President’s Message – May 2016

I am sure many of you will be aware of the recent revelations concerning the so-called “Panama Papers”, the leak of a huge amount of documents concerning tax havens where, allegedly, the wealthy use specialists to create offshore companies in which their wealth can be “hidden” and either evade or avoid taxes. The ability to move money easily around the world is one aspect of “globalisation”, i.e. the integration of economies, industries, markets, cultures and policy-making around the world. As readers will be aware, globalisation is, in general, the process by which national and regional economies, societies, and cultures have become integrated through the global network of trade, communication, immigration and transportation. Arguably, globalisation was often primarily focused on the economic side of the world, such as trade, foreign direct investment and international capital flows; however, more recently, the term has been expanded to include a broader range of areas and activities such as culture, media, technology, socio-cultural, political, and even biological factors, e.g. climate change.

So what does this have to do with property tax? It seems to me that there are a number of possible implications of globalisation for property tax. One of the positives is that information about property tax systems around the world is more widely known and, I hope, IPTI continues to help with that sharing of information and best practice. However, what some might see as a less desirable consequence of globalisation is that businesses, particularly large international corporations, can locate, or relocate, almost anywhere in the world and the incidence of taxes, including property taxes, will influence those decisions. The impact of globalisation on traditional manufacturing industries in various countries has, of course, been significant and resulted in changes in the operation of many businesses and, in some cases, closures of large plants. All these factors spill over into the property tax world either by reductions in tax revenue where businesses close and are not replaced and/or challenges for valuations of properties that are affected by world trade fluctuations.

We see current examples of that in the UK where traditional iron and steel plants are under great pressure due to cheap imports. Among other issues raised by the industry is that the UK property tax (business rates) not only increases their costs of operating in the UK, but also puts them at a considerable disadvantage in comparison with other countries where property taxes either don’t exist or are much lower. Similarly in North America, many industries are struggling to deal with competition from other countries and this is having both direct and indirect impacts on their property tax systems.

One other aspect of the Panama Papers that may not yet have attracted any headlines is that the disclosures underline the traditional strengths of property taxes; you can’t move or hide properties in the way that you can with money and the tax is therefore difficult to avoid or evade. Furthermore, the property provides an asset which can be used for enforcement of payment. So it will be interesting to see whether, in the longer term, a greater emphasis may be put on property taxes, as advocated by the World Bank, IMF, European Union, etc.

Anyway, having taken a quick look at the "big picture", let's return to what IPTI has been doing recently and what lies ahead in the immediate future.

During April we made progress with a number of important projects for various clients and also participated in a number of events. I was involved in several workshops we ran for the Irish Valuation Office in Dublin which covered a number of interesting valuation issues. I was also involved in what has now become an annual property tax seminar held in the UK with lawyers from Landmark Chambers. This event, held at the Royal College of Surgeons in London, was very well-attended and the audience obtained helpful insights into the most recent case law and other issues concerning business rates. Many of the presentations were made by eminent QCs involved in property tax litigation in the higher tribunals, the Court of Appeal and the Supreme Court. I chaired the discussion session after the main presentations and it was a good opportunity for the audience to ask questions of the leading experts on the panel. Lawyers, of course, are usually asking the questions so it is always interesting to see how they answer them for a change!

Another event we held during April was a webinar on the valuation of shopping centres. This was another in the series of webinars we are running in partnership with the Institute of Municipal Assessors (IMA) in Canada. We had two very able and experienced presenters, one from the private sector and one from the public sector, who shared their views with the webinar audience. We have many more IMA-IPTI webinars being held over the coming months; as usual, full details are available on our website: www.ipti.org.

Looking ahead, we have two events coming up in May which will be both informative and interesting. The first is the Ontario Property Tax Summit (OPTS) being held at Niagara Falls on 16 May. This will involve a number of speakers both presenting and discussing the progress made since the last OPTS and what more needs to be done to address the outstanding issues and challenges identified. We have a very distinguished group of speakers and panellists lined up for this event and I am sure it will be a significant step forward in ensuring all stakeholders have an opportunity to shape the way in which the property tax system moves forward.

