Session 6
Recurrent Property Tax

Presentation by:

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Introduction

Property Taxation is gaining strong and renewed interest around the world.

In particular among developing countries due to its revenue mobilization potential.

Property Tax is considered a "good tax" with many desirable features.

However, Property Taxes have not yet become a significant revenue producer for developing countries...

Introduction

➢ What makes Property Tax a "good tax"?

➢ Why do Property Taxes underperform?

➢ What are the obstacles to an efficient Property Tax?

Why is property tax a "good tax"?

- Fair: imposed on property owners whose properties increase in value due to improvements in local infrastructure

- Can contribute to infrastructure development

- Transparent and visible due to immobile tax base (relatively difficult to evade)

- Efficient and stable revenue source; provides meaningful revenue autonomy to local governments in fiscal decentralized systems

- Progressive: burden predominantly borne by middle- and high-income earners

- Less distortive effects on long-term economic growth than other taxes

- Stabilizing effects on house prices; promotes efficient land use

Property tax has considerable revenue potential if well-designed and properly administered!
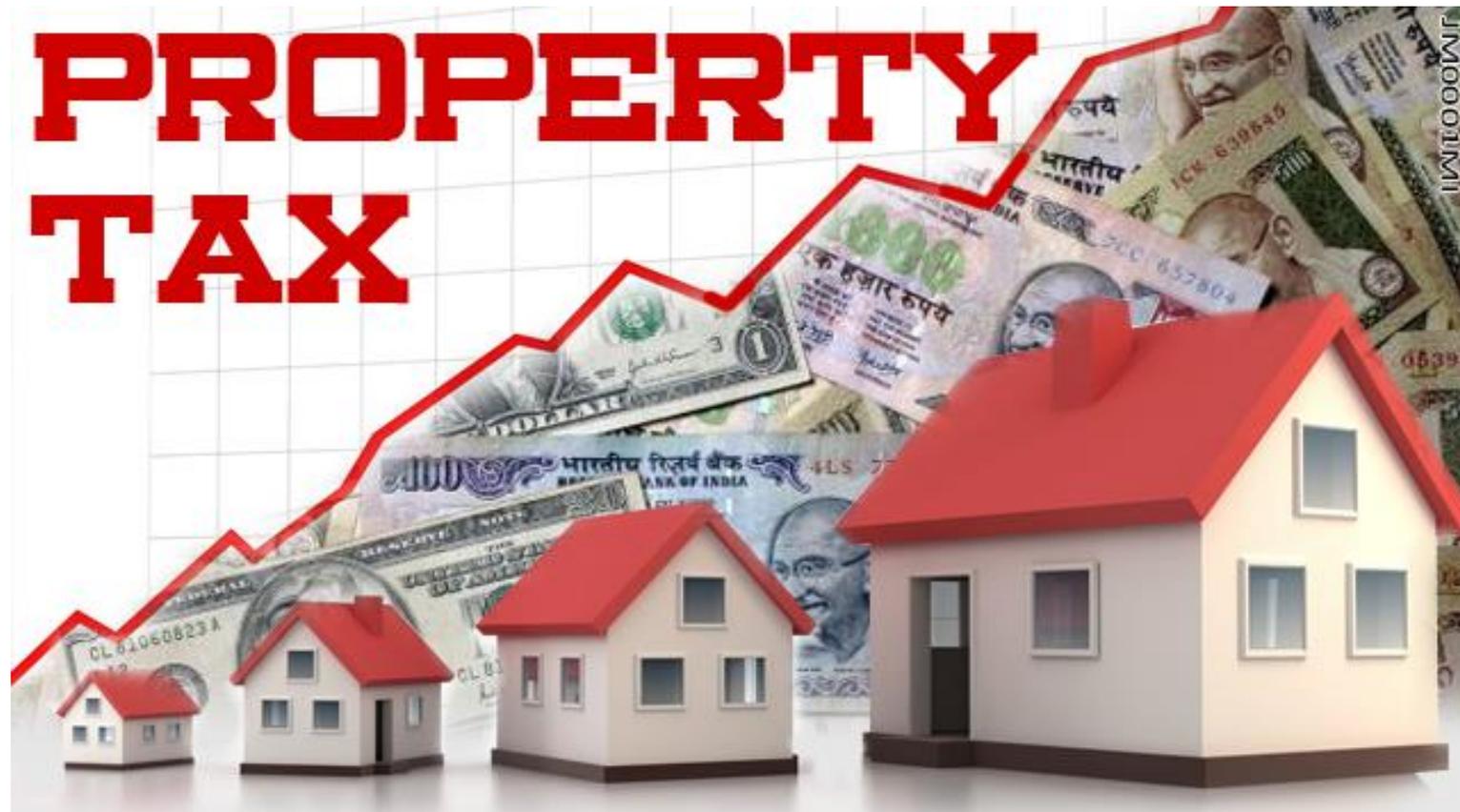
But...

