

## **Review of Comprehensive Real Estate Tax from The Perspective of Property Taxation\***

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In South Korea, the recurrent tax on real estate is a dual structure composed of property tax and comprehensive real estate tax. The biggest advantage of the recurrent tax lies in its ability to secure tax revenues. The recurrent tax can function as the price of local public services. The recurrent tax can complement income tax by performing a distributive role and is theoretically explained as being able to achieve stabilization of the real estate market through changes in tax burden. The review of the comprehensive real estate tax is as follows. First, since its introduction, the tax revenue has shown significant volatility as it has been used as a policy tool. Second, the comprehensive real estate tax is difficult to regard as the price of local public services because it is levied on an individual's total values of real estate and the full amount is transferred to local governments as the real estate share tax. Third, the current comprehensive real estate tax is designed to maintain the property tax system, making it insufficient for achieving the distributive goal. Fourth, the impact of the comprehensive real estate tax on stabilizing the real estate market is difficult to empirically prove due to frequent policy changes in response to fluctuations in the real estate market. Recently, as the issue of asset disparity due to the rise in asset values has emerged worldwide, it is necessary to review the role and necessity of the comprehensive real estate tax and redesign the system accordingly.

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## 1. INTRODUCTION

On May 30th, 2024, the Constitutional Court ruled that all provisions of the comprehensive real estate tax (CRET) related to taxpayers, tax bases, tax rates, tax amounts, and tax burden limits for the years 2020-2021, when the tax burden was strengthened, were constitutional. The Constitutional Court determined that the legislative purpose of imposing the CRET is constitutional, as it aims to stabilize real estate prices and protect genuine buyers by strengthening taxation on owners of high-value real estate. It also concluded that imposing a national tax with a higher rate compared to local property tax (PT) is an appropriate means to achieve this legislative purpose (Constitutional Court Ruling 2024.5.30. 2022Hun-Ba238, etc.).

The CRET has long been a subject of considerable debate due to significant differences in tax burdens among taxpayers based on the taxation threshold, as well as the heavy taxation on owners of multiple residential properties and undeveloped or vacant land at higher rates. Since its introduction, these issues have sparked numerous controversies. In particular, since 2017, with the implementation of policies to strengthening the CRET alongside efforts to align the assessed property values with market prices, the number of taxpayers has increased more than threefold, from 400,000 in 2017 to 1.28 million in 2022, leading to heightened dissatisfaction among taxpayers.

Against this backdrop, the Yoon administration has adopted “Correcting the Real Estate Tax System for Stable Housing” as a national agenda. The administration has set objectives such as “correcting the real estate tax system, which has been used for managing the housing market, in accordance with tax principles” and “adjusting the real estate-related tax burden to an appropriate level, considering the taxpayers' ability to pay.” Regarding the CRET, the administration plans to establish fundamental reforms, including the tax rate structure, to overhaul the CRET system and optimize the tax burden. In the long term, there are also detailed plans to integrate the CRET with the PT. Recently, the Democratic Party (Minju Dang) has also voiced the need to ease the CRET for single homeowners. Consequently, there are active discussions in various fields, including academia and politics, not only about reforming the CRET but also about the potential integration with the PT.

Since the introduction of the CRET, South Korea’s recurrent tax on real estate (RTRE) system has operated under a dual structure, with both the PT and the CRET. Previously, the PT was levied on buildings, and the comprehensive land tax was levied on land, following a dual taxation approach based on the types of taxable property. However, with the introduction of the CRET in 2005, targeting owners of high-value real estate, the system was restructured into a dual system based on total property values. The PT is levied on land, non-residential buildings, and residential properties, with residential properties taxed on a per-unit basis and land taxed on a cumulative basis within the jurisdiction. The CRET is levied on the portion exceeding the nationwide aggregated taxable value for individuals on certain types of land and residential properties subject to the PT. As a result, whether the CRET is imposed depends on whether the taxable amount exceeds the threshold.

The PT on land is based on the comprehensive land tax introduced in 1990, which applies differentiated tax rates depending on the purpose and use of the land, dividing it into three categories such as general aggregate, separate aggregate, and separate taxation. This classification system for taxable properties is based on the previous comprehensive land tax, which primarily taxed land based on individual ownership. However, to address the irrationalities of comprehensive aggregate taxation,

separate criteria were established for economically or efficiently used land and land requiring policy support or heavier taxation (Park, 2018).

There has been debate about the nature of the CRET since its inception. On one hand, some view it as a RTRE, where the owning of real estate itself constitutes the tax base. On the other hand, others see the CRET as a tax on unrealized gains, considering it a prepayment of the capital gains tax, viewing it from the perspective of income tax. The courts have determined that the CRET is a RTRE (Supreme Court rulings 97Nu1563 on December 22, 1998, and 99Du110 on April 24, 2001). Due to its nature as a RTRE, the imposition and collection of the CRET have been recognized as leading to partial invasion on the principal (2006Guhap30546). Last May, the Constitutional Court also stated that “it is difficult to view the CRET as violating property rights by constituting double taxation in relation to the PT and capital gains tax” (Constitutional Court Ruling 2024.5.30. 2022Hun-Ba238, etc.). Even at the time of its introduction, the government explained that the CRET was fundamentally different from a wealth tax and was a RTRE. This highlights the need to examine the policy functions of the CRET as a RTRE for its reestablishment.

In recent years, the sharp increase in asset values, partly influenced by economic shifts during and after the COVID-19 pandemic, has fueled discussions on wealth disparity and tax reforms in advanced countries such as the United States, the United Kingdom, and Germany, including the induction of a “net wealth tax”. South Korea is no exception. Reflecting the recent era of rapidly rising asset values, discussions on wealth inequality are ongoing. It is necessary to reconsider the role of the RTRE. Especially, with ongoing discussions on integrating the PT and the CRET, it is crucial to examine the roles of the RTRE and develop the policy alternatives.

To this end, this study examines the functions and roles of the RTRE, based on the PT and the CRET, and evaluates the functions of the CRET to reestablish the role of the recurrent tax on real. The study is structured as follows: chapter 2 examines the functions of the RTRE, chapter 3 evaluates the functions of the CRET in South Korea, and chapter 4 concludes with policy implications.

