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International Property Tax Institute

PRESIDENT'S MESSAGE

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May I take this opportunity to wish all readers a very Happy New Year. I hope that you all had a very enjoyable break over the festive period and are looking forward to what 2023 has in store.

There are two recent papers concerning property tax and related issues I would like to bring to your attention.

One is a paper recently published by the International Monetary Fund (IMF) titled "Equity and efficiency effects of land value taxation". The abstract states: "It is a well-known result in economics that land value taxation is efficient since it does not distort the supply of the tax base. Considering only efficiency, land value should thus be fully taxed. Using optimal taxation theory with heterogeneous households, we show that it may be optimal not to tax land value fully for distributional reasons. The decisive variable is the covariance of land value held by households and their social welfare weight. Empirical data from the US and France, however, indicates that ownership of land value (in absolute terms) is negatively correlated to the social welfare weight. Middle income households would pay relatively more land value taxes than high income households, but less in absolute terms. With reasonable revenue recycling, land value taxation would thus reduce the net tax burden of low and middle income earners, because they would benefit more from the recycling than they pay in additional taxes."

The introduction to the paper states: "Land value taxation is neutral (Tideman, 1982; Oates and Schwab, 2009), meaning that a compensated land value tax does not distort the tax base. This makes it is preferable to distortionary taxes like capital and labor income taxes from the point of view of economic efficiency. For this reason, it has been advocated by eminent economists including Adam Smith, David Ricardo and James Mirrlees (Mirrlees et al., 2011). In practice, however, very few countries use land value taxes and if they do, they apply low rates (Fernandez Milan et al., 2016). Recent research on land and economic rents has given even more relevance to the idea of land value taxation. Piketty (2014) describes an increasing capital/income ratio due mainly to a rapid accumulation of housing wealth. Knoll et al. (2017) explain the increase in housing wealth by a strong surge in land prices. Jointly, the results by Piketty (2014) and Knoll et al. (2017) point to an increasing empirical relevance of land value taxes.

The discrepancy between the theoretical appeal of land value taxation and its lack of use has several reasons. Clearly, the political economy of introducing land value taxes is one important reason (Hughes et al., 2020). Distributional concerns, however, also play an important role. Data provided by Garbinti et al. (2021) and Bricker et al. (2017) shows that housing wealth increases in absolute terms with wealth but

decreases in relative terms. This points to the potential that a land value tax might be regressive. Stiglitz (2015) by contrast highlights the role of economic rents in increasing inequality. Land value taxation could thus also reduce inequality.

In this paper we provide the first analysis of the efficiency and equity effects of land value taxation in an optimal taxation framework. We take into account that households are heterogeneous in wealth and also in their asset portfolios. The difference in asset portfolios means that the share of land in total wealth may vary systematically across households of different wealth. As a result, a land value tax may be more or less progressive. We find that the optimal level of land value taxation is determined by the marginal cost of public funds (MCF) and the covariance of land value held by households and their social welfare weight.

Taxing land value away completely is optimal, unless the MCF is smaller than one or land value is concentrated among households with a low income level. Optimal land value taxation thus depends both on the wealth inequality and on the portfolio composition. In an economy where low income households invest a high share of their assets in land (for their primary residence or for subsistence agriculture for example), it might be best to abstain from full land value taxation for equity reasons. Higher land value taxes, however, also allow for a lower level of other taxes. It could thus be optimal for low income households to have full land value taxation, even if they own a higher proportion of their wealth in the form of land than high income households.

There is little literature on the interaction of equity and efficiency effects of land value taxation. Franks et al. (2018) use a numerical model to consider heterogeneous households and land value taxes. Kumhof et al. (2021) estimate the effect of introducing land value taxes in a model calibrated to the US economy and find that it would generate large welfare gains. While Kumhof et al. (2021) has workers, capitalists and landlords, our model features households which differ by labor productivity as well as land and capital ownership. In addition, households have different levels of wealth.