➢ There are obstacles to efficient administration

➢ Requires an up-front investment in training and creation (or upgrading) of the necessary administrative infrastructure

➢ Elasticity: not as buoyant as Income or Sales taxes

➢ Unpopular with high wealth individuals and large companies – which will seek to escape its impact

Axe the Tax

PROPERTY TAX

Property Tax: revenue performance

Property Tax Revenue as a share of GDP 2014-2015
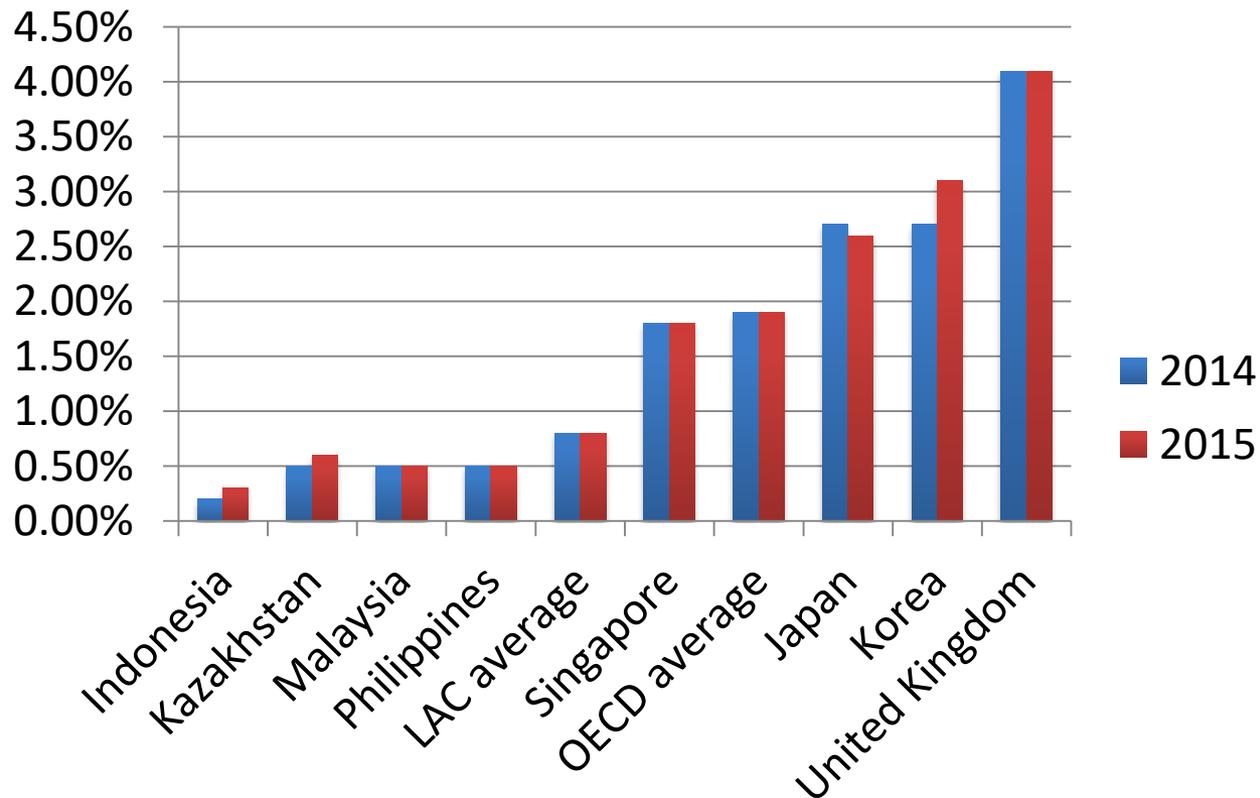
Source: OECD, Revenue Statistics in Asian Countries, 2017; OECD, Revenue Statistics 2017, OECD, Revenue Statistics in Latin America and the Caribbean 1990-2015, 2017.

