Municipal Property Tax Policy

Enid Slack
Institute on Municipal Finance and Governance
Munk Centre for International Studies, University of Toronto

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The property tax plays an important role in local government

- Source of revenue for local governments
  - Ability to deliver services
  - The extent of local control affects local autonomy
- 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

Property Taxes in Selected OECD Countries

	Property tax as % of total tax revenue	Property tax as % of GDP
Australia	4.5	1.4
Canada	8.6	2.8
Denmark	2.6	1.2
Finland	1.1	0.5
France	5.1	2.2
Germany	1.2	0.4
Japan	11.5	2.0
New Zealand	5.8	2.0
Spain	2.0	0.7
United Kingdom	9.2	3.3
United States	10.8	2.9

Note: All data are for 2008 except for Australia which is for 2007.
Source: OECD Revenue Statistics 1965-2008, OECD 2009

Topics for Workshop

- Economic Principles
- Unique Features of the Property Tax
- Tax Policy
  - Who determines tax strategies?
  - What is taxed?
  - How are tax rates differentiated by property type?
  - How high can tax rates go?
  - Are property tax incentives a good idea?
  - What mitigation measures are appropriate?
- Concluding Comments

Economic Principles for Designing a Good Local Tax

Economic principles for designing a good tax

- 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 only a minor supporting role" (Randall Holcombe 1998).

- Political pressure to maintain the tax burden at or near its current level (e.g. capping increases) or to favour one group of taxpayers over another (e.g. over-taxation of business) often overrides economics principles.

Unique Features of the Property Tax

Unique features of the property tax

- Visible
- Inelastic
- Volatile
- Property is immovable
- Based on benefits received
- Local autonomy
- Arbitrariness of tax base

Tax Policy – Who determines the strategy?

Who determines the strategy?

- A local tax is one where the local government:
  - determines whether the tax is imposed
  - determines the tax base
  - sets the tax rate
  - collects the revenue and enforces the tax
  - receives the revenue

Who determines the strategy?

- Rarely are all decisions made by local governments
- Local tax rate setting is essential to being a local tax
- The level of government making the spending decisions should set the tax rate

Tax Policy - What is included in the tax base?

What is included in the tax base - land only or land and improvements?

- Land only:
  - Fewer potential revenues
  - Provides incentive to develop land
- Land and improvements:
  - Lower tax rates to achieve same revenues
  - Discourages investment in property

What is included in the tax base – how many exemptions?

- Some properties are exempt in most countries (churches, cemeteries, government properties):
  - Shrinks revenue base
  - Inequitable
  - Affects location decisions
  - Implications for economic competition

Tax base - exemptions

- What needs to be done:
  - Minimize exemptions
  - Payments in lieu on government properties
  - Grants instead of exemptions
  - Assessed values for exempt properties

Tax Policy -- How are tax rates differentiated by property type?

Setting Tax Rates

- Differential rates can be used to reflect:
  - differential benefits received from services
  - mobility of capital (efficiency)
  - land use objectives

Economic Arguments: Benefits Received

- On the basis of benefits received from local government services, non-residential properties should pay less property taxes than residential properties

- Non-residential properties use fewer services than residential properties

Economic Arguments: Benefits Received

- MMK study in Vancouver (2007) – non-residential sector pays $2.42 in taxes for each $1 of benefits received; residential sector pays $0.56

- Hemson study in Toronto (2003) – the office sector pays 17 percent of municipal taxes but generates only 5 percent of the expenditures financed from property taxes

Economic Arguments: Efficiency

- Property taxes should be heavier on those components of the tax base that are least responsive to a tax increase

- Since businesses tend to be more mobile than homeowners (more responsive to tax changes), efficiency argument suggests that non-residential property should be taxed more lightly than residential property

Economic Arguments: Accountability

- Municipalities can export non-residential property tax to residents of other jurisdictions e.g. in the price of products they sell

- No accountability at local level when non-residents pay for services enjoyed by residents

Economic Arguments: Accountability

"Every fiscal tub should be required to stand on its own bottom, and no fiscal unit should be allowed or encouraged to reach out and tap other people's pocket books in order to finance expenditures whose benefits are confined to residents of the taxing area"

(Wayne Thirsk, 1982)

Land Use Objectives

- Lower taxes on apartments encourage higher density; lower taxes in some locations will encourage development in those locations

- Property tax differentials that do not reflect service differentials will create subsidies (positive and negative) that will worsen development patterns

- Is it advisable to use the property tax to achieve land use objectives?

Why are there differential tax rates?

- Higher rates on apartments: Homeowners have higher voting rates than renters
- Higher rates on business: Residential taxpayers vote in municipal elections; businesses do not
- Lower rates on farms: to preserve farmland (but do they work?)

Tax Policy -- How high can tax rates go?

Peak of the revenue hill?

- Can tax rates increase any more for residential property?
- Can tax rates increase any more for non-residential property?
- Are we at the peak of the revenue hill for property taxes?

Tax Policy -- Are property tax incentives a good idea?

