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International Property Tax Institute

PRESIDENT'S MESSAGE

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I would like to start this newsletter by referring to a recent paper published by the Lincoln Institute of Land Policy. The title is "Property Taxes: What Everybody Needs to Know" and it contains some very interesting information along with some informed opinion. Written by Ronald C. Fisher, a professor of economics at Michigan State University, I think it is worth a read by anyone interested in property tax.

In a short introductory note such as this, I can't do justice to the paper, but I hope I can provide a flavour of what it contains in the following paragraphs.

The author starts by acknowledging an earlier (2009) paper produced by the Lincoln Institute which, he says, was addressed to policy makers largely because the property tax was often under assault in the policy arena at that time. There were proposals in a number of states to substantially reduce the property tax, substitute alternative revenue sources, or even to eliminate the tax entirely. In many cases, it seemed that the reasons offered for these changes were inconsistent with the research evidence and understanding. Thus, the goal was to inform and assist policy makers.

However, he continues, it has become clearer that understanding the operation and fiscal details about local government taxation is of value to everyone; yes, policy makers, but also homeowners and renters, business owners and operators, community leaders, those involved in adjudicating issues about the tax (lawyers and judges), students, and others. In short, everyone. That is why he has updated the earlier work.

He states that property taxes continue to provide a fundamental fiscal foundation for all types of local governments in the United States. The property tax is the largest single source of revenue under the control of state or local governments. Property taxes also involve several structural characteristics that are different from other types of taxes, which can lead to some confusion and misunderstanding. Therefore, property taxation seems to be a topic for which improved education and understanding is especially valuable - for everybody.

He continues, political or policy objections to property taxes generally often amount to a charge that the tax is "unfair." Economists and other tax analysts focus on the effects on housing consumption, location decisions of both households and businesses, and local government decisions about the efficient quantity of public services. The gap between popular and political perceptions of property taxes, on the one hand, and the views of tax analysts on the other can, he says, be especially wide.

He points out that the $529.6 billion in property taxes collected by local governments in fiscal year 2018 accounted for about 30 percent of all local government general revenue and nearly 70 percent of local government taxes. As the primary revenue source directly controlled by local governments, the property tax has been central to local fiscal autonomy.

Property taxes, he says, provide more than one-third of general revenue for public schools nationally, about 28 percent of revenue to county governments, and about a quarter of revenue for cities. Townships, many of which provide public services in more rural areas, depend on property taxes for about 62 percent of revenue. Overall, the share of local revenue from property taxes has increased modestly since 1982, although substantially so for townships.

He refers to the fact that the fiscal reliance on property taxes for state and local governments varies substantially among the states. Property taxes, he says, are most important relatively in New Hampshire (37 percent of general revenue) and New Jersey (29 percent). In contrast, property taxes are relied on relatively least in Alabama (7 percent of general revenue), New Mexico (8 percent), and Delaware (8 percent).

He continues, property taxes are the primary way that individuals and businesses pay for services provided through local governments. Those services provided through local governments tend to be those that most affect citizens on a day-to-day basis. Nationally, and combining all types of local governments, K-12 education is by far the largest local public service, accounting for more than one-third of local government spending.

He also refers to the wide array of other public services and facilities provided through local government. These activities that individuals and business rely on include police and fire protection; water and sewer systems; public hospitals and public health services; highways, roads, and streets; public transit, parks, and recreation services; waste collection; community colleges; etc.

He points out that the property tax is different from other state-local government taxes because the property tax base - the property's market value - usually must be estimated because market transactions are unavailable. Most properties do not sell every year. Therefore, he says, methods and procedures for assessing the value of property for tax purposes are a crucial part of the property tax process. An assessor determines the market value of all properties using a specific set of procedures, usually established by state law.

He states that, to estimate market value, assessors use three methods. Data from actual sales and property characteristics can be used to estimate the values for similar properties that are not sold, value might be based on initial cost adjusted for depreciation and construction cost changes, or value might be measured by the present value of the future net income expected to be generated by the property. The first approach is used most often for assessing single-family homes and land, whereas the cost and income approaches are usually used for commercial and industrial properties. In a well-functioning property tax system, the tax will be related to the market value of the property.

Interestingly, he says that, in 19 states and the District of Columbia, the growth of assessed property value that will be taxed is limited in some way so that the taxable value of property becomes separated from market value. Although the objective is to limit how fast homeowner property taxes can grow, such limits defeat the main principle of the property tax - the tax base is the value of property. With these limits, tax liability will not reflect the growth in the market value of properties. In some states, the limit on assessed value that is taxable is removed when a property is sold, which can lead to horizontal inequity - similar properties having different tax liability - and to "lock-in" which is an unwillingness to sell a property, solely for tax reasons. Generally, he says, exemptions and credits are better than value limits to reduce taxes for certain types of property or property owners.

The author states the two key questions for all taxes concern their long-run budget implications. Does the tax base grow automatically in response to economic growth? And to what degree does the tax base vary from year to year as the economy fluctuates? Demand for public services normally increases with economic (income) growth, requiring additional revenue to provide additional services. If a tax base varies substantially as national economic conditions vary, then budget planning becomes more difficult.