Property Tax: revenue performance

Property Tax Revenue as a share of total taxation 2014-2015
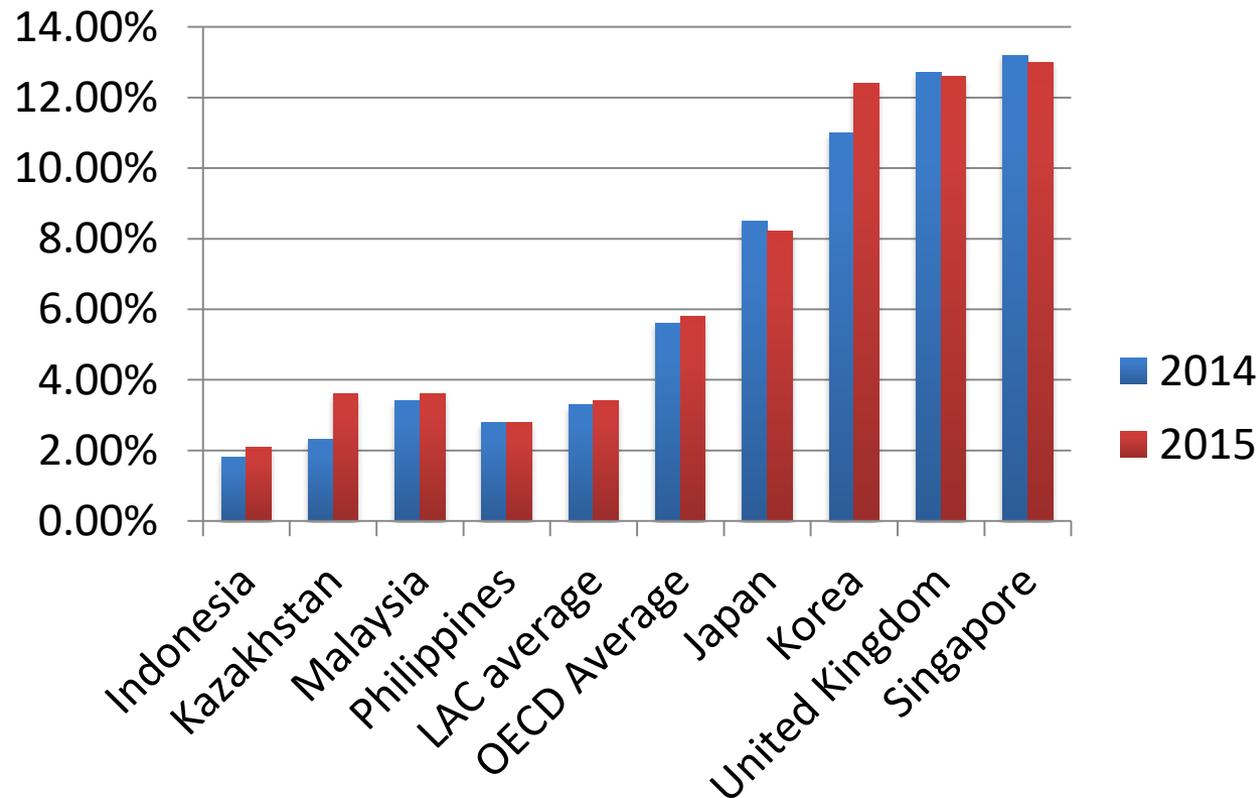
Source: OECD, Revenue Statistics in Asian Countries, 2017; OECD, Revenue Statistics 2017, OECD, Revenue Statistics in Latin America and the Caribbean 1990-2015, 2017.

