Different Taxes and Their Impact on Residential Real Estate Prices

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By Stephen Chung BS BBldg(HKU) MS in Real Estate Development(MIT) ARICS AHKIS MAACE MHKIREA PQS RPS-QS
Zeppelin Property Consultants Limited - Phone (852) 2401 6388 / 6602 Fax (852) 2401 3084
Real Estate Development Planning, Investment Analysis, Asset Management, Marketing Strategies & Joint Ventures

Assuming two economies having the same scale, performance and characteristics except one has a higher level of taxation, the one with lower taxes is likely to have higher residential real estate prices. This is because given all other factors being equal, lower taxes = more disposable income = a higher capability to pay (for food, clothing, transportation and shelter). Nonetheless, not all types of taxes exert the same influence. A brief observation as follows:

(A) **(Personal) Income Tax**: the impact is quite direct as a higher tax % = less disposable income = lower capability to pay (or save for a down payment). For instance, say 2 families in different economies earn the same annual income of $100,000 yet one is taxed at 15% and the other at 30%. Assuming non-housing expenses occupy 30% of gross income, the lower-tax family will have $55,000 left for housing while the higher-tax family will only have $40,000. Assuming current rates, a 20-25 year term, and 30% deposit requirement, the former can afford to buy (very roughly) a $800,000 home while the latter can only afford to pay a maximum of $600,000. In other words, the higher-tax family can only pay 75% of what the lower-tax family can pay.

(B) **Capital Gains Tax**: the impact is direct yet may affect investors more than home owners (for as long as the home is not sold, it is not taxed. Also, many economies will exempt the "primary residence" from such a tax). Let's say an investor requires a 50% return on his $1M investment. If no capital gains tax applies, then he will invest if he is confident that he can sell it for $1.5M later (for simplicity, time is out of the picture). If a 30% tax applies, then he will only invest if he thinks he can sell it for around $1.7M to retain his 50% profit margin. In short, the latter investment needs to perform better and probably may look riskier to the investor given all other things being the same.

(C) **Corporate Tax**: the impact is not small yet may not be too obvious. Given all conditions for doing business being the same, the economy with the lower tax will attract more businesses, local or foreign, to set up operations there. A higher level of economic activity generally will create more vibrant markets including real estate markets.

(D) **Sales Tax**: in most developed economies this tax rate is generally within 5-10% for most goods and services. Assuming non-housing expenses occupying around 30-40% of gross family income, the impact of a 10% sales tax would be around 3-4%, i.e. relatively small.

(E) **Real Estate Taxes of all forms**: in most developed economies these taxes are usually not formidable to an extent that decisions to buy or not buy rest significantly on them. Most would-be buyers simply treat them as a budget item in the prospective transaction or ownership.

(F) **Tax-Deduction for Mortgage Interest paid**: if this facility exists, it will help boost real estate prices somewhat though this may be more psychological than real as economies offering this exemption will generally have a capital gains tax (imposed even on the "primary residence"). The cash flow is enhanced though more or less the same tax amount may be paid eventually.

Readers may use for interest the above to very roughly gauge the overall effects of taxes on real estate prices as an economy evolves and embraces probable structural changes including ones related to taxation.