Koethenbuerger and Poutvaara (2009) analyze land value taxation in a dynamic model, but the basic efficiency argument remains: full land value taxation is the most efficient form of taxation, it maximizes utility in equilibrium. It may, however, not be welfare maximizing to tax land value fully as the old generation at the time of the introduction of the tax might suffer a significant loss of income. This case can be seen as a special case of our model, where a large part of the population has “zero productivity” due to old age but owns considerable land value. Like Koethenbuerger and Poutvaara (2009), we find that in such a setting it could be optimal not to tax land value fully, for example by (partially) exempting old land owners.

Edenhofer et al. (2015) also consider distributional aspects in a model of rent taxation and overlapping generations. While they do not explicitly model an equity-efficiency trade-off, they show the importance of targeting the rent taxation revenue at the least wealthy part of the population. The literature on land value taxation typically addresses distributional effects only for a switch from property to land value taxes (Plummer et al., 2010). A property tax is applied to both land value and the value of buildings. Taxing buildings is less efficient than taxing land value as it disincentivizes investments in buildings.

To analyze the trade-off between equity and efficiency of land value taxation we employ a framework of optimal taxation with households of heterogeneous labor productivity. It thus builds on the approach of Mirrlees (1971). For the formulation of the tax rules for labor income and land value we employ a formulation for the marginal cost of public funds suggested by Jacobs and de Mooij (2015) and use the definition for the marginal value of income suggested by Diamond (1975). The application of optimal taxation theory to land value taxes appears to be new.

The literature reviewed in Medda (2012) considers land value capture as a means of financing infrastructure investments. This means that land value increases from a given investment are used to finance the investment. This paper by contrast considers the entire land value (and not only increases) as a legitimate basis of taxation. In addition to the efficiency and distribution benefits analyzed here, it may even be the only tax necessary (Arnott and Stiglitz, 1979).

Schwerhoff et al. (2020) analyze which types of economic rents exist and what the optimal government response to each type is. The study finds that most economic rents are created intentionally (for rent extraction) and should be addressed by competition policy (possibly including fines and taxes). Land rents, by contrast, reflect the natural scarcity of land. Welfare maximization would thus require taxation. In an empirical study, Kalkuhl et al. (2018) find that a linear land tax would be regressive in developing economies, because close to 100% of low income households own land for subsistence farming. In this context, a land value tax could be made progressive by exempting a small amount of land from taxation for each household." A copy of the IMF paper is available via the following link:

https://www.imf.org/en/Publications/WP/Issues/2022/12/17/Equity-and-Efficiency-Effects-of-Land-Value-Taxation-527079

Another recent paper of interest titled "A review of Ireland's Local Property Tax" has been published by Sciendo. It has been written by Dr Gerard Turley, a Lecturer in Economics at the School of Business & Economics which is part of the University of Galway in Ireland.

The introduction to the paper states: "Local recurrent taxes on immovable property are common across time and space. Property taxes predate income tax and many other taxes. A majority of countries worldwide use property taxes in some shape, and do so primarily to fund local government. Until recently, Ireland was an exception as there was no annual tax on residential property. This paper is a review of the Local Property Tax (LPT) system, which was introduced in July 2013 and had its first property revaluations in November 2021. Using the theoretical framework of local public finance and the tax assignment pillar of intergovernmental fiscal relations, the rationale, history, features and administration of this new residential property tax are outlined. While recognising country-specific circumstances, opportunities and challenges are explored with a view to future improvements in the design and implementation of the LPT. The paper begins with theory, on the economic rationale for local government. A section on tax assignment and property tax follows. A brief overview of the history of local property taxes in Ireland is followed by an account and a review of the LPT. The paper concludes with some lessons and challenges." A copy of the paper is available via the link below:

https://sciendo.com/article/10.2478/admin-2022-0025#

I am pleased to say that the author of the paper was one of the many erudite speakers at the Conference of Valuation Agencies (CoVA 2022) which IPTI facilitated in Oxford last month.

That takes us on to IPTI activities. Having just mentioned CoVA 2022, I should say a bit more about it. The conference was held at St Anne's College, Oxford in the UK on 8-9 December. CoVA is a relatively new event which was first held as a virtual conference in December 2021. CoVA 2022 was an in-person event with people attending from around the globe. We had an excellent group of speakers from both the public and private sectors who covered a wide range of topics of particular relevance to valuation agencies. It was regarded as a very interesting, informative and enjoyable event.