## **2. THE TAX SYSTEM AND FUNCTIONS OF THE RECURRENT TAX ON REAL ESTATE**

### **2.1. The Characteristics of the Comprehensive Real Estate Tax**

In South Korea, the RTRE is structured as a dual system comprising the PT and the CRET. The CRET is an additional tax imposed on high-value real estate owners, on top of the existing PT burden. In most countries, the PT is a local tax that is based on the benefit principle. The benefit principle suggests that since the value of real estate reflects the benefits of local public services, taxing the value of real estate through PT serves as a pricing mechanism for these services. In this sense, South Korea’s PT can be said to be based on the benefit principle.

According to the benefit principle, the PT, which is a general tax burden for real estate owners, does not need to be highly progressive because the benefits of public services do not increase progressively with the value of the property. Therefore, most countries, except Denmark, apply a proportional tax rate. However, there are also arguments that the size of the benefit does increase progressively with

the value of the property (Kim and Yoo, 2020), so it is difficult to assert that progressive tax rate is not consistent with the benefit principle. Nonetheless, South Korea's PT is not entirely based on the benefit principle, as it incorporates a slight degree of progressiveness to also pursue vertical equity among all taxpayers who hold real estate.

The CRET aims to enhance the "fairness of tax burden" on real estate holdings, stabilize "real estate prices," and contribute to balanced regional development and sound national economic growth (Lee and Kim, 2012). The latter goal of balanced regional development seems to have been added because the revenue from the CRET is distributed to local governments through the real estate grant tax. The main functions of the CRET are likely "to enhance the fairness of the tax burden" and "to stabilize real estate prices."

The theoretical argument that increasing the tax burden on RTRE leads to a decrease in real estate prices through capitalization suggests that the introduction of the CRET signifies an increase in the tax burden, which, in turn, leads to the stabilization of real estate prices. Thus, real estate price stabilization can be understood as an indirect rather than a direct purpose of the CRET. Ultimately, the CRET is understood as being primarily aimed at income redistribution through the increased tax burden on high-value real estate owners. When the government introduced the CRET, it explained that it is fundamentally different from a wealth tax, emphasizing that the CRET is a RTRE rather than a wealth tax.

The CRET, given its focus on high-asset individuals, is similar as the wealth tax in Europe (Park, 2021a). The net wealth tax is levied on net wealth (total assets excluding liabilities) and is currently implemented in four countries: France, Switzerland, Norway, and Spain. Except for France, which limits its net wealth tax to real estate, the other three countries apply it to all assets, including real estate, financial assets, and more. Both the CRET and the wealth tax share the common goal of targeting the wealthy to achieve redistribution. The net wealth tax and the CRET both aim to pursue vertical equity rather than simply expanding the tax base by taxing assets that exceed a certain threshold. However, there are key differences as follows (Park, 2021a).

First, while the wealth tax aggregates the value of all taxable assets constituting wealth for taxation, the CRET is levied on each asset category separately. The wealth tax broadly defines taxable assets as those comprising wealth and taxes their combined value. In France's 2018 reform, the wealth tax (*Impôts de Solidarité sur la Fortune*, ISF), which previously taxed all assets such as real estate, cash, financial assets, furniture, vehicles, and precious metals, was replaced by the real estate wealth tax (*Impôt sur la Fortune Immobilière*, IFI), focusing solely on real estate, similar to South Korea's CRET. However, unlike France's IFI, which taxes the combined value of all taxable real estate, South Korea's CRET taxes residential properties and land separately, with land further subdivided into separate aggregate (land attached to commercial buildings) and general aggregate (undeveloped land, etc.), each taxed independently. Thus, the CRET has individual tax thresholds for residential properties, separately aggregate land, and generally aggregate land, and if a taxpayer's holdings in each category fall below these thresholds, they are exempt from the CRET, even if they own properties in all categories.

Second, while the CRET imposes a heavy penalty on multiple homeowners, the net wealth tax does not differentiate between assets and provides benefits for the primary residence, even for multiple homeowners. The net wealth tax considers housing as an asset constituting wealth, and it either exempts the primary residence from taxation or taxes only a part of its value, offering benefits to

multiple homeowners. In contrast, the CRET distinguishes between single homeowners, multiple homeowners, and corporations holding properties, with no concessions made for the primary residence in the case of multiple homeowners. Therefore, the taxation of housing under the CRET operates more as a tool aimed at achieving policy objectives by heavily taxing multiple homeowners, rather than recognizing housing as an asset in the same way as the net wealth tax.

Third, while the net wealth tax is levied on net wealth (total assets minus liabilities), the CRET is levied on the total value of real estate, distinguishing it from the net wealth tax. The net wealth tax is designed to complement income tax by taxing net wealth, and most wealth taxes are structured so that the combined tax on wealth and income does not exceed a certain percentage of income. In contrast, the CRET taxes real estate assets without considering income, making it different from the net wealth tax. The CRET can be seen as complementing the PT by applying a highly progressive tax rate on high-value real estate, thereby increasing the progressivity of the recurrent tax.

In summary, while the CRET resembles a wealth tax in that it targets high-value real estate owners, it differs fundamentally in that it does not aggregate taxable assets, imposes a heavier tax burden on multiple homeowners, and taxes the total value of real estate rather than net wealth.

## **2.2. The Functions of the Recurrent Tax on Real Estate**

### **2.2.1. Generating stable tax revenue**

The greatest advantages of the RTRE are its revenue potential and revenue stability. The primary function of taxation is to secure financial resources for central or local governments. Since the RTRE is based on “immobile” property, it is utilized as a local tax in most countries and serves as a major revenue source for local governments. The revenue stability of this tax, one of its key characteristics, further enhances its suitability as a local tax. The revenue stability of the RTRE is based on the characteristic of taxing a “presumptive value” (Bird and Slack, 2007). While the tax base, which is the value of the real estate, is required for levying the tax, the actual value of the property is difficult to ascertain until it is sold. Therefore, estimated value obtained through assessment is generally used, and this assessed value is typically lower than the market value since it is based on past transaction prices. In most cases, only a portion of the assessed value is used as the tax base (e.g., the ratio of fair market value in Korea), and limitations designed to curb rapid increases in tax burden (e.g., Proposition 13 in California, USA) result in a low reflection of the market value in the tax base.

Additionally, because the assessed value of real estate is based on past transaction prices, there is a time lag compared to current market prices, and the assessed value lags behind the market trends. Due to the characteristics of a presumptive value as the tax base, it is difficult for the tax to immediately reflect real estate market fluctuations. The limitation that the tax base does not accurately reflect the current market conditions can actually be an advantage as a local tax, as it can reduce revenue volatility caused by economic fluctuations being immediately reflected in tax revenue. Particularly for local governments, which have fewer mechanisms to absorb revenue shocks compared to central governments, revenue stability may be more essential for local taxes than for national taxes.

