SILESIAN UNIVERSITY

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PROPERTY TAXES

PRESENTATION SUBTITLE

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INTERNATIONAL TAXATION AND TAX SYSTEMS/NPMZD

OUTLINE OF THE LECTURE

1. HISTORY OF PROPERTY TAXES

2. PROPERTY TAX DESIGN

3. IMMOVABLE PROPERTY TAX DESIGN

"The power of taxing people and their property is essential to the very existence of government." ~ James Madison

HISTORY OF PROPERTY TAXES

- Property taxes were used in Egypt, Babylon, Persia, and China and throughout the ancient world. Most people were poor and lived in hovels. The primary focus of early property taxation was land and its production value.

- After 1066, William the Conqueror created an early form of land taxation. Town officials kept cadastral records of everyone who owned property. Each town kept a book of the assessment of each property and the total amount of property tax due for each person.

HISTORY OF PROPERTY TAXES

- After 1290, personal property taxes were implemented in England with exemptions for the poorest (i.e., those whose assessments were less than a shilling). The church was also exempt.
- The personal property tax rate was one-tenth for those who resided in cities and one-fifteenth for rural residents. These assessments were rough estimates of a person’s assets, and underassessment was the norm. The average tax equaled about two shillings per annum, which was about two days’ wages for a peasant. The personal property tax was difficult to administer because many people attempted to hide and move personal property. This practice was especially common among wealthier taxpayers who had multiple residences and moved assets to avoid taxation.

HISTORY OF PROPERTY TAXES

- In Boston, the Puritans implemented property taxes to pay for the church and the religious education of their children. Regardless of one’s religion, it was mandatory that everyone pay the property tax. Taxes from Boston’s towns went directly to the church. This practice lasted for over one hundred years. The Boston Town Records of 1676 show the name of each taxpayer, the number of acres of land, the value of houses, the number of cows, swine and sheep, the value of mills and the assessment of personal estate. The assessors kept maps that were numbered. Each number had corresponding narratives listing assets, value and tax. Detailed and proportionate maps showed the metes and bounds of property. Assessors used maps of various scale. By 1822, Boston assessing records broke down real and personal property value along with the calculated taxes for each taxpayer.

HISTORY OF PROPERTY TAXES IN EUROPE

- The Enlightenment also saw technological advancements in property tax administration. The development of the Austrian cadastre in the 18th century became the model for cadastral systems until the advent of computers and aerial photogrammetric mapping. Many countries' cadastral records are organized according to cadastral areas (or "communities") derived from the original cadastral surveys made during the Austro-Hungarian Empire.
- The post war period has seen technological advancements. The advent of digital computers has made advancements in cadastral and valuation systems. Rising expectations about the integrity of valuations has led to the development of professional valuation standards. Mass valuation for property taxation is not a major concern, however.

PROPERTY TAXES

- There are good economic reasons for taxing property.
- The supply of property, and especially land, is not very responsive to its price, which means that it can be taxed without significantly distorting people's behaviour.
- The ownership of land is also generally visible and easily established, which makes it relatively straightforward to identify who should be paying the tax.
- The fact that land and property have identifiable and unchangeable geographic locations also makes them natural tax bases for the financing of local government.
- But deciding exactly how to tax land and property is particularly complex, because they combine a number of characteristics that each suggest different tax treatments.

HOW TO TAX PROPERTY

- To understand how to tax land and property, it is important to keep these issues and themes distinct.
- To be clear:
    - ➢ Land, whether used for business or residential property, can be taxed at an arbitrarily high rate on economic efficiency grounds.
    - ➢ Business property is an input into the production process and, on efficiency grounds, should not be taxed.
    - ➢ Owner-occupied housing combines the features of an investment and a consumption good, and we should consider its taxation from both these points of view.
    - ➢ Rental housing is an investment good from the point of view of the owner and a consumption good from the view of the renter. Overall, there is a presumption in favour of taxing it at a similar level to owner-occupied housing.

➢ Land and property should be thought of as distinct bases for taxation, although in most countries taxes are levied on the combined value of property and the land on which it is located.