Also in December we delivered another in our "Mass Appraisal Valuation" series. This one was MAVS 103 "Data Readiness (Part 2)". As indicated by the title, this was the second in a two-part presentation on this important topic. Our two very experienced presenters provided a thorough understanding of the data requirements essential to support a successful mass appraisal. Topics covered in the webinar included the importance of accurate data; identifying various types of data; sample vs population; data requirements for the three approaches to value; various data sources and alternative data collection tools. It was a very informative and entertaining session.

We have a wide range of events coming up over the next few months. For details of all our forthcoming events, please visit 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. For more information, and links to the original news articles, please look at IPTI Xtracts on our website.

In Canada, a new "Underused Housing Tax" (UHT) is being introduced. The UHT is a new national 1% tax imposed annually on the value of non-Canadian-owned residential property that is considered by the legislation to be "underused." These new rules are in force for the 2022 calendar year and may have implications for certain Canadian owners of Canadian residential real estate (as well as for non-Canadian owners), even if the residential property may not actually be "vacant" or "underused" as those terms are understood in ordinary parlance. Every person that is an owner of a residential property (as defined in the legislation) on December 31 of a calendar year is required to file a UHT return for the calendar year by April 30 of the following calendar year unless the owner is an "excluded owner." One category of excluded owners consists of individuals who are Canadian citizens or Canadian permanent residents, provided that they own the residential property directly in their personal capacity. However, if the individual owns the property through a corporation, trust or partnership, that entity is generally not an excluded owner and has a UHT filing obligation even if the property is not "underused" for purposes of the UHT. An owner (other than an excluded owner) of a residential property on December 31 of a calendar year is subject to a 1% tax on the "taxable value" of the residential property unless exempted. In general terms, exemptions are available under certain conditions for Canadian ownership, new owners (i.e., where the residential property was acquired in the calendar year), residential properties that meet "qualifying occupancy" requirements, "seasonally inaccessible" residential properties, residential properties that are uninhabitable for certain periods due to disasters or renovation, and vacation properties in non-urban

areas. There are also exemptions that apply depending on the moment in the calendar year that the construction of the residential property was substantially completed. Persons that are owners on December 31, 2022 of properties that are "residential properties" for purposes of the UHT legislation may be required to file a return and, unless exempted, pay the 1% tax by April 30, 2023.

In the USA, Los Angeles has introduced what is being called a "Mansion Tax". Measure ULA (United to House LA) was passed by 58% of the City of Los Angeles' voters in the November 2022 referendum and will become law on January 1, 2023, but it will only impact transactions starting on April 1, 2023. The new tax will be payable to the city in addition to the existing documentary transfer tax already imposed on property sales within the city, which has a combined city and county rate of 0.56%. ULA is more accurately referred to as the "Homelessness and Housing Solutions Tax". It will impose a new tax on the transfer of certain residential and commercial real property located in communities within the City of Los Angeles valued at over $5 million. The city estimates these transfer taxes will generate $900 million a year to pay for housing subsidies and provide financial assistance for tenant protections and housing security. Currently, the City of Los Angeles and Los Angeles County levy documentary transfer taxes on every transfer instrument that conveys land sold within the city and county. When the property's value exceeds $100, the city collects tax at a rate of $4.50 per $1,000 of consideration. The county levies a tax of $1.10 per $1,000 of consideration. The city and county transfer taxes currently amount to $5.60 per $1,000 of consideration. On April 1, 2023, there will be a substantial increase in the transfer tax amounts payable when recording transfer deeds. The City of Los Angeles will impose an additional transfer tax on the sale or transfer of "high-value" commercial and residential real properties within the city boundaries. That tax will be calculated in the following manner: 4% for properties sold between $5 million and under $10 million and 5.5% for properties sold for over $10 million. The additional tax will apply to the entire sale value, not just the amount over the $5 million and $10 million thresholds, regardless of whether there has been a gain or loss on the sale. A property's value will include any lien or encumbrance remaining on the property after the sale. Based on the provisions drafted in Measure ULA, it appears likely that for property tax reassessment purposes, the city will also interpret the tax as applying to a transfer of interests in a legal entity which result in a change in ownership of real property held by the legal entity.