However, the characteristic of maintaining stable revenue despite real estate market fluctuations could also act as a limitation in the mid to long-term, as it may hinder the growth of tax revenue. The time lag in reflecting real estate market fluctuations in the tax base, and the low reflection rate of market

prices, are clear advantages in that they limit the impact of short-term shocks on revenue. However, paradoxically, the inelasticity of the RTRE implies a limitation in growth potential, as it becomes difficult for the tax base to automatically increase with economic growth. Moreover, since the RTRE is levied on the mere ownership of property, taxpayers often resist this tax, as they are required to pay taxes on assets that do not generate cash flow. To mitigate taxpayer resistance and protect those with limited liquidity, various measures to limit the increase in tax burden, such as caps on tax burden increases and caps on the growth rate of the tax base, are built into the real estate tax system. These measures, however, can act as obstacles to the natural increase of tax revenue in the mid- to long-term. Along with taxpayer resistance, the various mechanisms to limit the rise in tax burden suggest that there will be political challenges in continually expanding the tax burden, and the possibility of stagnant tax revenue is high. While the inelasticity of the RTRE provides the advantage of reducing short-term revenue volatility, it also brings the disadvantage of limiting revenue growth in the mid- to long-term.

### **2.2.2. The price of local public services**

The significance of the benefit principle in local taxation lies in its ability to function as the price mechanism for local public services, thereby guiding efficient resource allocation (Joo, 2018). Although the primary purpose of taxation is to generate revenue, it is essential to ensure tax fairness on the ability-to-pay principle or the benefit principle. The ability-to-pay principle asserts that tax burdens should be allocated according to the taxpayer's ability to pay, while the benefit principle posits that tax burdens should correspond to the benefits received from public services. The RTRE, which taxes the value of real estate, is widely regarded as the proper local tax for implementing the benefit principle. This is because the value of real estate within a jurisdiction reflects the benefits of various public services, such as education, security, roads, and parks. Consequently, an RTRE based on real estate value can function as the price paid for these public services (Park, 2021). In essence, since the quality of public services influences real estate value, the RTRE can be viewed as the cost of those services.

The benefit-tax nature of PT is grounded in Tiebout's (1956) theory of local public goods, which posits that taxpayers, given complete mobility, select their residential area based on their preferences for public goods. Expanding on Tiebout's hypothesis, Hamilton (1975) argued that PT should function as a user fee for local public goods rather than a tool for redistribution (Benefit tax view). Bird (1993) further proposed that decentralizing public sector activities to the smallest possible units enhances overall social efficiency, acknowledging the varying preferences and costs among members of society. However, for decentralization to be effective, local governments must have independent revenue sources sufficient to meet local needs (Peterson, 1973). Bird asserted that PTs on residential real estate and user fees for public services are the most appropriate revenue sources for local governments and should be utilized without central government interference. Consequently, the benefit-tax characteristic of PTs is crucial for achieving local decentralization. In most countries, PT is a local tax imposed by the lowest level of local government. Reflecting this benefit-tax characteristic, many countries apply a proportional tax rate to PT (Lee and Kim, 2018).

The PT based on the benefit principle can also improve the efficiency of resource allocation. When taxpayers bear PT as the price for local public services, they are likely to support only those activities where the benefits of services exceed the tax burden. This incentivizes local governments to allocate

resources more efficiently. The benefits of public services are reflected in real estate prices, increasing their value, and PT used for public services will eventually be capitalized into real estate values (Fischel, 2001). However, such claims can only be realized if the following strict assumptions are met (Bird and Slack, 2002). First, the funds for public services that enhance asset value must be secured through PTs. Second, voters should be able to determine property tax rates and the level of public services. Third, voters dissatisfied with the tax burden and the level of public services must be able to move freely to other jurisdictions. Fourth, voters are rational agents sensitive to changes in asset value. Finally, local governments should act in accordance with voters' preferences. However, it is practically impossible to satisfy all these conditions, meaning that a PT proposed in the Tiebout model does not exist in the real world. Nevertheless, compared to other taxes, PT is still regarded as the tax that best realizes the concept of user fees (Cabral and Hoxby, 2012).

### **2.2.3. Income redistribution**

To explain the distributive role of the RTRE, we examine the rationale for taxing property. In tax theory, income and consumption are the primary tax bases. Income is understood as a comprehensive concept based on the "comprehensive income tax" (Haig-Simons income tax), which encompasses all sources of income. It refers to the change in "potential consumption," defined as the economic value an individual can consume over a certain period without reducing their assets. Consumption is based on the approach of a "comprehensive consumption tax" and assumes that an individual's welfare (or ability to pay) is reflected in their lifetime consumption, meaning it refers to the total amount consumed over an individual's lifetime. If the goal is to adhere to the pure concept of comprehensive income, then changes in potential consumption capacity should be included in the tax base (Noh, 2002).

Comprehensive income and consumption taxes do not use assets themselves as a tax base. Instead, they argue that assets should be comprehensively taxed under the concept of "imputed rent." Under a comprehensive income tax system, imputed rental income can be understood as a measure introduced to ensure equity between homeowners (owner-occupied housing) and renters (Alm, 2018). The rental costs paid by tenants are not deductible from the tenant's comprehensive income tax, which has the same effect as being taxed on that income. Even though homeowners and renters enjoy the same housing services, homeowners do not have to pay rent, thereby increasing their potential consumption capacity. It is therefore reasonable to tax this increase in consumption capacity, known as imputed rent.

However, some literatures suggest that PTs can be seen as a supplementary tax to the imputed rental income under a comprehensive income tax. Since the current income tax system does not tax imputed rent on owner-occupied housing, PTs levied on housing value can be understood as a supplementary tax on "imputed rental income" (Masui Yoshihiro, 2018; Fatica and Prammer, 2018; Blochliger, 2015). However, the limitation of this interpretation is that PTs are levied regardless of the owner's residence, so they cannot be fully understood as a tax on imputed rental income. Current PTs are levied not only on owner-occupied housing but also on rental properties, and if PTs are interpreted as a tax on imputed rental income, it could lead to debates about double taxation on rental income (Kim, 2009; Noh, 2005).