Possible reasons for underperformance

Policy design	Administration	Institutional	Political
Narrow tax base, many exemptions, tax incentives, low tax rates, etc.	Capacity constraints, under-valuation, lack of re-evaluation, poor enforcement, failure to include all properties in the tax base, etc.	Institutional constraints and lack of cooperation between government agencies	Lack of political will and public support

I. Policy Design

Valuation

Tax
Base

Tax
Rate

Tax Base

Key findings

➢ The tax base of property tax varies among countries; some tax land only (site value taxation), most tax both land and improvements

➢ **Common exemptions**: government owned and occupied properties (hospitals, schools, libraries, etc.), charitable institutions, churches, cemeteries, foreign embassies, properties owned by International Organisations

➢ **Other exemptions**: agricultural land, principal residences, incentives for business properties

Tax Base

Key Lessons

➢ Little evidence to support the effectiveness of exemptions and tax incentives

➢ Special treatment of agricultural land does not prevent it from conversion to urban use

➢ Tax incentives for industrial/commercial properties to attract investments may create windfall gains

➢ Exemptions corrode the tax base, lower the levels of public services, create higher tax burden to taxed properties, affect location decisions, introduce economic distortions and may lead to perverse tax competition between municipalities

Tax Base

Conclusion

➤ Alternative instruments can be more cost-effective: e.g. exemptions for low-income households to encourage owner-occupancy could be sought through subsidies

➤ Objectives: raising domestic revenue, simplicity and fairness:

- Broad-based, few exemptions
- Sunset clauses on all exemptions
- Publishing annual expenditure analysis on revenue forgone

# Valuation

There are typically 2 approaches to determine a taxable amount:

Value-based assessment

Methods and techniques that rely on market transactions

Non-value or area-based assessment

Calculation based on size of land and/or building
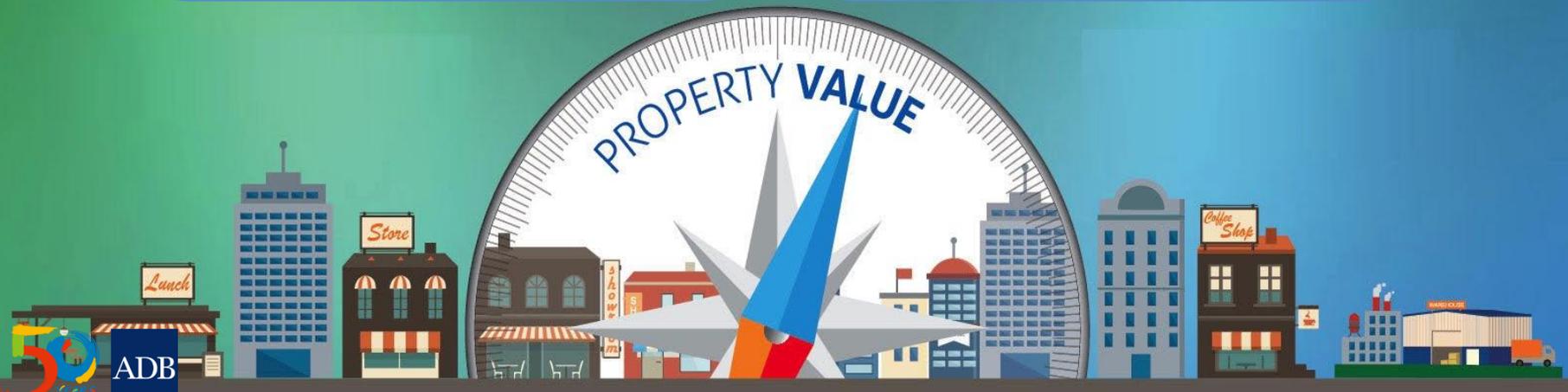
Valuation

Value-based system

Market value

- The price between a willing a buyer and a willing seller in an arm's-length transaction
  Common methods: comparable sales method (residential), income method (commercial) and replacement cost methods (unique properties)
- Most OECD countries, such as Canada, US, Japan; also the Philippines

Annual rental value

- The price for which a property might reasonable expected to be let out from year to year

- Australia, Singapore, Hong Kong, Trinidad & Tobago

Valuation

Non-Value or area-based system

Price is determined by multiplying a measurement of a area by a rate and other applicable factors

Applied on land only (rate/m2) or buildings only (rate/m2 of actual floor or usable floor area)

Common in countries where no formalized market exists (Eastern Europe, such as Poland, Czech Republic, Croatia; also Kenya, Chile and Tunisia)