LAND TAX

- The economic case for taxing land itself is very strong and there is a long history of arguments in favour of it. Taxing land ownership is equivalent to taxing an economic rent—to do so does not discourage any desirable activity.
- Land is not a produced input; its supply is fixed and cannot be affected by the introduction of a tax.
- With the same amount of land available, people would not be willing to pay any more for it than before, so (the present value of) a land value tax (LVT) would be reflected one-for-one in a lower price of land: the classic example of tax capitalization.
- Owners of land on the day such a tax is announced would suffer a windfall loss as the value of their asset was reduced. But this windfall loss is the only effect of the tax: the incentive to buy, develop, or use land would not change.
- Economic activity that was previously worthwhile remains worthwhile.
- Moreover, a tax on land value would also capture the benefits accruing to landowners from external developments rather than their own efforts.
- Henry George, the political economist, writing in the mid 19th century, argued that land taxes are equitable because the value of land is determined by community effort, not by individual effort.

BUSINESS PROPERTY

- In the UK, business property is taxed through the national non-domestic rate (or business rates), which is levied as a percentage of the estimated rental value of the property, with reduced rates for low-value properties.
- The business rate is not a good tax. It discriminates between different sorts of businesses—agriculture is exempt, for example. More fundamentally, from an economic perspective, business property is an input to the productive process of a company.
- Another effect of business rates in practice arises from the treatment of unused or undeveloped land, on which business rates are levied at reduced or zero rates.
- This provides a clear and perverse incentive to use land inefficiently. This puts the issue in rather stark perspective.
- If property is subject to tax and land is not, then, if the property is not being used, a tax incentive for demolition is created. If empty or unused property is taxed at a lower rate than property being used, then a tax disincentive to use it is created.
- An LVT avoids these problems.

HOUSING TAXATION

- Whilst there are not good reasons for taxing business property, there are good reasons for taxing housing.
- Housing has two main attributes that are relevant for tax design:
    - First, by living in a house, you consume a flow of services. If we have a consumption tax such as a VAT, a reasonable presumption is that housing should in some way be covered by it.
    - Second, homeowners also own a valuable asset; indeed, it is usually their most valuable asset. The value of the house may go up and down.

▪ The distinction between these two attributes is explicit in the case of private rented property: the landlord invests in the asset, while the renter consumes (and pays for) the flow of services. But the two attributes are just as surely present in owner-occupied housing: in effect, the owner-occupier is both landlord and tenant simultaneously.

▪ At present, the tax system treats rented and owner-occupied properties differently, creating a distortion in favour of owner-occupation.

TYPES OF TAXES ON PROPERTY

- When considering property tax revenues, it can be important to distinguish among the various kinds of taxes on property.
- The International Monetary Fund (IMF) and OECD have developed largely complementary schemes for classifying taxes, which they use in presenting revenue statistics. Taxes on property include:
  - recurrent (annual) taxes on real (immovable)property,
  - recurrent taxes on net wealth,
  - taxes on estates, inheritances, and gifts,
  - taxes on financial and capital transactions (including real property transfers),
  - other non-recurrent taxes,
  - other recurrent taxes on property (including taxes on movable property such as vehicles and machinery and equipment).

PROPERTY TAXES

- Public finance experts regard taxes on immovable property as a suitable source of revenue for local governments.
- They also believe that they contribute to a well balanced revenue system.
- Revenue systems that include a mix of taxes and other sources of revenue make it easier to find a balance among competing policy objectives, weather economic difficulties, and compete effectively in the global economy.
- Immovable property taxes are suited to local governments because it is clear which government is entitled to the tax revenue from immovable property, and such property cannot flee the tax collector.
- Local government services often are provided to properties or their owners and occupants.

PROPERTY TAX RATES

- There are several approaches to setting property tax rates.
- Rates can be:
  - fixed in legislation,
  - determined based on budgetary needs,
  - some combination of the above,
  - periodically adjusted for inflation.
- Rate structures can be uniform or progressive.
- Property tax rates can be single or compound.

