhen Stock Exchange trading. The rout also extended to China-focused property companies in Hong Kong, including Shimao Property Holdings Ltd., whose stock fell 5.1% to 13.16 Hong Kong dollars, or about $1.69.

The new tax, designed to absorb 30% to 60% of a developer's profit depending on the size of the returns, was first introduced in late 1993 but was rarely collected. Analysts said the early regulations lacked specifics, in particular, how to calculate the value a developer had added to a property. It was therefore ignored by local tax bureaus assigned to collect it.

Now, the central tax bureau says it expects developers to pay up. Tuesday's rules established more specifics for determining how much value had been added to land between the time a developer buys and sells it, taking into account what has been built.

Depending on how aggressively local tax authorities apply the rules, the tax should reduce the attractiveness of some property investment in China, particularly for smaller firms with tighter financial conditions. Foreign firms that invest in Chinese property would likely see their profit margins eroded too, whether the tax is levied on them or on local partners, because the tax would still cut into profit on each development.

One impact of the measure could be to further encourage developers to build cheaper housing, a long-running goal of Beijing. Regulations already require builders to build smaller, more-affordable apartments in certain developments. Because low-cost developments are generally less profitable, with lower profit margins, Tuesday's notice effectively subjects them to less tax. According to Tuesday's statement, a 60% profit tax would be levied on any transaction where a developer's profit is 200% or more. A profit of less than 50% would subject a developer to the minimum 30% tax. The notice suggests authorities will focus on future developments rather than claim back taxes.