The second major event in May is our annual Mass Appraisal Valuation Symposium (MAVS) which is also being held at Niagara Falls, this time on 17 and 18 May. There will be leading experts from all over the world coming to share their knowledge and experience and I have no doubt it will be a great event. We have speakers and delegates from every continent and we will be covering a wide range of property tax issues so the 2016 MAVS is an event not to be missed.

Having mentioned globalisation earlier, it is now time to look at what has been happening in property tax systems in selected countries around the world.

In New South Wales, Australia, the debate continues over whether stamp duty should be replaced with a broad-based land tax. Advocates say recent research shows that this could generate thousands of jobs, bring down rental prices and boost the economy by $5 billion. However, at this stage, it seems that the State Government is not contemplating such a change. Supporters of the idea point out that the ACT Government has made this move and are currently in a 20-year transition from stamp duty to a broad-based land tax.

There is a separate debate going on in parts of Australia over the use of land value capture as a mechanism to assist the funding of major infrastructure projects including new inter-city rail systems and city centre tram systems. Commentators say that windfall gains to private land owners stemming from developments outside their control are a far better object for taxation than income and consumption, which prop up vast avoidance industries; the latter comment links back to the Panama Papers. One commentator said that American economist Henry

George's almost religious advocacy popularised the virtue of land taxes in the 1880s, but the arguments go back to Adam Smith. "Ground rents are a species of revenue which the owner, in many cases, enjoys without any care or attention of his own," Adam Smith wrote, arguing land was the best object of taxation. Taxes on land are unique economically because they can't be avoided and they don't distort supply, unlike taxes on everything else, which do. That means the tax can't easily be passed on. "A tax upon ground rents would not raise the rents of houses," Smith added. The debate continues.

Cities across Canada should consider new and innovative approaches to financing their share of infrastructure spending, according to a new C.D. Howe Institute report. In "Tapping the Land: Tax Increment Financing of Infrastructure," author Adam Found shows how cities could use tax increment financing (TIF) to finance infrastructure ranging from sports arenas to public transit. Under TIF, the benefits conferred to nearby properties by new local infrastructure are transformed into additional property tax revenue, which is then used to finance that same infrastructure. TIF's key virtue is its ability to capture infrastructure-induced increases in land value without increasing general tax rates. TIF can finance infrastructure without worsening the existing negative impacts of property taxation on investment. Another potential virtue of TIF over general revenue taxes is its enhancement of equity by aligning location-specific infrastructure benefits (such as a transit station within walking distance) with costs. "TIF better matches those who benefit from new infrastructure with those who pay for it," commented Found. "Otherwise, using general taxes to finance infrastructure that brings benefits to specific areas only will subsidize those near the infrastructure at the expense of all other taxpayers."

In Japan, the Tokyo municipal government has recently decided to enter into discussions with the Ministry of Internal Affairs and Communications to consider changing how the fixed asset tax (kouteishisanzei) is calculated and assessed for buildings. The goal is for the changes to take effect and be extended to all of Japan by the beginning of the 2021 fiscal year. At present, fixed asset tax in Japan is paid annually to the local government by owners of land and/or buildings, with the tax basis assessed once every three years. The basic tax rate is 1.4% of this assessed amount. For buildings, the assessment process entails the local government appraising the value of each material used in construction of the building (wood, reinforced concrete, etc.), which is known as the cost of reconstruction (saikenchikukakaku) valuation method. This valuation method was first introduced in Japan during the 1963 fiscal year. The problem with this valuation method is that it takes a lot of time and effort for the authorities to calculate. For new high-rise buildings, in the worst case scenario it can take up to two years after construction is completed for the final assessment amount to be fixed. The hope is that changing the valuation method can shorten the time needed to calculate the tax basis to a few months at most. The main new valuation method being considered is based on the acquisition price of the property; however, the authorities are also considering the discounted cash flow method.