In the early policy report for tax reform in the UK, the Meade Report (1978) advocated for reform towards a comprehensive consumption tax system and explained the reason for asset taxation, distinct from consumption, as the additional benefits that asset owners receive from holding assets. Asset



owners enjoy benefits of “security, independence, and influence” derived from asset ownership, so they should bear an additional annual wealth tax on top of the comprehensive consumption tax. However, the more recent Mirrlees Report (2011) from the UK argued that additional asset taxation is unnecessary while advocating for a tax reform towards a comprehensive consumption tax system. The Mirrlees Report defined the ability to pay as being based on social welfare, defined as a weighted average of individual welfare, which is determined by the amount of consumption and work hours. The “security, independence, and influence” benefits that Meade Report attributes to asset ownership are challenging to measure objectively as taxable capacity and do not influence social welfare functions, making additional property taxes unnecessary. As such, various discussions on property taxation reveal limitations in applying the principle of tax burden based on “ability” found in income and consumption taxes. Therefore, in many countries, the rationale for PTs is found more in the “benefit” principle than in the “ability” principle.

With the issue of wealth inequality raised in Piketty's “Capital in the Twenty-First Century” (2014), and in the context of asset value inflation due to recent quantitative easing and low-interest policies, there has been active discussion on introducing a “net wealth tax” as a corrective tax. U.S. Democratic Senator Elizabeth Warren proposed the Ultra-Millionaire Tax Act (March 1, 2021), which would tax the super-wealthy with net assets exceeding \$50 million. In the UK, there is also discussion of introducing a one-time wealth tax to cover the fiscal deficit caused by COVID-19 (Advani et al., 2020). The recent discussions on wealth taxes aim to reduce wealth disparities, indicating a renewed emphasis on the “ability-to-pay” principle in asset taxation.

#### **2.2.4. Stabilization of real estate market**

The RTRE can have an effect on stabilizing real estate prices and curbing volatility (Blochliger et al., 2015). The Comprehensive Real Estate Tax (CRET) specifically aims to “enhance the equity of the property tax burden” and “stabilize real estate prices” (Article 1 of the Comprehensive Real Estate Tax Act, “Purpose”), highlighting its role in stabilizing the real estate market. The price stabilization effect of the RTRE is attributed to the tax being capitalized into housing prices. Muellbauer (2005) illustrates this through a simplified user cost model of housing, where the user cost is defined as the sum of mortgage, maintenance, acquisition, and holding tax costs, minus the expected return on the property's value.

In the long-run steady state, the marginal value that a homeowner derives from consuming housing will equal the marginal return on investment from housing as an investment asset. The value of the property can be derived using the following equation: the property value can be considered the present value of the housing service cost (imputed rent) that the homeowner received, excluding maintenance costs and PT costs (Equation 1). Therefore, if the PT burden increases more rapidly than the imputed rent, the increase in the Tax/IMPR ratio will decrease the property value, thereby suppressing the rise in housing prices. Conversely, if the Tax/IMPR ratio decreases, the property value will increase, mitigating the decline in housing prices (Muellbauer, 2005; Blochliger et al., 2015). In other words, the volatility of housing prices depends on how the PT absorbs demand-side shocks. The price sensitivity of housing demand tends to decrease as the PT rate increases (van den Noord, 2003). All else being equal, higher tax rates reduce the marginal value of rental services, making housing demand more elastic. Although housing supply is very inelastic in the short term, it becomes more elastic in

the long term.

In this context, a permanent, exogenous shock to housing demand will moderate short-term housing price increases and reduce long-term housing price declines to a greater extent as the PT rate rises. However, in the short term, as seen in the user cost model, even if the PT rate is raised, it is natural for property values to rise if the expected return on property value is significant enough to offset the increased tax burden. Therefore, when analyzing the impact of recent PT increases on the real estate market, it would be more appropriate to conduct a long-term analysis rather than a short-term one. However, the exact duration of what constitutes the “long term” has not been empirically confirmed.

**<Equation 1> Equation for House Value in Long-run equilibrium (Muellbauer, 2005)**

$$VH = (IMPR - Maint - Tax) \left( \frac{1 + RR}{RR} \right)$$

where the notations indicate that VH is the housing value, RR is the real interest rate, IMPR is the imputed rent, Maint is the maintenance cost, and Tax is the cost of PT.

There is also a counterargument that the decrease in property value due to an increase in RTRE is a temporary phenomenon that occurs at the time of the tax burden change, rather than a permanent one. Kim (2004) points out that when recurrent property taxes are increased, the tax burden on current homeowners increases at that time, but the rate of return on property for future buyers remains unchanged. When recurrent taxes rise, the sale price decreases by the present value of the increased tax burden. Consequently, those who purchase property after the tax increase will buy at a lower price that reflects future tax burdens. Therefore, the total cost, which includes the purchase price and the tax burden, does not change for them. Norregaard (2013) similarly explains that the change in the PT burden is temporary. Once a newly introduced (or increased) PT is fully capitalized into real estate prices, current property owners will suffer a one-time loss in wealth, while new property owners will be unaffected. Thus, once established (or increased), the RTRE are considered neutral to investment because they do not affect the rate of return. This neutrality means that taxation on accumulated wealth does not change future behavior depending on the extent of the tax. While the theory suggests that property taxes can be effective in curbing speculative housing price surges and volatility, whether they are truly efficient in practice remains an empirical question (Norregaard, 2013).

### 3. EVALUATION OF THE ROLES OF COMPREHENSIVE REAL ESTATE TAX

#### 3.1. Generating Tax Revenue

Figure 1 shows the trends in revenue from the recurrent taxes on real estate and the CRET revenue as a percentage of the recurrent taxes on real estate from 2005 to 2022. The combined revenue from the PT and the CRET increased from 4.7388 trillion KRW in 2005 to 23.2788 trillion KRW in 2022, a 4.9-fold increase, averaging an annual growth rate of 9.8%. As of 2022, the RTRE accounted for 16.559 trillion KRW, while the CRET contributed 6.7198 trillion KRW, making up 28.9% of the total RTRE. Specifically, the RTRE grew from 4.0962 trillion KRW in 2005 to 16.559 trillion KRW in