Valuation

|	👍	👎
Market value	• Equitable, fair • Highest and best use • Promotes effective land use	• Requires quality data and high-skilled professionals • Taxpayer's dispute, appeals
Rental value	• Reflect current use of property	• Rent does not reflect highest and best use • Difficult to estimate rental value (issues with vacant land and rent controls)
Area based	• Simple/cheaper to administer • Less volatile than market value • No need for revaluations • Little room for taxpayer's disputes	• Unfair • Inequitable over time • Less buoyant revenues than value-based methods

Valuation

Conclusion

➢ Choice depends on the specifics of the country

➢ In theory: market value is preferred, because it maximizes fairness of the property tax and encompasses the capitalized revenues expected from the highest and best use, thus promotes land use efficiency

➢ In practice: most countries use a mixture of valuation systems (for example: the UK uses market value for residential properties and rental value on non-residential property)

➢ Some countries tax less than the assessed value (Trinidad and Tobago: 90% of the annual rental value)

Tax Rate

Key findings

➢ Tax rates are low in most countries (0.5%-1%)

➢ Many countries differentiate rates by property class (e.g. low rates on farm land; higher rates on vacant lots in urban area to discourage speculation)

➢ Level of local discretion on rate-setting varies among countries. Studies suggest that local setting of tax rates increases accountability for tax decisions at the Local level

➢ To avoid distorting tax competition among municipalities or tax exporting, setting minimum and maximum tax rates respectively may be needed at the Central level

II. Property tax Administration

'Fiscal cadastre' maintenance

Billing, collection, and enforcement

Appeal
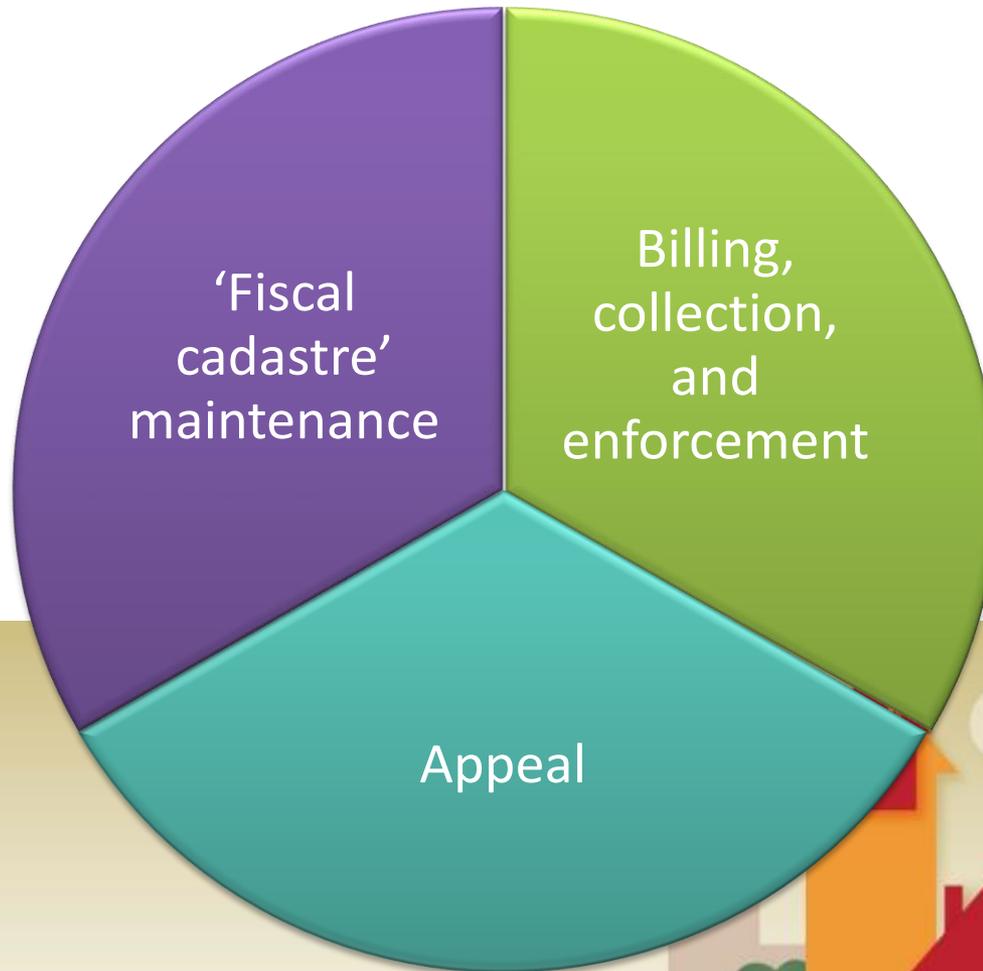
Fiscal cadastre maintenance

Key findings

➢ Fair and productive property taxes require both good initial assessment and periodic reassessments (or indexing by rate of inflation) to reflect changes in value

