PRESIDENT'S MESSAGE

February 2018

In a recent publication, Bloomberg stated that "Property Tax Could be the Hottest Tax Issue of 2018". Referring to the position in the USA, Bloomberg went on to say that the passage of federal tax reform, and the resultant cap on the state and local tax (SALT) deduction, has thrust state taxes into the national spotlight in a way that perhaps hasn't been seen for many years. State and local tax practitioners, of course, are regularly immersed in the issues concerning sales and use taxes, state corporate and individual income taxes, state excise taxes, and property taxes. In late December, however, the property tax, in particular, "stole the show" as a nationwide drama played out around whether taxpayers would be able to prepay property taxes and take advantage of the last opportunity to claim an un-capped state and local tax deduction on federal income tax returns.

Bloomberg went on to say that the uproar over property taxes in the waning days of 2017 may have been a precursor to a lot more scrutiny of the property tax in 2018 that goes well beyond distress over capped deductions. For example, in his final state of the state address, outgoing New Jersey Gov. Chris Christie "warned" that property taxes will be a major concern for the state as the new governor takes the reins. Texas, one of the few non-income tax states, is expected to "accelerate [its] efforts at property tax relief in 2018 in advance of the 2019 Legislature," as reported by Bloomberg in a legislative preview for the Lone Star State. In Wisconsin, retail proponents of the "dark store" theory of property valuation face limits on using "dark property" as comparable to property that is not dark property under pending legislation.

Lawmakers working on state tax reform in Nebraska are expected to tussle over priorities - while urban representatives see a need for lowering corporate and individual income taxes, legislators from rural districts are looking for property tax relief for the "agricultural sector," according to Bloomberg. And Pennsylvania's legislature is set to again consider the "Property Tax Independence Act", a bipartisan bill introduced several times in recent years, that is designed to eliminate the school property tax, apparently "the most-hated and egregious tax" among at least some of the state's voters.

Bloomberg added that property taxes comprise 31.3 percent of state and local tax collections in the U.S., according to the Tax Foundation. The Council on State Taxation (COST) issued a report last August finding that property taxes are "by far the largest state and local tax paid by businesses," at 38.4 percent of total state taxes paid and 76.8 percent of total local taxes paid. These figures illustrate the critical role of property taxes as revenue for the states and localities and as a potential burden for companies and homeowners. As state and local governments and taxpayers alike decide how to respond in the wake of the 2017 federal tax reform act, we may see the property tax emerge as the hottest policy issue of the year.

It will be interesting to see, during the course of 2018, whether these predictions come to pass; as usual, IPTI will keep you informed about developments in all these areas.

Having mentioned the so-called "dark stores" issue, during January, IPTI's Corporate Advisory Committee (CAC) held a very interesting teleconference to discuss the matter. Although this has been mentioned in previous newsletters, for the benefit of those who may not be familiar with it, the issue arises in connection with the valuation of "big box" retail stores, particularly those in North America. The main issue is whether or not the subject property should be valued having regard to its existing occupier and lease terms, or on the basis that it is vacant (i.e. "dark"). If it is to be valued as if vacant, the argument is that it should be valued on the basis of the sale price achieved for other similar, but vacant, big box stores. Of course, much depends on the legislation that prescribes the basis of valuation - which may differ from one jurisdiction to another - but most require the open market value of the property to be ascertained. Part of the argument is whether the valuation should be assessed on the basis of "value-in-use" or "value-in-exchange", assuming there is a difference between the two in the case of a particular property. There is considerable litigation in progress on the issue, and some legislation that seeks to "direct" how such properties should be valued.

In my view, it should be left to valuation experts to determine the value of any property for property tax purposes using whatever method (or methods) they consider appropriate, giving due weight to the most relevant available evidence. In the event of a dispute over the value of a particular property, it is hoped that an independent third-party trier of fact would adopt the same approach and examine which of the parties has, in the opinion of that third-party, provided the most compelling evidence to support their valuation. Legislating to "prescribe" how any type of property should be valued often results in greater uncertainty and increased litigation. In view of the continuing arguments over the issue, IPTI is considering arranging a webinar where the matter can be explored in more detail.