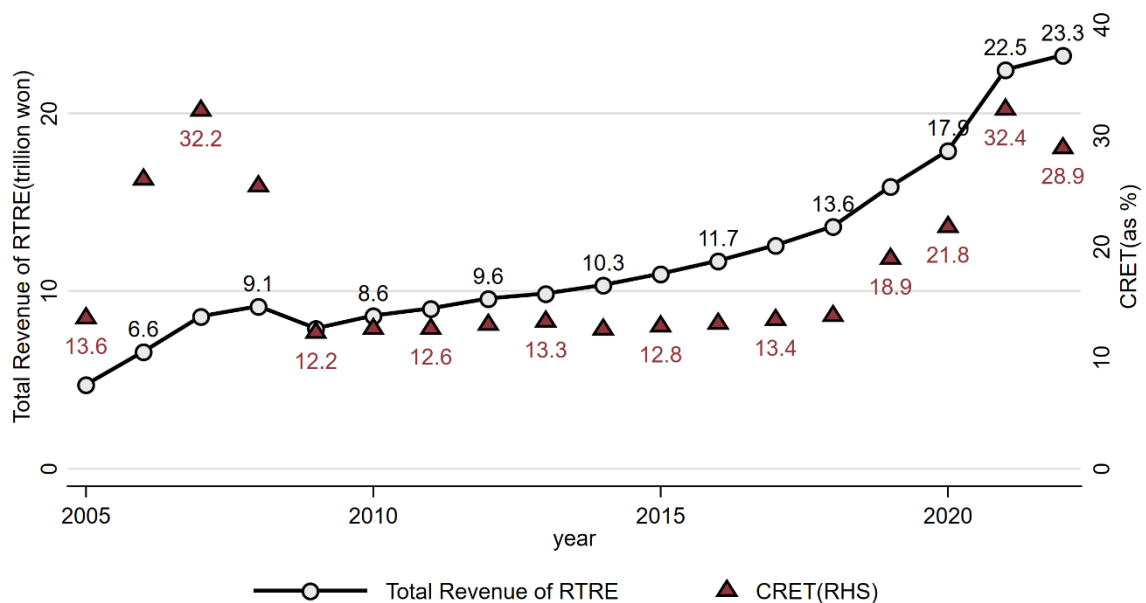
2022, with an average annual growth rate of 8.6%.

During the same period, the CRET increased at a faster rate than the PT. The CRET rose from 642.6 billion KRW in 2005 to a peak of 2.7671 trillion KRW in 2007. Afterward, it remained stagnant at around 1 trillion KRW from 2009 to 2018, before sharply increasing to 3.0072 trillion KRW in 2019, 7.2681 trillion KRW in 2021, and 6.7198 trillion KRW in 2022. This represents a 10.5-fold increase in CRET revenue from 2005 to 2022, with an average annual growth rate of 14.8%. However, in 2023, the revenue dropped by 37.6% to 4.1951 trillion KRW.

The proportion of the CRET relative to the total RTRE has shown significant volatility depending on real estate policies (Figure 1). Following the introduction of the CRET in 2005, its share of the RTRE increased from 26.0% in 2006 to 32.2% in 2007 during a period of real estate market boom and strengthened recurrent taxes on real estate. However, with the onset of the global economic crisis in 2008 and the implementation of tax relief policies in response to taxpayers' resistance against the rapidly increasing tax burden, the proportion of the CRET decreased to 25.4% in 2008 and remained in the 12-13% range for about a decade from 2009 to 2019.

Starting in 2017, with the implementation of policies to strengthen recurrent taxes on real estate through increasing the assessed values and raise the CRET, the proportion of the CRET increased to 21.8% in 2020 and further to 32.4% in 2021. However, following the suspension of the roadmap for the assessed price adjustments and the decrease in the CRET rate after 2022, the proportion decreased to 28.9% in 2022.

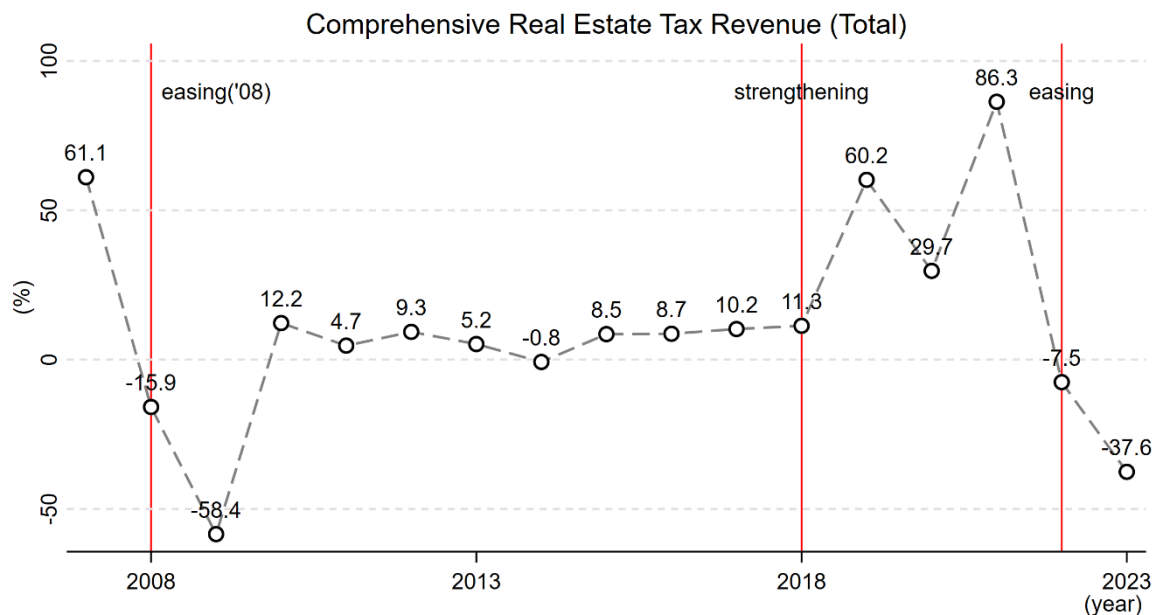
<Figure 1> Trends in Tax Revenue of Recurrent Tax on Real Estate



Note: RTRE refers to the recurrent tax on real estate and CRET refers to the comprehensive real estate tax.

The volatility in CRET revenue due to changes in PT policy directions can be more clearly observed through the year-on-year tax fluctuation rates (Figure 2). In 2007, CRET revenue increased by 61.1% compared to the previous year. However, after the implementation of tax easing policies, the year-on-year fluctuation rates showed significant declines, with decreases of 15.9% in 2008 and 58.4% in 2009. Following this period, CRET revenue increased steadily, except for in 2014. Under policies aimed at strengthening recurrent taxes, CRET revenue surged by 60.2% in 2019 and by 86.3% in 2021, growing from 1.8773 trillion KRW in 2018 to 7.2681 trillion KRW in 2021, a 3.9-fold increase, with an average annual growth rate of 57.0% during this period. However, following the tax easing policies implemented in 2022, CRET revenue decreased by 7.5% in 2022 and by 37.5% in 2023 compared to the previous year.