Recent USA research shows that the effective real estate tax rates vary substantially across and within counties, with the highest rate area displaying rates that are often multiple times higher than the lowest rate areas within the same county. The report states that an "effective property tax rate" is the amount of property tax paid divided by the value of the home as reported by home owners, thus giving an apples-to-apples comparison of true tax burden for homes in various locations. The alternative to an effective rate measurement is to compare statutory tax rates, which can be misleading given differences in assessment rules, tax credits, lags in accurate assessments by taxing jurisdiction and other complicating factors. The report presents tables of effective property tax rates for more than 3,100 counties, including the lowest and highest tract rates within each county. At the low end of the national spectrum, there are Louisiana parishes with twelve of them registering property tax rates that are effectively under $2 dollars per $1,000 of value. At the high end, there are Orleans and Monroe Counties, New York and Camden County, New Jersey with property tax rates averaging close to $29.

In Croatia, it is reported that new tax laws could be adopted by the end of the year. A working group for tax reform has already been founded, has about twenty members and is made up of experts, tax advisers, representatives of the Croatian Chamber of Economy, Croatian Employers Association and the Finance Ministry. In addition to this working group, there are calls for another team to be formed which will look at the possible changes to the so-called "communal utility fee", which is a Croatian version of property taxes. The law has been amended about thirty times, so the Ministry concluded it would be best to prepare a new law. The final version of the law will depend on the political decision whether to introduce property taxes. The Prime Minister reportedly supports such a tax, but since its implementation would take a lot of time, it is possible that in the first phase utility fee law will be changed. Under current law, the fees and numerous exemptions are determined at a local government unit level. However, now the idea is to equalize criteria with a new law.

In the Isle of Man the government is considering changing the way that property is valued to determine the rates. Ratepayers throughout the island are being asked to help with government research into the potential effects of changing the way that residential property is valued. The system could shift from historic rental values of properties to current capital values. Rates demands currently being issued by Treasury will include a request for ratepayers to indicate which capital value band their property would be in if the system were changed. A Treasury spokesman said: "Property owners are not obliged to provide this information but we would encourage them to do so. A good level of returns will help to provide a clearer picture of how the proposed changes may affect future rate demands for individual properties across the island." He added: "There is no need to ask an expert or professional to carry out a valuation. Returns will only be used for research purposes and information about individual properties will not be published or passed on to third parties." At present bills for local authority, water and sewerage rates are calculated using an estimate of the rental income that a property would have earned in the 1960s, when the structure of the housing market was significantly different. The Treasury is investigating the implications of moving to a system based on current capital value – the price a home would fetch if sold on the open market – under which properties would be grouped into nine valuation bands. It is believed that capital value would provide a more accurate and up to date basis for domestic rating, with fewer anomalies than the existing system.

Moving on to Africa, Ghana's parliament would have to review the criteria for disbursement of the District Assemblies' Common Fund, according to a professor with the Kwame Nkrumah University of Science and Technology. Government is mandated to allocate a proportion of collected national revenue to the local assemblies to drive development. But a leading land economist says conditions for selection and sharing of the common fund must be tied to the property rate collection potentials of each assembly. He said "I don't see, for example, why the major cities should be paid huge sums of money from the district assemblies common fund when there are poor assemblies who cannot afford to execute development projects because the kind of revenue that they are collecting from property rate is so low; yet we give all the money to the big assemblies," he stated. He observed that the Accra, Kumasi and Secondi-Takoradi Metropolitan Assemblies have huge opportunities to generate revenue from property rate collection. He said that cities and towns are not developing at a faster pace because assemblies receive cheap money from the Common Fund, hence fail to be proactive in property rate collection. He is also advocating taxation on idle lands to compel people to develop their lands "rather than leaving them idle and creaming off profits when the value has increased and just have to sell them".