➢ Frequent valuations maintain the legitimacy of property tax and reduce shocks in tax burden increase

➢ The frequency of revaluation varies across countries, from annual (the Netherlands), bi-annual (Denmark) to infrequent; Most countries are in the ranges of 3-10 years

➢ Some countries use indexing (e.g. by rate of inflation) between valuation-periods

Fiscal cadastre maintenance

Common obstacles

- lack of resources and expertise to administer property tax properly

- fragmented data keeping between government agencies

- system for monitoring and recording land transfer may be lacking

- administrative functions are often performed manually and ad hoc

- poor land regulatory oversight

- problems in identifying all taxable property in the tax base

- problems updating values on a regular basis

Fiscal cadastre maintenance

Conclusion

➢ Self-assessment might be an appealing procedure in countries with limited administrative capacity, however likely to produce underestimates

➢ New technologies: computerized cadastral systems with digital maps, using computer-assisted mass appraisal (CAMA) systems to facilitate market research, integrated with tax administration and geographic information systems (GIS)
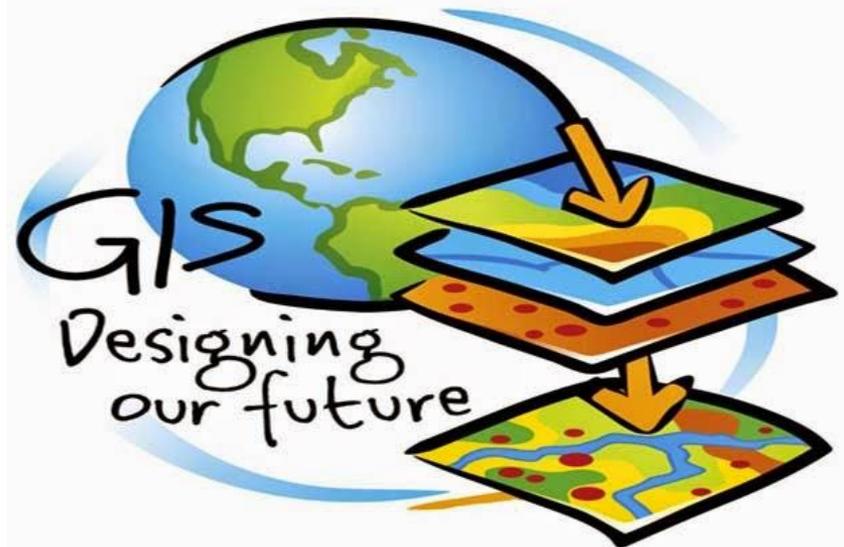
Tax collection and enforcement

Key findings

➢ Tax collection involves sending out tax bills, collecting the taxes and ensuring payment – often a local government function

➢ Enforcement measures often include:
- interest and late fee
- sale of property to satisfy the tax obligation
- most countries do not permit property transfers unless taxes are paid

➢ Tax arrears are generally high in developing economies due to lack of resources or expertise to administer the property tax and weak enforcement

Tax collection and enforcement

Measures to improve compliance

➢ Alternative collection methods:
   - pay the tax by installments through withholding from employment or pension income (*Ireland*)
   - voluntary deferral system: payment when taxpayer's financial circumstances improve or when property is sold or transferred
   - *Greece*: collection via electricity bills (shutting-off electricity as sanction for non-payment has deemed unconstitutional)

➢ Improve the ease of payment: online payment, pay at municipal offices, banks, retail stores, etc.