FIXED RATES

- Fixed rates or fixed ranges in rates are simplest to introduce.
- However, such rate structures give local governments only a limited ability to set rates that match local needs.
- It is difficult to match burdens with the capacity to pay taxes.
- Moreover, yields cannot be easily predetermined, and, once maximum rates are reached, yields are totally dependent on the size of the property tax base.
- Inflation and infrequent reassessments may diminish revenues in real terms.
- However, tax rates or values can be indexed to reduce such losses.
- Countries with indexing include Georgia, Moldova, Poland (the agricultural land tax is based on price of 500 kg of rye), Russia, Slovakia, United Kingdom (Uniform Business Rate).

RATES BASED ON BUDGETARY NEEDS

- When rates are based on budgetary needs, the first step is to determine the amount of revenue desired from the property tax, which is called the property tax levy.
- This levy usually is the difference between planned expenditures and the revenues anticipated from other sources (fees, other taxes, grants from other tiers of government, and so forth).
- This approach is taken in France and Netherlands, where there are no limits, except that annual increases in either the owner’s tax rate or the user’s tax rate cannot exceed 20 percent.
- Subject to any canton limits, municipalities in Switzerland also may set rates based on budgetary needs.

COMPOUND PROPERTY TAX RATES

- Property tax rates can be single or compound (that is, built up from the rates of overlapping regional and local governments).
- A compound tax rate structure can blur accountability for overall property tax burdens.

- Examples of compound rates can be found in Austria, Belgium, Denmark, France, and Germany.
- In Austria, the rate applied to a particular property is the federal rate multiplied by municipal coefficient (the maximum multiple is 5 or 500%).
- Similar to Austria, the rate in Germany is a combination of the federal basic rate (Steuermesszahl) and the locally determined municipal coefficients (Hebesatz).
- In Belgium, the rate is the sum of the regional rate and the municipal rate.

TAXABLE PROPERTY

- The objects (or coverage) of a property tax are the types of property for which the tax must be paid absent an exemption or other form of property tax relief.
- Property falls into two general categories:
    - immovable property
    - movable property (which in its broadest definition is all property that is not immovable, in practice, only certain kinds of movable property are taxed, e.g., business machinery and equipment and vehicles, aircraft, and watercraft).

- Because movable property is defined by exception, precise categorization of property as movable or immovable can be difficult in practice, and gray areas inevitably arise.

BASIS OF ASSESSMENT

- The basis of a property tax is the quantity that is measured or estimated to decide each property's relative share of the total property tax burden.

- The two fundamental bases are value and non-value (area based system).

AREA BASED SYSTEM

- Land area, building area, or both is the usual basis for non-value property tax system.
- Under area-based property tax systems, taxes are determined simply by multiplying a measurement of area by a rate and any applicable modifying coefficients.
- Area-based systems have the advantage of being simpler to administer.
- Basically, only property classifications and area measurements are needed. They are easier to implement, because market data do not have to be collected and analyzed. There is no need for revaluations.
- They also are more objective than value-based systems, in that area measurements are less contestable than value determinations.
- On the other hand, area-based property tax systems are often believed to be less fair. Highly desirable properties pay the same taxes as undesirable properties.
- The disadvantages of area-based systems can be offset by the introduction of adjustment coefficients.

VALUE BASED SYSTEM

- Meaningful uniformity in property taxation is achieved when effective property tax rates (property taxes as a percentage of property values) are roughly equal.
- Uniformity is most easily achieved when current market value is the basis of the property tax.
- When a measure of value is the basis for a property tax, there are several options - market value, restricted market value (such as current use value), or some notional (or normative) value.

- Moreover, value can be on:
  - a capital value or
  - an annual-value basis.

- Each basis will have advantages and disadvantages of a theoretical and practical nature.

VALUE BASED SYSTEM

- Under **annual value**, only the current year's rental values figure in the valuation.
- Under **capital value**, the current and future years' rental values figure in the valuation.
- When annual value is the basis, it can be expressed on a gross or net basis.
- Under the former, the owner would be assumed to pay all operating expenses; under the latter, the occupier would be assumed to pay (specified) operating expenses (such as repairs and insurance, as is the case with the British uniform business rates).
- Annual value and capital value are not mathematically equivalent ways to apportion property taxes.
- The bases vary in proportion to the capitalization factors that convert annual rental values to capital values.
- These factors are influenced by several things, including the perceived certainty that future rents will be paid.