In Malaysia, the Ipoh City Council has introduced a scheme to incentivise property tax payers to pay their dues on time. A total of thirty property tax payers who pay in full on time are invited to attend a "lucky draw" to win prizes. One man who won a motorcycle said "I always pay my yearly assessment on time, but this prize will motivate me to continue paying my assessment," adding that he pays about RM4,000 in assessment for his house and shop. Five main prize winners each took home a motorcycle. Other prizes included bicycles, televisions and electronic gadgets such as mobile phones and tablets. A spokesman said the city council has collected RM29.7mil for 2015, compared to RM28.2mil in 2014, which is a 4% increase in collection. "This increase is a positive sign that people are paying off their annual assessment," he added. He added that the city council aims to achieve five-star status. "One of its requirements is to collect up to 95% of the assessment rates," he said.

In the USA, a non-profit radio station in Ohio that plays Christian music is a place of "public worship" and thus exempt from property taxes, the Supreme Court recently decided. The split decision (a 4-3 ruling) overturns the state tax commissioner's finding that the property is a commercial enterprise, with its property used exclusively as a radio station, not as a church. The Court said that the tax commissioner improperly failed to "consider whether (it) exhibits the essential qualities of a church." The 2.2-acre property houses the 15,600-square-foot radio station, which includes a small chapel that constitutes 2 percent of the building's space. In a strongly worded dissent, one of the judges said "The majority found that the "broadcast of 'adult contemporary Christian' music mystically transforms its radio station into a tax-exempt house of worship. If that framing were proper, we would face a church-state issue that poses complex constitutional conundrums. The public does not gather at the station for religious services." This decision may be seen in the context of a wider review of existing property tax exemptions that is taking place in many jurisdictions.

A similar issue has arisen in Bermuda where debate recently started on whether churches should retain their tax-exempt status when it was realised that 134 of the island's churches and rectories were paying zero land tax. The land tax on non-exempt properties in Bermuda ranges from $3,600 per year to $576,000 per year according to the Land Valuation Department and the island has one of the highest numbers of churches per capita in the world. Churches, while not officially regulated, gain their exempt status because of the social role they are charged with. A Ministry of Finance spokesman said: "The Government appreciates all of the excellent community work that our churches do and consider that they pay their fair share of taxes. What is being suggested by online commentary has not been a consideration of the Government." A recent report by the National Institute of Economic and Social Research noted that Bermuda's land tax system could be "rationalised" without specifically referring to churches. It said that "Taxes on land and property could be increased in the short term, while considering longer-term reforms to improve equity and efficiency."

And the same issue arises in Australia where, according to the Sex Party (in case readers are wondering, I did not make this up!), religious institutions should pay more state-based taxes. The party is pushing to overturn long-standing exemptions and wants new laws to be introduced to force religious groups to take on an increased share of the tax burden.

And finally, I have referred in previous newsletters to the practice in parts of India of using drumming bands to "shame" reluctant property owners into paying overdue property taxes. Recent reports state that, since the drummers started work early this year in Mumbai, property tax revenue has jumped 20 per cent. Reports say that the tax collectors are glad the drummers are touring the neighbourhood with them. One official said "When the staff show up to collect tax alone, people get angry and beat them up; the band has brought an improvement." Apparently, four drummers march up front and, behind them, a municipal employee holds a flag with the government's coat of arms. On hearing that the band was coming his way, one taxpayer, desperate to avoid the shame, managed to pull together the money he needed and rushed to the town hall to pay. Despite being on the receiving end, he expressed grudging admiration for the collection tactic. "It's very, very effective," he said.

Sceptics predict the effects of the drumming on tax evaders will fade when the band's appearances become routine. However, a government spokesman said they have already thought of that and during this fiscal year, which began on 1 April, he plans to deploy groups of transgender women, known in India as "hijras", to perform mocking dances to shame tax delinquents.

"You couldn't make it up", as they say!

Paul Sanderson
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