Looking back over January, one of the events at which I spoke was the Annual Rating Conference organised by the Royal Institution of Chartered Surveyors (RICS). This was held in London and covered a wide range of interesting topics. One of the speakers was Ken Barclay who chaired a recent review of non-domestic rates (the property tax relating to non-residential properties) in Scotland. I mentioned the review report that was published in August last year in a previous newsletter. In December last year, the Scottish Government published an implementation plan which set out how it intended to adopt the recommendations in the Barclay Review. It was refreshing to see an example of a government setting up an independent review and being prepared to implement the recommendations. I had quite a long discussion with Ken and it was interesting to find out that, although he had no background in the field of property taxes, he quickly identified the key issues and made what most professionals working in this area regard as sensible, practical recommendations that could be more widely adopted.

Having mentioned the RICS, I should add that I had the pleasure of having lunch with their new President, John Hughes, when he visited London in January. John is based in Toronto, Canada and has been involved in many IPTI events over the years. The RICS is celebrating its 150th anniversary this year and we continue to enjoy IPTI's partnership with the RICS, working together in different parts of the world.

Also during January, we had a virtual meeting of IPTI's Board of Advisors. As Members of IPTI's Board of Advisors are located in many different countries around the globe, we had to have two tele-conferences on the same day to take account of time differences. I am grateful to all Board Members who participated in those meetings and contributed their views on various issues. I should add that many Board Members have been involved with the latest COST-IPTI Property Tax Scorecard that we are in the process of updating, the outcome of which we will be publishing later this year.

Looking ahead, in February, we will be holding a workshop in partnership with the Institute of Municipal Assessors (IMA) on the topic of "Identification and Quantification of Physical, Functional and External Depreciation". This IMA-IPTI workshop will be held in Ontario, Canada and will deal with practical issues in the identification and quantification of physical, functional and external depreciation. Practical case studies will be provided, and attendees will have an opportunity to test their knowledge, with instructors' assistance, in applying the theory for identifying and quantifying all types of depreciation.

We are also holding another IMA-IPTI webinar later in February; this one will be on the topic of "Valuation of Income Producing Properties - Deriving Capitalization Rates and Expenses". Any interest in real estate capable of generating income is typically valued by direct capitalization. Although capitalization rates can be estimated using various methods, the technique used will depend on the quantity and quality of the data available. Deriving capitalization rates from comparable sales is the preferred technique when sufficient sales data of similar comparable properties is available. Using practical examples, our two expert speakers will focus on the estimate of expenses and deriving an appropriate capitalization rate using the direct capitalization methodology.

Also in February, I will be participating in a round-table event in London to discuss the many pressing issues currently affecting the business rates system in the UK. In particular, I have been asked to provide data about property tax systems in other countries and make comparisons between the UK system and other jurisdictions.

In March, we be holding another meeting of IPTI's Corporate Advisory Committee (CAC) and in April the CAC will be hosting a one-day workshop in Chicago on the subject of "Managing Property Tax Portfolios - Multi-Jurisdictional and Global Challenges". This event is for representatives of large corporate entities that have significant property tax liabilities in many different jurisdictions. Effectively managing such property taxes is a challenging process, and this workshop will focus on sharing best practice in this area.

Moving on to May, we will be holding another Ontario Property Tax Summit. In June, our 2018 Mass Appraisal Valuation Symposium (MAVS) will be held in Halifax, Nova Scotia, Canada in cooperation with the Property Valuation Services Corporation (PVSC) of Nova Scotia. We will also be holding a pre-symposium one-day workshop entitled "Addressing Challenges in Property Taxation".

More information about all our forthcoming events, along with registration and other details, 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 around the world.

