



Why Value-Based Property Taxation?

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OUTLINE

- Why the property tax?
- Economics principles for designing a good tax
- Why value-based property taxes?
- What are the problems?

WHY THE PROPERTY TAX?

THE PROPERTY TAX IS A GOOD TAX FOR LOCAL GOVERNMENT

- Supports local autonomy; important component of fiscal decentralization
- Difficult to avoid and easy to enforce
- Connection between municipal services and property values
- Visible and accountable
- Roughly progressive
- Allows public sector to derive share of private sector windfall gains from public investment in infrastructure

THE PROPERTY IS ALSO IMPORTANT BECAUSE ...

- **Impact on land use**
 - Property tax can shape urban development patterns
- **Impact on other economic and social goals**
 - Property tax can influence business location
 - Property tax relief can help relieve property tax burden on low-income taxpayers

BUT THERE ARE PROBLEMS ...

- Visibility means taxpayer awareness and taxpayer resistance: the tax everyone loves to hate
- Citizens resent enforcement of taxes which threaten their homes
- Property valuations have a subjective component which is often disputed; need appeals system

ECONOMIC PRINCIPLES FOR DESIGNING A GOOD LOCAL TAX

ECONOMIC PRINCIPLES

- Equity based on benefits received
- Equity based on ability to pay
- Efficiency
- Accountability
- Stability and predictability
- Ease of administration

ECONOMICS PRINCIPLES VERSUS POLITICS

- “Tax policy is the product of political decision making, with economic analysis playing a minor supporting role” (Randall Holcombe, 1998)
- Political pressure to maintain the tax burden at or near its current level (e.g. not updating assessments) or to favour one group of taxpayers over another (e.g. over-taxation of business) often overrides economics principles

WHY VALUE-BASED PROPERTY TAXES?

ASSESSMENT METHODS

- Area-based assessment:
 - Unit
 - Unit value
- Value-based assessment:
 - Market value
 - Annual (rental) value
 - Land/site value
- Value-based in countries with long tradition of land markets; area-based where there is no formal land market

AREA-BASED ASSESSMENT

- Per unit assessment: rate is levied per m² of land area, building or a combination of the two
- Unit value assessment: assessment rate per m² is adjusted to reflect location or other factors
- Most common in countries in Central and Eastern Europe where there is an absence of developed property markets; also in parts of Germany, Chile, Kenya, Tunisia, India
- Bangalore: unit value system introduced in 2008; values regularly adjusted

MARKET VALUE ASSESSMENT

- Defined as price between a willing buyer and a willing seller in an arm's length transaction
- Approaches to estimating market value
 - Comparable sales (residential)
 - Income (non-residential)
 - Depreciated cost (non-residential)

MARKET VALUE ASSESSMENT

Approach	Tax Base	Property Types
Comparable sales	Estimate market value by comparing to recent sales of similar properties	Residential; need transactions to get objective sales values
Income	Convert future returns from ownership of property into present value equivalent	Income-producing properties e.g. non-residential and commercial
Replacement cost	Estimate value based on land value, building cost, depreciation	Unique properties with no comparable sales and which do not generate income

MARKET VALUE ASSESSMENT

- Requires active property market
- Used in many OECD countries (e.g. Canada, US, Japan); used in Indonesia and Philippines
- Variation of market value used for residential property tax (council tax) in UK

ANNUAL (RENTAL VALUE) ASSESSMENT

- In theory, tax on rental value should be equivalent to a tax on market value
- In practice, rents reflect current use and not highest and best use
- Needs active rental market
- Difficult to estimate rental value when there are rent controls (e.g. India); issues around vacant land
- Used in several countries: Australia, UK (for non-residential property), India, Thailand, Malaysia, Singapore, Hong Kong

SITE VALUE

- Popular tax with economists on efficiency grounds: tax on land is less distortionary than tax on improvements
- Problems with moving from tax on land and improvements to tax on land only
 - Assessment problems – few land sales
 - Revenue adequacy – need higher tax rates
 - Winners and losers
- Declining use around the world as more and more countries move to capital value taxation

AREA-BASED VERSUS VALUE-BASED ASSESSMENT

- Market value is preferred because it:
 - Reflects benefits from local services
 - Captures neighbourhood amenities
 - Less regressive than area-based
 - Less inequitable over time
 - Revenues more buoyant than area-based
- Can move from area to value-based

WHAT ARE THE PROBLEMS WITH THE VALUE-BASED PROPERTY TAXES?

PROBLEMS WITH MARKET VALUE BASE

- Can be volatile (not stable and predictable for taxpayers)
- Costly administration (identification, assessment, collection, and enforcement)

HOW TO ADDRESS VOLATILITY

- Avoid assessment limitations (e.g. Proposition 13 in California)
 - Breaks the link between taxes and market value
 - Inequitable ... for generations
 - Decreases household mobility
 - Favours those whose property values have increased at expense of those whose values are stagnant
 - Can't get out of it

HOW TO ADDRESS VOLATILITY

- Better options to address volatility:
 - Annual reassessment
 - Phase ins
 - Tax credits
 - Tax deferrals

PROPERTY ASSESSMENT

- Properties do not sell in a market transaction each year --- valuation is thus an estimating process
- Assessment can be costly
- But, virtually no compliance costs (on the part of taxpayers) associated with property tax
- Techniques of mass appraisal (formula-based valuations driven by observable features of property with valuation coefficients based on a sample of market transactions)
- Need appeal process

FINAL COMMENTS

- The property tax is a good tax for local governments
- Appropriate role of property taxes, design, and implementation differ in different countries and change over time in any one country --- “no one size fits all”
- ***Where possible***, market value assessment is the best base for the tax
- Need to address issues of volatility and administration