**Figure 2 The Percent Change in Comprehensive Real Estate Tax Revenue**



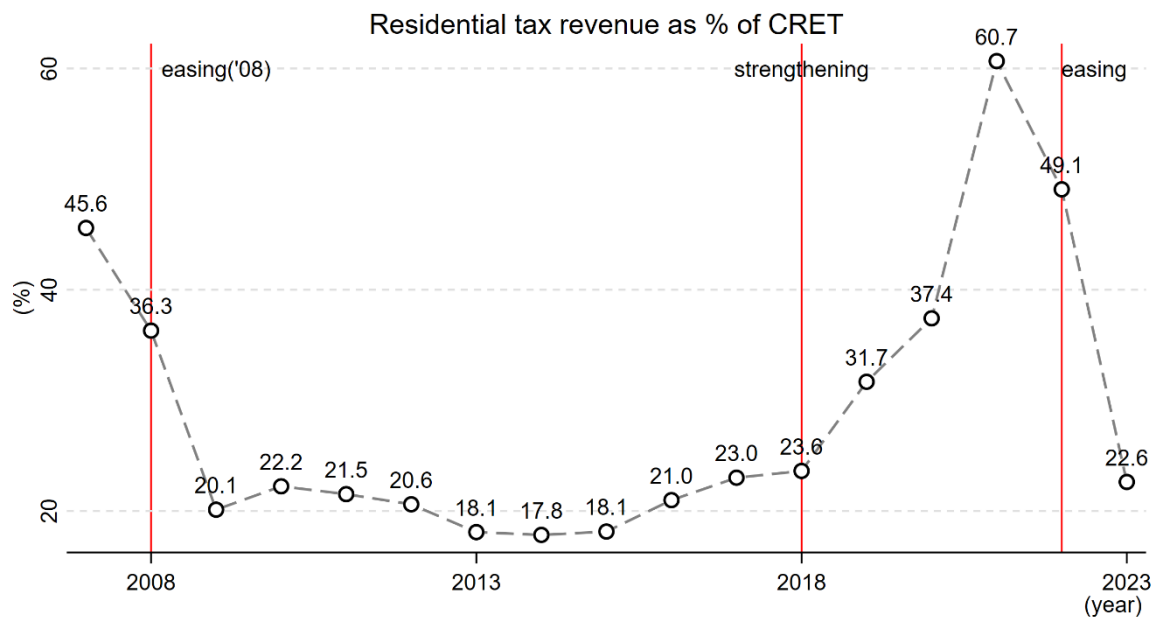
Note: “easing” refers to the period of easing policy on recurrent property taxes and “strengthening” refers to the period of strengthening policy on them.

The fluctuations in CRET revenue are largely attributed to residential tax revenue. The proportion of residential properties in CRET revenue was 45.6% in 2007. However, this share decreased to 36.3% in 2008 and further to 20.1% in 2009 due to tax easing policies. Under strengthened tax policies, this proportion increased significantly, reaching 37.4% in 2020 and 60.7% in 2021. As tax easing policies resumed, the proportion of residential properties decreased sharply again to 22.6% in 2023.

RTRE has the advantage of generating stable revenue despite fluctuations in the real estate market. This is due to the time lag in the reflection of market conditions in the tax base and the low share at which market values are reflected, which limits the impact of short-term shocks on tax revenue.

However, in South Korea, the use of residential CRET as a policy tool for stabilizing the real estate market has resulted in substantial volatility in CRET revenue over the past two decades. As a result, it is challenging to evaluate South Korea's CRET as a category capable of ensuring the revenue stability characteristic of recurrent real estate taxes.

**Figure 3 Residential Tax Revenue in Comprehensive Real Estate Tax**



Notes: 1) CRET refers to the comprehensive real estate tax.

2) “easing” refers to the period of easing policy on recurrent property taxes and “strengthening” refers to the period of strengthening policy on them.

### 3.2. The Price of Local Public Services

The CRET is levied on the portion of the aggregate property value that exceeds the threshold. As a national tax, it is levied and collected by the National Tax Services office corresponding to the taxpayer's address, not the location of the property. The entire revenue from the CRET is allocated to local governments as real estate distribution tax, including municipalities, districts, and special autonomous cities (Sejong Special Autonomous City and Jeju Special Autonomous Province). The distribution amount is determined based on criteria such as local financial conditions (50%), social welfare (35%), regional education (10%), and the scale of property taxes (5%). Therefore, the allocation of real estate distribution tax to local governments is independent of the property location and the taxpayer's address.

The benefit principle of the RTRE is based on the theoretical background that the benefit from local public services is reflected in the value of the real estate in that jurisdiction, allowing the PT on real estate to function as the price for these services. To realize the benefit principle, the geographical

scope of the benefits and the geographical scope of the tax burden must align. However, the CRET does not meet this requirement. First, since the tax is assessed based on the taxpayer's address, the CRET cannot function as the price of the increase in real estate value due to local public service input if the property location differs from the taxpayer's address. Second, even if the property location and the taxpayer's address are the same, since the tax revenue is distributed based on the local government's fiscal conditions, it is difficult for the tax as the price of public services. Therefore, the CRET, with its high progressive tax rates applied to high-value properties, cannot fulfill the benefit principle of RTRE.

### **3.3. Income Redistribution**

The purpose of the CRET is to seek vertical equity in the tax burden for high-value property owners and to achieve income redistribution. The income redistribution function of RTRE is based on the concept of comprehensive income taxation. Comprehensive income tax assesses all net changes in asset values, so the total value of real estate should be included in the taxable base. However, the CRET, which retains the PT system rather than being newly designed based on the comprehensive income tax concept, is inadequate for fulfilling its policy objective of income redistribution. The major limitation is that it continues to follow the separate taxation system for land use categories. The separate taxation, which accounts for half of the tax base of the PT on land, is not subject to the CRET, and the separate aggregate, which accounts for 42%, has a deduction limit of 8 billion won per individual. As a result, the CRET does not properly tax land that constitutes 90% of the land tax base, failing to achieve the policy goal of redistribution.