The government in South Korea is considering using an increase in property tax to curb house price rises. Earlier measures - including levying heavy capital gains taxes on those who have invested in multiple homes and restricting mortgages - have not been effective. During a briefing on economic policy directives for 2018, the finance minister said the government would comprehensively consider diverse factors such as equity in taxation. “Since tax revision has a huge impact, it is crucial to have a discussion. We will prepare measures after gathering diverse opinions through a special committee,” he said. The official tax hike plan on homeowners is expected to be unveiled in August when the government announces its tax revision plans. On top of pressuring demand by raising property taxes, the government plans to stabilise the market by increasing the supply of new homes. According to the government housing welfare roadmap, one million homes will be supplied for the next five years through public sector companies such as the Korea Land and Housing Corporation. They will target newlyweds, young people and low-income households.

A recent report from the Organization for Economic Cooperation and Development (OECD) showed that South Korea's property tax rate compared with its GDP stood below the average for member countries. According to the Paris-based organization, the country's recurrent taxes on immovables reached 0.80 percent of its economy in 2017. This placed it the 16th highest among 31 countries that were checked and below the 0.91 percent average for other developed market economies with high incomes. Among countries examined, Britain had the highest property tax rate, followed by Canada and France. The United States and Israel made the top-five list, while the small European state of Luxemburg had the lowest tax rate at 0.07 percent. Switzerland, the Czech Republic, Austria and Turkey also had low property tax rate numbers compared with their GDP.

In Canada, non-residential property taxes in Montreal are going up by an average of 3 per cent in the city's 2018 budget. Business groups say they’re disappointed with an average three per cent increase in the non-residential property tax rate included in Montreal’s 2018 budget. It’s the biggest average increase in non-residential property taxes since 2012. It’s the first time since 2015 that general non-residential tax charges have increased more than residential rates. “It’s not good news, the total tax burden for businesses in Montreal is four times what it is for residential tax payers with the same assessment,” said the director of economic affairs at the Canadian Federation of Independent Business. “Small businesses are disproportionately footing the bill.” Businesses in Outremont will see the biggest increase in overall tax rates - 6.3 per cent. That’s followed by the Sud-Ouest and Rosemont–La Petite-Patrie, where overall non-residential tax rates will rise by 4.6 per cent. Even before the increase, Montreal had the highest effective municipal property tax rates in the country, according to the C. D. Howe Institute.

In Australia, with effect from January 2018, owners of residential properties in certain Melbourne suburbs, which have been unoccupied for more than six months in a calendar year, will be liable to pay the Victorian Government's new "vacant residential land tax". The tax is based on use and occupation of residential properties in 2017. As the legislation was introduced in May 2017, all properties are deemed to have been occupied between 1 January and 30 April 2017. This means a property will only attract the tax in 2018 if it was unoccupied for more than six months between 1 May 2017 and 31 December 2017. The tax is in addition to land tax; the absentee owner surcharge, which is an additional surcharge over the usual land tax rates for land owned by "absentee persons"; and the Federal Government's annual vacancy fee, which is levied on foreign owners of residential real estate where a property is not occupied or genuinely available for rent for at least six months in a 12-month period. The tax is assessed at 1% of the "capital improved value" (CIV) of the property. CIVs are displayed on council rates notices and take into account the value of any improvements on the land. For example, if the CIV of a property is AUD500,000 and the Tax applies, the tax payable would be AUD5,000. This is different to regular land tax which is calculated on "site value", which is the unimproved value of the land.

The Cuban government will put into force a tax on the “idleness” of agricultural and forestry lands in the second semester of this year, as part of the efforts to increase food production in the country. Its gradual application is included in the Law 113 of the Tax System and requires the creation of technical and organizational conditions based on the controls of the land, the evaluation of its quality and level of exploitation. The island´s government owns 80 percent of the land and leases most of it to farmers and cooperatives. The rest is owned by private family farmers and their cooperatives. The fixed amount to pay can be 180, 135, 90 and 45 pesos per hectare (equal to U.S. dollars), according to the category of the land, classified as first, second, third and fourth category. Idle lands are considered those that are insufficiently used or not in agricultural, livestock or forestry production, except the land needed to rest, in order to rotate crops or covered with marabou, weeds or invasive plants, said an official. According to recent data from the Ministry of Agriculture, the country has an agricultural area of 6,342,418 hectares, but around a million hectares are still idle, which represents 16 percent of the total.