VALUE BASED SYSTEM

- A country may use more than one basis.
- For example, agricultural property may be taxed on a current use or soil productivity basis, while urban property is taxed on a market value basis.
- Because actual value changes over time and because the methods used in valuation influence the outcome, most countries characterize property tax values as “cadastral values,” “tax values,” or some such term.
- This makes clearer the use to which the value applies.
- Professional valuation standards recognize that the purpose of a valuation can affect how value is measured.
- Moreover, actual values change over time, so that valuations made at different times will not be identical.
- In value-based property tax systems, assessments can be a fraction of the determined value.
- For example, in Sweden, properties are taxed on 75 percent of their estimated market values.

DIFFERENTIALS

- It is common to classify property on the basis of its use and to vary the amount of tax exacted from property in each class.
- The ostensible purpose of differentials is to shift burdens toward those better able to pay and away from those who are least able or who need an incentive to perform a useful activity.
- However, the real purpose can be merely to appease voters.
- Typically, agricultural and residential property is favored, and business property is not.
- The main mechanisms for establishing property tax differentials are to employ differing assessment ratios (the ratio of taxable value to market value), differing property tax rates, or both.
- In area-based systems, different coefficients can be applied to the area measurements instead of, or in addition to, rate differentials.

PERSONAL EXEMPTIONS, SIMILAR RELIEF MEASURES

- There are several additional ways of providing property tax relief to residential property owners and occupants.
- These measures can be comprehensive, favoring all residential properties, or selective, favoring only the elderly, the disabled, those who provided qualifying military service, or those with lower incomes.
- Relief usually is restricted to a person’s primary residence (in fact, second or holiday houses can be taxed at higher than normal rates).
- Relief can be given for only a portion of the assessed value (or area of the property), providing a further element of progressivity to a property tax system.
- Small, low-value residences are exempt from property taxes on grounds of “efficiency” (Netherlands).
- Other approaches for providing selective residential property tax relief are based on building area and area per family member.
- Residential property also can completely escape taxation (Belgium).

INCENTIVES AND DISINCENTIVES

- Property tax incentives are intended to influence investment decisions and reward (or subsidize) certain economic activities.
- Incentives usually provide only a partial exemption.
- Except for agriculture, incentives usually are for a limited period, such as five to ten years.
- When they are of a fixed duration, they often are on a sliding scale basis.
- That is, the amount (percentage) of property tax relief is reduced in steps each year until the exemption is completely eliminated.
- Incentives available to individual properties often require an application, and they may be contractually enforced.
- That is, they are received only as long as contractual conditions are met.
- Penalties may be applied when property use is changed.

INCENTIVES AND DISINCENTIVES

- Although not as common, higher (as opposed to lower) taxation also can be used as an incentive.
- Under this approach, property taxes would be lowered to the normal level if the desirable activity occurs.
- At one time the tax rate on unfinished construction in Belarus is ten times the rate on ordinary commercial enterprises.
- In Bulgaria, undeveloped plots are assessed at 125 percent.
- Lithuania taxed buildings that had been unused for more than one year at 5 percent instead of the usual 1 percent.
- It is unlikely that such punitive differentials are effective, especially when demand for the type of building in question is low or nonexistent.

INSTITUTIONAL EXEMPTIONS

- Countries commonly exempt from property taxation some or all of the property owned by certain types of non-profit organizations, provided that the properties are used for qualifying purposes.
- Common exemptions include property owned by:
  - governments (central, regional, and local governments) and used for governmental purposes (including property of foreign states, such as embassies);
  - institutions that provide charitable, educational, and other quasigovernmental services and used for stipulated purposes (such as non-profit hospitals);
  - religious institutions and used for religious purposes.
- Usually institutional exemptions are complete (100 percent) and are of indefinite duration. Initial applications and periodic reapplications can be required.