In Luxembourg, to clamp down on speculation and the growth of property prices, Bill No. 8082 ("Property Bill") has been filed with the Luxembourg Parliament reforming the land tax (impôt foncier – "New IFON") and introducing two new national taxes: a land mobilisation tax (impôt à la mobilisation de terrains – "IMOB") and a tax on the non-occupation of housing (impôt sur la non-occupation de logements – "INOL"). The New IFON will continue to apply to all owners of land in Luxembourg (with a lump sum tax deduction of EUR 2,000 for the primary residence - subject to conditions). The main point of the reform is the update of the land values which have not changed since 1941. The revised new values of land are largely conditioned by the building potential according to the classification in the General Development Plans (PAG). For the rest, the calculation method remains unchanged, i.e. the (revised) base value will be multiplied by a municipal tax rate set by each municipalities (within a range of 9% to 11%). The New IFON is levied yearly by municipalities and is tax deductible for individual and corporate income tax purposes. The IMOB aims to create an incentive for the actual construction of buildings on land earmarked for urbanisation. It will require the establishment of a national register of undeveloped land. The IMOB will

be calculated on the same basis as the New IFON but will be multiplied by a progressive tax rate increasing with the number of years the land remains undeveloped. The INOL aims to tax a building constructed for residential purposes that remains unoccupied (i.e. when no natural person is registered in it for a period of six months). To establish that a dwelling is not occupied, a national register of buildings and dwellings will be created. The INOL will amount to EUR 3,000 per dwelling for the first year. The tax will increase by EUR 900 per year up to a maximum of EUR 7,500. If the property remains unoccupied, this amount will be due annually.

In Australia, it is reported that the "mega-rich" owners of Sydney's most luxurious trophy homes would be taxed to fund affordable housing under a proposal put forward by the NSW Greens. The "Extreme Wealth Property Tax" would impose a flat 4 per cent tax on owner-occupied mega-mansions with a land value over $10 million, or an improved value exceeding $20 million, with all revenue going towards building more social and affordable homes. Under the plan, the existing land tax on properties above the premium threshold ($5,925,000) would also increase, from 2 to 5 per cent. The premium threshold itself would be expanded to include investors with eight or more properties. The NSW Greens' spokesperson on housing and homelessness said the tax would target those at "the really extreme wealth end of the housing market", and that every luxury property taxed under the scheme could fund several affordable houses. He continued, "There are people who have homes worth $20 million, $30 million, $100 million, and because they're owner-occupied, they don't pay any land tax on those whatsoever. Let's start talking about taxing the billionaires and the mega-mansions as a way to be able to fund and invest more in affordable housing." He continued, "In addition to providing the state with revenue for affordable housing, the policy could act as a "disincentive for these people to sit on these kinds of luxury mega-mansions and open up the supply of land close to the city for more affordable housing."

Next, a brief note about what appears to be a property tax "error" in India. The Taj Mahal in Agra, which draws millions of tourists to India each year, has been served notices for property tax and water bills for the first time in its 370-year history. Both the Taj Mahal and the Agra fort have been served notices for outstanding bills by various units of the Uttar Pradesh government. The Times of India quoted a senior municipal officer in Agra saying an investigation had been ordered into how the notices had been issued. The officer also said a private company was processing the notices on contract with the government.

And finally, I thought I was no longer capable of being surprised by anything that happens in the "wild and wacky world" of property taxation, but this story certainly caught my eye. Under the heading "Dominatrix trio propose tax-funded sex dungeon at council meeting", it is reported that a council meeting in Fort Lauderdale, Florida was interrupted when a trio of latex-clad dominatrices walked in and demanded a property tax-funded sex dungeon. The leader of the trio finished her speech by telling the council to not let her "glamourous look distract you from doing your duty to consider my demand." She continued, "I look forward to spanking each and every single one of you at the new dungeon. You are dismissed." The article concluded that, so far, there is no news as to whether funding for the dominatrices' requested sex dungeon is going to be approved, but it said, "it is the silly season and anything can happen!"

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