In Germany, the convoluted property tax system could be illegal. Properties are valued differently in the east than in the west. The country’s highest court is asking whether this is unconstitutional - a decision that will impact 35 million pieces of real estate, billions in state revenues and hundreds of jobs. It’s been almost 30 years since the wall came down, but Berlin is still a city divided. German property tax has been criticized for years because of the bizarre, arbitrary and outdated way in which it is calculated. Property taxes in the former West German states are based on unit values from 1964, whereas taxes in former East German states are based on unit values from 1935. Authorities had the option of updating these values every six years, but in practice this never happened. The court will shortly begin hearing arguments and consulting experts, before deciding whether the country’s property tax is unconstitutional. If the court says the system needs reforming, German municipalities have suggested that up to 35 million pieces of real estate will need to be revalued. Sector experts have already said that this ambitious project could take up to 10 years. German municipal authorities have long lobbied for changes, but the German government decided it was a federal matter. Property tax is one of the most important forms of income for German cities and municipalities, adding up to around €14 billion ($17 billion) in revenue per year and making up between 10 and 15 percent of their annual takings. Calculating the tax is complicated. It involves three criteria: the (outdated) unit value; a federally-mandated rate based on how the property is used (whether an apartment of a single-family home, for example); and then what is known as a “Hebesatz.” The latter translates literally to “clause for an increase.” It is set by every municipal authority separately and used to make up for the unequal and outdated valuation. On average, it adds 500 percent to the base value, and tends to be higher in the east and lower in the west.

In California, it is being suggested that the well-known Proposition 13 exemption should be made “immortal”. Under Prop. 13, the taxable value of every California home is set at the date its owner purchased it. From that original base, a home’s assessed value cannot increase by more than 2 percent annually - no matter how much the market value goes up. In this way, Prop. 13 provided homeowners an ever-escalating discount on property taxes as the value of their homes rose. The California Association of Realtors' new ballot initiative seeks to make Prop. 13 property tax savings even more generous by allowing anyone over 55 years old to sell their California house and carry those same low property taxes to their next home, no matter the new home’s market value, or its location in the state, or the number of moves they make. Proponents call this a “new birth of freedom”. They say Prop. 13 only protected older homeowners from being forced out of their homes by rising property taxes. This “Son-of-Prop-13” also frees older homeowners who might feel trapped in their homes by their unwillingness to surrender those property tax savings. One commentator asks “Why limit property tax protections to just the old and living? To express the central importance of property taxes here, I propose that every California homeowner be entitled to property tax savings that extend beyond their death.” This would allow taxpayers, or their estate, to transfer property tax savings to whomever they want (a nephew, a neighbor, a bridge partner), for however long they want. It will be interesting to see whether any of these proposals ever see the light of day!

More reports are coming out of China about the introduction of a new property tax system. China's finance minister has published his policy statement which outlined that property tax will be levied on industrial and commercial properties, as well as personal residential houses, based on their "appraised value". He also suggested the legislation work would be completed by 2019, which would lay the foundation for its enforcement in as early as 2020. Commentators noted that "appraised value" means a comprehensive assessment of the original and current value of the property, while also taking into account affecting factors such as the real estate market situations and the price of similar property in surrounding areas.

And finally, to show that tax collectors have a sense of humour, the main UK tax authority, HMRC, recently published some of the more bizarre “reasons” they receive for failure to complete tax returns on time. They include: “I've been far too busy touring the country with my one-man play”; “my ex-wife left my tax return upstairs, but I suffer from vertigo and can't go upstairs to retrieve it”; “my business doesn't really do anything”; and “I spilt coffee on it”. But my personal favourite is: “I couldn't file my return on time as my wife has been seeing aliens and won't let me enter the house”. You couldn’t make it up!

Paul Sanderson

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