Examining the PT system, the purpose of differentiating land tax based on land use is understood as promoting efficiency of land use by reducing the tax burden on land used for policy-promoting purposes. Under the assumption that the land use designated by the government ensures the efficiency of land utilization, differentiated taxation based on land uses may hinder tax efficiency but could enhance the efficiency of land use. For instance, in industries where large land uses are unavoidable, such as agriculture, industrial facilities, and social infrastructure. For large commercial facilities in urban areas, its value can be quite high even if the land area is not very large. Land used productively as a production factor may have a high degree of ownership concentration. Considering the need to hold large and high-value land, the PT system differentiates taxation by land use and uses reduction systems to alleviate taxpayers' burdens when additional tax support is needed.

However, the CRET, which aims to perform income redistribution, has a lower need to consider the efficiency of land use. While exempting separately taxed land from the CRET may promote efficient land use, it may not be justified from an income redistribution perspective. The high exemption threshold of 8 billion won for separately aggregated commercial real estate (e.g., buildings, retail spaces, offices) distorts tax equity among different investment assets and weakens the income redistribution. Furthermore, since the CRET assesses housing, separately aggregated land (land for commercial buildings), and comprehensively aggregated land (vacant land) separately, there are individual taxable base thresholds for each type, and they are not aggregated for taxation. For example, even if an individual owns housing, separately aggregated land, and comprehensively aggregated land, if each type is below the taxable base threshold, the CRET is exempt. By following the PT system's structure

for different taxable categories, it is fundamentally challenging to achieve vertical equity in the tax burden for real estate with the CRET.

Additionally, the current CRET does not have an independent tax-abatement system and follows the PT. Considering the distributive role of the CRET, adopting the PT reduction system as is may not be appropriate. For local PT reduction systems, it is crucial to evaluate the benefits and tax costs of specific business activities on the local economy. However, to achieve the policy goals of the CRET, its reduction system should be designed differently from the PT. Evaluations of equity concerning whether the policy goals and targets are appropriate and how the introduction of specific exemptions changes tax progressivity are important. The current system of the CRET, which follows the PT system, is not suitable for fulfilling its distributive role.

### **3.4. Stabilization of Real Estate Market**

Previous studies have been conducted to analyze the impact of RTRE on the stability of the real estate market, but in South Korea, it is almost impossible to empirically analyze the effects of individual policies of real estate. This is because several policies are implemented simultaneously, including not only RTRE policies but also other demand-side policies such as increased burdens from capital gains tax and acquisition tax, as well as stricter financial regulations and various supply-side policies. As a result, it is challenging to identify the effects of individual policies. Furthermore, the period when RTRE burdens began to increase coincides with a period of rapidly rising real estate prices, indicating that the recurrent property taxes were strengthened as a policy tool to control rising prices. Thus, even if the analysis shows a positive correlation between rising real estate prices and increased the recurrent property taxes, it cannot be interpreted as a causal relationship. In other words, during periods of rising real estate prices, the government intentionally increased the recurrent property taxes, and from 2008, when prices stabilized, it eased the recurrent property taxes, leading to endogeneity issues between real estate prices and the RTRE burdens. Since the recurrent property taxes were strengthened during periods of rising prices and weakened during price declines, a clear positive correlation between real estate prices and recurrent property taxes is inevitable.

One approach to address this issue is to consider empirical analysis with a time lag between real estate prices and RTRE burdens. For instance, considering the relationship between the RTRE relief policies of the Lee Myung-bak administration and the surge in real estate prices during the Moon Jae-in administration, there is a possibility that results might show that easing PT burdens led to rising real estate prices. However, interpreting this as a policy effect should be done with caution. This is because without adequately controlling for various unobserved variables, the marginal impact of changes in the RTRE burdens on real estate prices cannot be reliably analyzed. Moreover, the Lee Myung-bak administration, like other administrations, employed both demand and supply-side policies alongside the RTRE relief, making it impossible to isolate the effects of the RTRE policies alone.

To verify these views, I conducted a simple cointegration regression analysis between housing prices and the RTRE burdens. Generally, tax revenue and housing prices are likely to be non-stationary time series, and regression analysis of non-stationary time series can result in spurious regression. Differencing a time series can lead to the loss of information about long-term changes in the data and only show short-term fluctuations. To address this issue, I used a cointegration regression model.

Therefore, it is necessary to check whether a cointegration relationship exists in the model. If a cointegration relationship exists between variables, it can be considered a long-term model between non-stationary time series. The establishment of a cointegration relationship implies that the residuals of the regression analysis should not have a unit root and should exhibit stationarity. Augmented Dickey-Fuller test for a unit root indicate that a unit root exists in all variables. <Table 1> shows ADF test results.

**Table 1 Augmented Dickey-Fuller Test Results**

Variables	Intercept		Intercept and Trend	
	t-Statistic	Prob.*	t-Statistic	Prob.*
Housing Price	1.654066	0.9996	0.355046	0.9988
Effective Tax Rate	-1.68335	0.4379	-1.82299	0.6893
M2	-0.79846	0.8169	-2.58733	0.2867
Interest Rate on Mortgages	-0.32339	0.9177	-2.32199	0.4196
GDP	-1.31639	0.6215	-1.76937	0.7153
Housing Supply (Seoul)	-2.43597	0.1334	-2.26824	0.4487
Housing Supply (Others)	-2.83466	0.0555	-2.77697	0.2078

\*MacKinnon (1996) one-sided *p*-values.

The model assumes that housing prices are determined by the effective tax rate of the RTRE, interest rates, money supply, housing supply, and income. The variables used in the regression include the apartment sales price index in Seoul (monthly) as a proxy for housing prices, the recurrent tax revenue on real estate divided by total private real estate value for the effective PT rate, the monthly mortgage interest rate interest rate, M2 for money supply, a 3-year lagged number of housing permits as a proxy for housing supply, and GDP for income.

$$\text{<Equation 2> housing prices} = f(\text{TAX, IR, M2, S, Y}),$$

where TAX refers to the effective tax rate of the RTRE, IR refers to the effective PT rate, M2 refers to money supply, S refers to housing supply, and Y refers to income.

The analysis uses Fully Modified OLS (FMOLS) to account for cointegration among time series variables, with the period set from 2006 to 2020. The simultaneous relationship between housing price and the effective tax rate was not statistically significant. The results of the simultaneous analysis between housing prices and the effective tax rate are as follows.

