Effects of Sales Tax on House Price

Stephen Chung
Senior Vice President / Director of Real Estate Analysis
Zeppelin Property Consultants Limited
April 2000

Hong Kong was relieved to hear that there were to be no new taxes for the financial year, especially when prior to the budget speech it was speculated that some form of sales tax would be announced. Nonetheless, let us **explore some of the probable consequences IF a sales tax is to be levied on real estate**.

(1) **Purely from a technical viewpoint**: whatever sales tax is applied, the same amount will be deducted from the portion the seller receives. In short, **house price will fall by the amount of the sales tax given other factors remaining the same**. This is because to the buyer, the amount that he/she has budgeted for house buying is a fixed lump sum. For example, and for convenience's sake we shall assume the transaction costs such as agency fees, legal fees and the like to be constant and thus ignore them, a buyer has available $1,010,000 left to actually pay for a house when no sales tax applies. Now, let us say a sales tax is on and it is 1% based on purchase price. The same buyer can now only afford to pay the seller $1,000,000 and the remaining $10,000 goes to paying for the 1% sales tax.

(2) **Economies having a high personal saving rate will be able to "absorb" the impact a bit more**: "Absorb" here means the buyer, because of having some reserved savings, may subject to circumstances absorb part of the applied sales tax. This implies the seller would receive a sum between, if following the above example, $1,000,000 and $1,010,000. On the other hand, economies with low saving rates may (be forced to) behave in a more money-pinching way.

(3) **Real estate investment and speculation will decrease**: because the transaction costs have gone up. Exactly how much of a decrease depends on the sales tax rate(s) being applied and generally, the higher the rate, the higher the decrease. In addition, the base for capital appreciation has also gone down. Using the above example, originally it was $1,010,000 yet after the sales tax is applied, it becomes $1,000,000. Say if the market goes up 20%, the former will become $1,212,000 while the latter will mean $1,200,000 = a difference of $2,000 YET the overall capital to be spent (including the sales tax) remains unchanged. This means the rate of return has also gone down.

(4) **Investment sentiment and "atmosphere" will likely decrease too**: though a small rate e.g. 1 to 2% may be easier to get used to. On the other hand, if a high rate such as 5% or more is applied, not only will the investors / speculators be affected, but also the actual home occupiers though in many jurisdictions there would also be some exemptions for home-buyers.