Property taxes, he says, have been a stable revenue source compared to sales and income taxes, varying the least across years among all the major state taxes. The stability of the property tax base reflects the economic fact that capital investment (both residential and business) is, by nature, a long-run decision influenced more by long-run expectations than short-run economic circumstances. Property values traditionally have not declined substantially with each recession and, when they have declined, the typical lag in assessments has maintained taxable property values at least through the first part of the economic downturn.

Furthermore, he continues, property values in the United States have reflected long-run economic growth, so that property tax revenues also increased. Property tax revenue declined only in the years immediately after the Great Recession, but recovered shortly after.

He goes on to consider various aspects of property tax policy and whether policy changes are necessary to improve understanding of the tax. He also looks at the distribution of property taxes and considers the issue of exemptions and reliefs.

He concludes that, despite some of the challenges posed by property tax systems, property taxes remain important. He says that property taxes are relatively visible and contribute to government accountability. Property tax revenues have been responsive to economic growth and are the most stable of all tax bases. Property taxes often are economically efficient compared to alternatives, especially if they serve as local benefit charges. Finally, he says, property taxes may add to overall tax progressivity compared to the alternatives; importantly, property taxes are, in most instances, more progressive than sales taxes.

His final conclusion is that, if taxpayers or public officials object to property taxes on distributional, efficiency, or administrative grounds, the relevant issue is how property taxes compare to the alternatives. By almost every measure, he says, the property tax seems to come out ahead.

An interesting paper which is well worth a read by those who work in the property tax arena.

Moving on to IPTI activities, we have been involved in a number of online events recently. We held another in our series of webinars that we deliver in partnership with the Institute of Municipal Assessors (IMA). The latest IMA-IPTI webinar dealt with another aspect of the COVID-19 pandemic and looked at "The Effect of the Pandemic on the Hospitality Industry". As is well known, the hospitality industry was one of the hardest hit by the pandemic lockdowns and social distancing requirements. Recurring shutdowns made it extremely difficult for this sector to adjust to the changing situation. Our experienced presenters looked at the state of the industry over the period from the first severe revenue downturn in 2020 to where the industry is today and where it may be going. It was a very informative and interesting event.

During October I attended one of the first major face-to-face professional events held in the UK for those involved in property taxation. This was the Annual Conference of the Institute of Revenues, Rating and Valuation (IRRV). IPTI works in partnership with the IRRV in connection with a variety of events and projects. I was asked to speak on the topic of "The Challenges Facing the Rating Surveyor Over the Next Five Years". Rating refers to the UK annual property tax paid in respect of non-residential properties and rating surveyors are the professionals - both within the public and private sector - who deal with property valuations for the tax. As there are no shortage of challenges currently facing rating surveyors, this was not a difficult topic to talk about! I should add that the IRRV kindly invited IPTI to present an Award at the "Performance Awards Gala Dinner" held on the last night of the conference; a very enjoyable event.

We also held the first pre-CoVA informal discussion sessions last month. CoVA - the Conference of Valuation Agencies - is the major online conference that IPTI will be facilitating in early December. We decided to hold two online pre-conference sessions which were open to anyone who wanted to "network" with colleagues from around the world. We held two sessions on one day at different times to allow people to participate at a time to suit their local time zone. They were very interesting sessions where we talked about some of the issues that often don't get mentioned at conferences.

The next pre-CoVA informal online discussion sessions will be held on 10 November and if anyone would like to participate who is not already registered, please contact IPTI to obtain the joining instructions.

The main CoVA online event will be taking place on 7-9 December and I hope that as many of you as possible will join us for what I know will be an interesting and informative event.

More information about CoVA, along with other events coming up over the next few months, can be found on our website: www.ipti.org

Now it's time for a quick look at what is making headlines concerning property taxes in selected jurisdictions and countries around the world.

In France, concern has been expressed about the increase in the property owners' tax (*taxe foncière*) which, it is reported, has gone up by 27.9% in ten years. Landlords state that this rise is three times higher than rents or inflation in the period 2010-2020. This year also sees the tax for the first time going entirely to local communes and intercommunal bodies, with the part formerly given to departments having been transferred to communes instead.

Nantes is the 'large town or city' with the highest rise over the 2010-2020 period, with the average bill having risen 37.5%, the report shows. This is partly due to the Nantes Métropole urban area adding a charge on top of that for the city of Nantes council during this period. This was, however, partly offset by a reduction by four percentage points in the rate for the associated rubbish collection tax. Significant rises in *taxe foncière* are mostly caused by local authorities voting to increase the percentage rate they apply annually to the base values of individual properties which, for this tax, consist of one half of the *valeur locative cadastrale*, a theoretical rental value used by the tax office for each property. Top of the table for 10-year rises after Nantes was Villeurbanne (36.8%), followed by Clermont-Ferrand and Lille (36%), Saint-Denis (33.6%), Angers (33.3%), Créteil (33.2%), Aubervilliers (32.8%), Argenteuil (32%) and Limoges (31.4%). Angers tops the podium for having the highest overall percentage rate as of 2020, at 56.42% (communal and departmental parts combined, plus certain small, linked taxes), compared to Paris, the lowest, at just 14.14%. The next highest rates were at Amiens (55.87%) and Grenoble (54.72%). At the bottom of the table for ten-year increases were Montpellier and Nice, with only a 14.9% increase in their bills from 2010-2020, mostly due to the revaluation of the base values.