**Table 2 Simultaneous Regression Analysis of Housing Price**

Y=ln(Housing Price (t))	Coefficient	Standard Error	P-value
Effective Tax Rate (t)	-1.293	2.748	0.639
M2	2.903	0.321	0.000
Interest Rate	0.267	0.034	0.000
Income	-1.283	0.357	0.001
Housing Supply (Seoul, t-3)	0.169	0.041	0.000
Housing Supply (others, t-3)	0.000	0.000	0.002



Constant	-11.109	2.131	0.000
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Table 3 shows the regression results between housing prices and the effective RTRE rate. The relationship between the effective RTRE rate ( $t-1$ ) and housing prices ( $t$ ) is estimated to be positive, while the relationship between the effective RTRE rate ( $t-5$ ) and housing prices ( $t$ ) is negative. This can be interpreted as follows: a 1 percentage point increase in the effective RTRE rate leads to a 2.0% increase in housing prices after one year, but a 1.2% decrease in housing prices after five years. However, as mentioned earlier, due to issues such as endogeneity between variables and the identification problems among various policy tools, it is quite challenging to interpret the regression results as evidence that RTRE policies are effective in reducing housing prices in the long term.

**Table 3 Regression Analysis of Effective Tax Rate of RTRE on Housing Price**

Y=ln(Housing Price (t))	Coefficient	Standard Error	Y=ln(Housing Price (t))	Coefficient	Standard Error
Effective Tax Rate (t-1)	<b>2.567**</b>	<b>1.028</b>	Effective Tax Rate (t-3)	<b>-1.202*</b>	<b>0.687</b>
M2	2.044***	0.183	M2	2.302***	0.133
Interest Rate	0.209***	0.028	Interest Rate	0.227***	0.025
Income	-0.614**	0.285	Income	-0.72	0.279
Housing Supply (Seoul, t-3)	0.096***	0.033	Housing Supply (Seoul, t-3)	0.094***	0.031
Housing Supply (Others, t-3)	0.000***	0	Housing Supply (Others, t-3)	0.000***	0
Constant	-9.024***	1.763	Constant	-9.700***	1.73

Note: \*\*\*, \*\*, and \* denote statistical significance at the 1%, 5%, and 10% levels, respectively.

In the previous studies, the long-term and short-term effects of changes in the recurrent property taxes on real estate prices do not converge to the same conclusion. Thus, the effects of the CRET on property prices and their volatility have not been empirically confirmed. Therefore, excessively adjusting the burden of CRET for the purpose of stabilizing the real estate market may result in a loss of policy consistency rather than achieving stabilization effects.

### 3.5. Summary

This chapter examines the functions of the current CRET based on criteria such as generating stable tax revenue, realization of the benefit principle, income redistribution, and real estate market stabilization. Historically, the CRET has been a policy tax system where revenue fluctuates significantly due to institutional changes based on market conditions, resulting in low revenue stability. Additionally, as it is a national tax assessed on an individual basis and entirely allocated to real estate share tax distributed according to local government fiscal conditions, it is challenging to realize the benefit principle. While the objective of the CRET is to achieve vertical equity, it has been inadequate in achieving this goal. Although the legislative intent of the CRET is to stabilize property prices, frequent policy changes based on real estate market fluctuations in Korea make it difficult to empirically prove its effectiveness, and previous research has not converged on a consistent conclusion. Thus, the effects of the CRET on property prices and their volatility have not been empirically confirmed.

#### 4. CONCLUSION

This study explains the functions of the RTRE in terms of revenue generation, realization of the benefit principle, income redistribution, and the real estate market stabilization. The primary advantage of the RTRE is its ability to generate stable revenue despite short-term shocks and its broad tax base that provides significant revenue potential. However, the characteristic of generating stable revenue despite real estate market fluctuations can also have a disadvantageous impact on revenue growth in the medium to long term. Additionally, since the recurrent taxes on real estate are levied on property value, they work as a price mechanism for local public services, making them well-suited for realizing the benefit principle.

The RTRE can perform the income redistribution function of taxation. From the perspective of fiscal decentralization, there appears to be a theoretical consensus that decentralizing the redistributive role of taxes limits the implementation of redistribution (Inman and Rubinfeld, 1996). This leads to the conclusion that redistributive policies should be centralized at higher levels of government, where mobility costs are high, and the likelihood of migration is low (e.g., Musgrave 1971, 1997; Sinn, 2003). Based on this discussion, the income redistribution function of local property taxes conflicts with the benefit principle. While many countries are currently discussing various measures to address asset inequality, they are considering the introduction of national wealth taxes rather than increasing the progressivity of local property taxes, reflecting this issue.

The CRET aims to achieve vertical equity in the tax burden for high-value property owners. However, the current CRET is designed to maintain the same structure of PT, which limits its ability to achieve its independent function. Differential taxation based on land use and tax exemption or reduction systems could enhance economic efficiency in situations where holding large and high-value land is unavoidable. However, from the perspective of income redistribution, this may not be justified. Moreover, in a situation where asset values are rapidly increasing, providing tax benefits to owners of large real estate assets based on the efficiency of land use could significantly undermine the redistributive function between property owners and non-owners. Although the primary function of the CRET is defined as stabilizing the real estate market, its impact on market volatility and prices, while theoretically demonstrated, has not been empirically confirmed.

Since the introduction of the CRET in 2005, Korea's RTRE system has operated under a dual structure of PT and CRET. While some foreign countries also operate a dual recurrent tax system, it is more common to see property taxes levied on total assets and wealth taxes levied on net assets, excluding liabilities. Although Korea's PT and CRET are classified as separate taxes, they essentially operate under a unified tax system due to the application of the same taxation framework.

If the CRET continues to follow the PT framework and tax exemption or reduction systems as it currently does, there is no need for it to be an independent tax. From a tax administration perspective, local governments already handle most of the tasks related to the CRET. Local governments compile PT data to prepare the basic data for the CRET, while the Ministry of the Interior and Safety aggregates this data by individual to calculate the tax amount, and the National Tax Service handles additional reporting and collection. Particularly, although the central government levies and collects the CRET, local governments use the entire revenue, reducing the central government's incentive to actively collect

the tax. As a result, while the collection rate for PT is 98%, the collection rate for the CRET is only 85%. If the CRET maintains the current PT framework, it would be more efficient from a tax administration perspective to absorb it into the PT rather than keeping it as an independent tax.

Recently, with the global rise in asset values and the issue of asset inequality, advanced countries like the United States, the United Kingdom, and Germany are actively discussing the introduction of “net wealth taxes” to complement the income redistribution of their existing tax systems. In light of the increasing wealth inequality in Korea, it is essential to reconsider the role of the RTRE system. Specifically, after 20 years since the introduction of the CRET, there is a need to review its role and necessity for high-value property owners and redesign the system accordingly to meet the policy objectives.

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