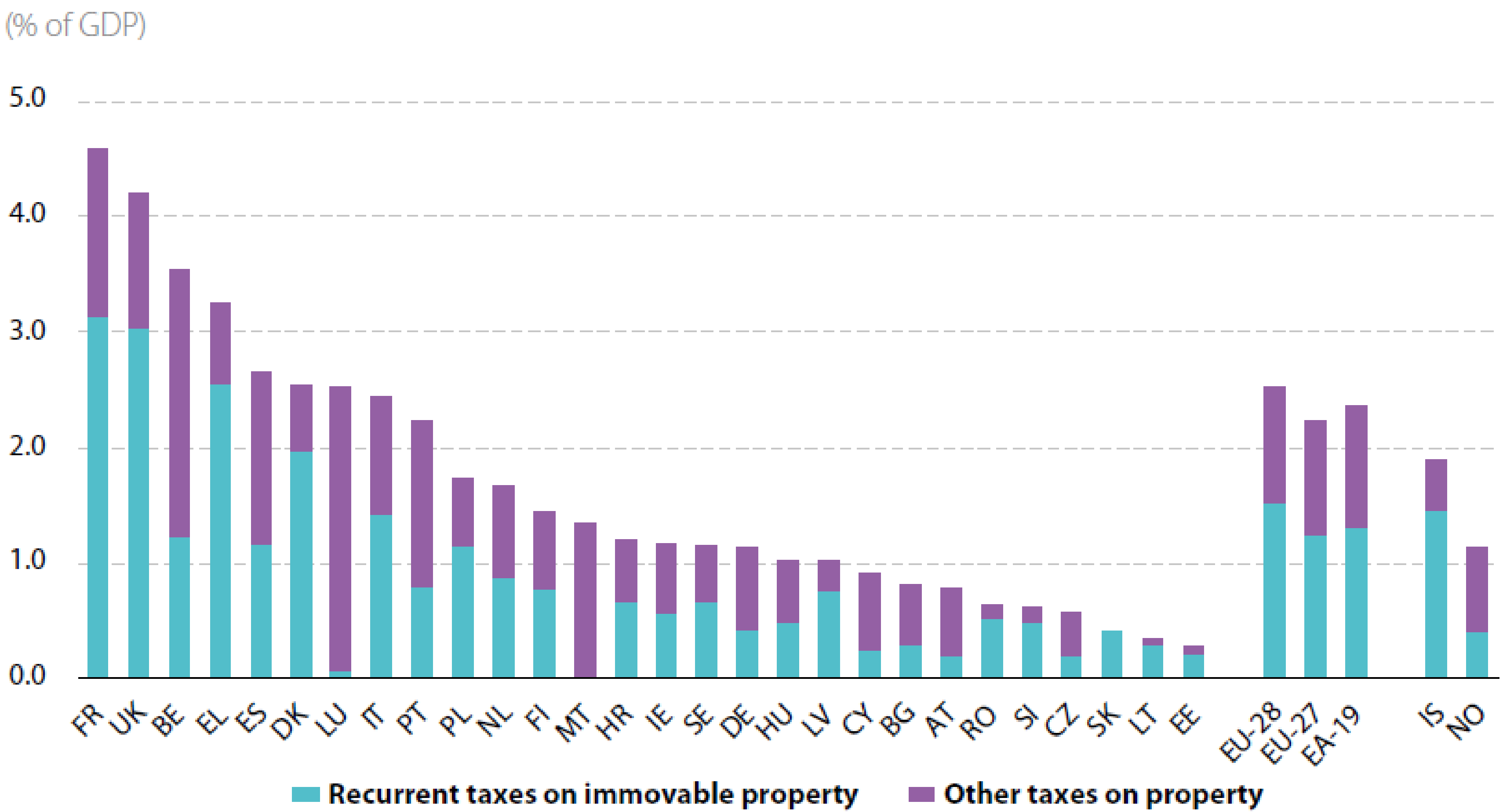
PROPERTY TAX ADMINISTRATION

- Property tax administration embraces
  - supervision and control;
  - fiscal cadastre maintenance, assessment, and sometimes valuation;
  - billing, collection (including enforcement of past-due obligations), and accounting for revenues;
  - and appeal.

- Sometimes these functions are performed by different tiers of government and organizations.
- Property tax administrations must deal with stakeholders such as taxpayers (individually and through interest groups), tax recipients, and policy makers in legislative bodies.
- It also addresses self-assessment, the role of the private sector, and automation.

PROPERTY TAXES

Composition of property taxes by Member State, 2018



Source: European Commission, DG Taxation and Customs Union, based on Eurostat data.