In Canada, owners of Ottawa properties that house small businesses can soon expect a 15 per cent tax break that could save them thousands of dollars. The City of Ottawa's finance and economic development committee recently approved a new tax category that will launch in 2022. This means the owner of any commercial and industrial property measuring 25,000 square feet or smaller will be automatically eligible for the discount. Property owners do not need to apply. The tax discount will be implemented over two years, starting with a 7.5 per cent discount applied to the final 2022 tax bill for everyone who qualifies. The remaining 7.5 per cent cut will be applied in 2023. City staff settled on property size to determine what constitutes a small business, instead of factors such as revenue or number of employees, because the information is already readily available. The discount will also apply to the eligible portion of a mixed-use property. Take, for example, a main street building that houses a retail store on the ground level, with residential units above. The new tax break will apply to the part of the property that is classified as commercial. More than half of the 11,000 commercial and industrial properties in Ottawa will qualify for the new tax class, staff say, and that could lead to an estimated $9.9 million in revenue loss for the city. That revenue loss will be made up in two ways, according to staff. First, the city will cancel the discount for vacant properties, which would bring in $1.4 million. Until now, owners of vacant commercial property received a 30 per cent tax discount, while owners of empty industrial property received a 35 per cent break. The remaining lost tax revenue will be borne by owners of larger properties who do not qualify for the new tax bracket. The city estimates these owners will see their taxes increase by an average of 1.46 per cent due solely to this tax change. In the last provincial budget tabled in the spring, the Ontario government allowed municipalities to create a new tax subclass for small business property owners so they could be charged a lower rate than their larger counterparts. The move to help small businesses was spurred by the pandemic, but the new tax class will be permanent.

It is reported that Estonia has Europe's lowest property taxes. "The Estonian tax system is largely based on labor and consumption taxes, while property taxes only play a modest part in funding social expenses," said the report. The report points out that while property taxes yield over 1 percent of GDP in most EU member states, up to 4 percent in France, the indicator for Estonia is 0.2 percent. The main property tax

in Estonia is land tax, the revenue of which goes to local governments. “The share of real estate taxes in tax revenue was 0.6 percent in Estonia compared with 3 percent as the EU average in 2019. Land tax revenue has not exceeded €60 million since 2012,” it notes.

In Australia, as part of the Victorian Budget 2021/22, the government announced the introduction of a new “windfall gains tax”. The aim of the tax is to capture a share of the profits currently enjoyed by landowners when their land is rezoned. The proposed legislation provides that the tax will apply to land that increases in value by more than $100,000 as a result of rezoning. It will be imposed on the landowner at the time of the rezoning. Where the increase is between $100,000 and $500,000, a tax rate of 62.5% will apply on the value uplift above $100,000. Where the increase is $500,000 or more, a tax rate of 50% will apply to the total value uplift. The tax will come into operation from 1 July 2023, 12 months later than initially planned. The value uplift will be calculated as the difference in the capital improved value of the land (changed from site value) before and after the rezoning takes effect. The former value being the most recent valuation in force for the land and the latter determined through a supplementary valuation certified by the Valuer-General.

After years of uncertainty, it seems that China is about to introduce a new property tax system. The top decision-making body of the Chinese parliament recently said it will roll out a pilot real estate tax in some regions. The State Council, or Cabinet, will determine which regions will be involved and other details. The long-mooted - and long-resisted - property tax has reportedly gained new momentum since the President threw his support behind what experts describe as one of the most profound changes to China's real estate policies in a generation. Such a tax could, it is reported, help restrain home prices that have soared more than 2,000 per cent since the privatisation of the housing market in the 1990s and created an affordability crisis in recent years. The tax will apply to residential and non-residential property but will not apply to rural land. The idea of a levy on homeowners first surfaced in 2003 but failed to take off due to concerns that it would damage property demand, home prices, household wealth and future real estate projects. In pilot programmes rolled out in 2011, the cities of Shanghai and Chongqing taxed homeowners, albeit just those possessing higher-end housing and second homes, at rates from 0.4 per cent to 1.2 per cent. Analysts expect a wider pilot to first include wealthier and economically more diversified regions in eastern and southern China such as the provinces of Zhejiang and Guangdong.

And finally, a story from the USA about personal property tax. A taxpayer reported that he was in trouble about a property tax bill relating to his wife’s car. The bill was from a different state to the one he now lives in. Having received a debt collector’s letter about a tax he knew nothing about - and for which he did not consider he was liable - he got in touch with the state in which he had lived three years earlier to explain the position. He found the person dealing with the matter very unsympathetic and maintained that he “should have known the law”. Amusingly, the taxpayer said he hadn’t read the entire statute book before he left! Even after explanation, the official refused to drop the matter and the taxpayer described the state as “a little like the Hotel California: you can check out any time you like, but you can never leave.”

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