Appeal

Key findings

Most countries have an appeal process:

Stage 1
- Informal review by the valuation office to correct factual errors and differences in view

Stage 2
- Proceed to a valuation review board comprising experts in valuation

Stage 3
- Appeal to a (specialized) tax court
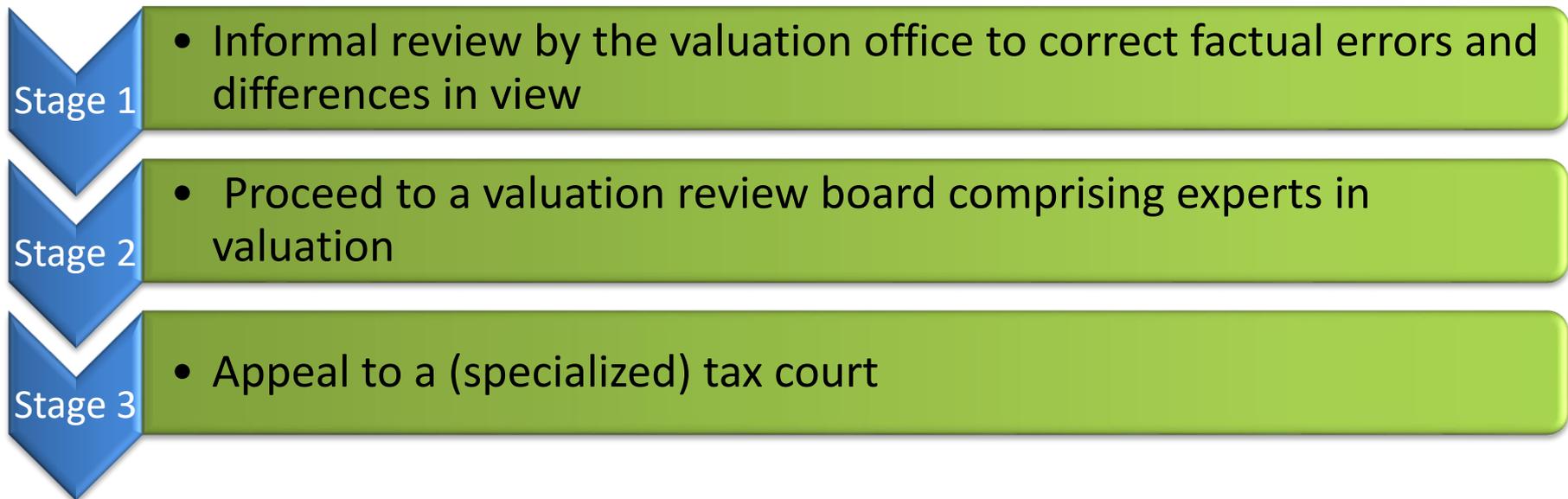
Appeal system, although desirable and necessary, may result in increasing inequality, because most utilized by better-off taxpayers

III. Institutional Support

Key findings

➢ Property tax depends on an array of supporting public and private institutions dealing with policy and administration aspects linked to e.g.:
- land and mapping
- property title registration
- property valuation

➢ Common challenges in many developing countries:
- fragmented data keeping and management between government agencies
- lack of inter-institutional coordination and collaboration
- weak administrative and regulatory oversight

Measures to improve institutional support

- ➢ Identifying the relevant institutions and their interest in sharing data

- ➢ Creating compatible systems integrating data from public and private entities

- ➢ Developing inter-institutional agreements between municipalities, property registration office and other (semi)government agencies

- ➢ Creating a system of administrative and regulatory oversight

IV. Political support and public acceptance

➢ Property taxes are **highly unpopular**

➢ Reasons include:

- Visibility

- Impacts on land use and urban development

- Tax is levied on (unrealized) wealth and does not reflect a real cash flow (liquidity constraints)

- Fear of political fallout with the elites

Making property tax politically more palatable

Phase-in mechanisms: phasing in the tax changes over time

Conducting annual reassessments (the Netherlands)

Improved taxpayer service

Providing alternative payment systems

Voluntary deferral systems

Tax relief schemes to low-income taxpayers

Better taxpayer education and proper communication strategy with stakeholders to increase public understanding and acceptance

Conclusion

- Countries should adopt a comprehensive approach:
  - appropriate evidence-based analysis,
  - adequate focus on both policy and administrative reforms
  - effective monitoring of ongoing and completed reforms

- Countries should also realize that successful property reform requires an up-front investment in training and creation (or upgrading) of the necessary administrative infrastructure in the form of a comprehensive and accurate cadastre or register

- Strong political support and good public relations are prerequisites for successful property tax reform

Thank you for your attention!

Any questions?