Impact of Property Taxes on Business Location

- What does the empirical literature tell us?
  - Property tax differentials matter more <u>within</u> metropolitan areas than <u>between</u> metropolitan areas
  - Size of the differential matters
  - Service differentials also matter

Property Tax Incentives for Business

- Many jurisdictions, especially in the US, provide property tax incentives to attract businesses to their municipality
- Do they work?
- Should they be used?

Impact of Property Taxes and Incentives on Business Location

- What does the empirical literature tell us?
  - Incentives matter more for some industries (more mobile, capital intensive) than others
  - Property tax incentives will have less impact if other municipalities also offer them
  - Services and quality of life matter
  - Size of incentive matters

Arguments in Favour of Property Tax Incentives

- Shows that municipality is pro-business
- Benefits of business location to community exceed costs of services (but who bears the costs and who enjoys the benefits?)
- Benefits of agglomeration economies -- benefits that existing and new firms gain from locating near each other e.g. larger market, many competing suppliers (but can the municipality determine who these firms are?)

Arguments Against Property Tax Incentives

- Zero sum game – development in one location at expense of another location
- Economic activity may have located without tax incentive
- Tax competition results in inefficiently low services
- Tax increases for existing taxpayers

Should Municipalities Offer Property Tax Incentives?

- Lower taxes overall on non-residential properties are preferable to tax incentives to individual firms

- Investing in infrastructure and providing services is preferable to tax incentives because they also Influence firm location but provide tangible resource to community

Tax Policy -- What mitigation measures are appropriate?

Property Tax Relief Measures

- Relief measures can vary according to:
  - Characteristics of the property (residential or non-residential)
  - Characteristics of beneficiaries (e.g. seniors)
  - Whether they are permanent or transitory

Property Tax Relief

- Property tax credits
- Tax deferrals
- Exemptions
- Grants
- Tax reductions, cancellations or refunds
- Assessment limitations
- Tax rate limitations
- Tax levy limitations

Property Tax Relief

- Relief measures make tax more acceptable to taxpayers
- Property tax credits and deferrals have some merit because they target relief on low-income taxpayers but …
- Assessment limits create more problems than they solve

Proposition 13 in California: How does it work?

- Time of sale reassessment: assessment increased by the lesser of inflation or 2% per year until property is sold
- No reassessment if property transferred to children of owner
- Seniors (over 55) can transfer assessed value to a replacement dwelling of equal or lesser value without reassessment

Impact of Proposition 13 in California

- Inequities: some owners pay much more in taxes than neighbours in comparable properties
- Inequities can go on for generations: one young family buys a new home and pays market value taxes; another inherits a home and pays taxes on parents' acquisition value

Impact of Proposition 13 in California

- Proposition 13 favours older, more affluent generation over younger first-time homebuyers
- Young first-time homeowners face higher taxes because starter homes are reassessed more frequently
- Decreases household mobility

What are the Problems with Assessment Limits?

- Breaks link between taxes and market values:
  - Taxes less uniform and more arbitrary
  - Properties with similar values pay different taxes
  - Erodes the tax base
  - No incentive to review assessment (since it is not used for taxes; never correct assessment errors)
  - Those with capped assessments have incentive to demand more expenditures

What are the Problems with Assessment Limits?

- Assessment caps take pity on those who are being made wealthier by the market at the expense of those whose property values are stagnant

- Stability and predictability at the expense of equity

- But, ignoring sound economics principles can result in an even less equitable tax in the long run and even greater taxpayer resistance

Problems with Assessment Limits: What Are Others Saying?

- “Phantom” tax relief – the appearance of property tax relief where none actually exists
  - Mark Haveman, Minnesota Taxpayers Association
- “Once a freeze is imposed, the process of thawing may be too painful to bear”
  - Joan Youngman, Lincoln Institute of Land Policy

Are there other ways to address volatility?

- Tools that can be used to mitigate impact of tax increases:
  - Property tax credits (based on income) for low-income taxpayers
  - Tax deferrals for the elderly (to address cash-flow problem)
  - Phase-ins of tax increases
  - Special provisions for those facing undue hardship

Are there other ways to address volatility?

- Accuracy in assessment is critical to a market value assessment base
- Assessment increases cannot be used as excuse for property tax increases
  - truth in taxation
  - revenue neutrality
- Taxpayer (and media) education is needed to understand the relationship between assessment and taxes

Addressing Volatility

- Taxpayers could be offered different payment options
- Need to address real hardships
- Don’t tamper with assessment base; mitigate impact of increases on those who cannot afford them

Property tax credits (circuit breakers) are fair and cost effective

- Based on property taxes paid (or rent paid) and taxable income
- Administered and paid for by state/provincial governments
- Tax relief increases as income declines -- reduces regressivity of property tax
- Targets relief to those most in need

Concluding Comments

Municipal Tax Policy: Conclusions

- Property tax strategies have an impact on:
  - Municipal revenues and local autonomy
  - Land use
  - Other social and economic objectives

Municipal Tax Policy: Conclusions

- Municipal revenues: local tax rate setting; minimum exemptions

- Land use: Property taxes should reflect benefits received; eliminate over-taxation of apartments and non-residential properties

- Social and economic objectives: lower business taxes overall preferable to targeted incentives; circuit-breakers preferred to assessment limits