International Property Tax Institute

PRESIDENT'S MESSAGE

January 2018

May I start by wishing you all a very Happy New Year and best wishes for what I hope will be an interesting and enjoyable 2018. I hope you had a good time over the Christmas and Boxing Day period and managed to find some time to relax so you are ready for the year ahead.

I would like to start this newsletter by sharing with you extracts from a very interesting recent article I read entitled "Rethinking India's tax system"; the full article can be found on our website in IPTI Xtracts. Written by Shruti Rajagopalan, a professor of economics, it proposes that Indian States should rely more on property tax which, he says, is economically efficient, incentive compatible, and progressive. He reviews existing income and consumption taxes in India and criticises their shortcomings. He goes on to say that property tax has four key benefits which he outlines as follows:

First, it is difficult to evade. Property cannot be moved, or hidden easily, and lasts long. There is an additional incentive to correctly declare the full extent of one's property. Property owners will not understate the amount of property owned, because it might adversely affect their wealth, future sales, disputes, inheritance, etc. Since property often forms a large proportion of total assets/wealth, there is a built-in incentive to declare property honestly, unlike incentives to understate income or sales.

Second, property tax is efficient because it creates fewer distortions. Typically, a tax on something results in less of it. High levels of income tax may create a disincentive to work. High sales taxes may lead to lower consumption, and, in certain situations, an informal economy, with goods sold off-the-books, etc. In this regard, property taxes are quite efficient. Typically, existing buildings, land, etc., don't reduce or disappear because of a tax. The main response available to the property owner is to sell the property, and as long as there is a buyer willing to take on the tax burden, revenue tends to be stable.

Third, property taxes tend to be more progressive than consumption taxes (but less progressive than income tax) because the wealthy, relatively, own more property. India has a very high percentage of home ownership, especially in rural areas. It will be important to design a progressive property tax system by classifying plot sizes, accurate land values and zoning data.

Finally, and most importantly, property taxes tend to be levied by local governments. This creates a very direct feedback mechanism between voters/taxpayers and their elected representatives, unlike income and sales taxes, which are levied centrally and spent far from where they are collected. In India today, the urban rich and middle class are able to exit the consequences of state dysfunction by buying into gated communities and private developments. Within these communities, individuals pay maintenance fees, which provide the same services that would be provided by a functional municipal system.

A property tax system makes such exit costlier - which might lead the rich and middle class, who have political and social capital, to participate in governance decisions and demand better public goods and services. Unlike income taxes (often withheld at source by the employer) or sales tax, where the tax is hidden in the retail price, taxpayers typically have to write a cheque to the government while paying property tax. This has the advantage of revealing the extent of the tax explicitly, which may lead taxpayers to demand low tax rates as well as exert pressure on local governments for better services.

Property taxes may also have other consequences specific to India, with its 24.7 million vacant homes. Much of the black money in India is channelled towards owning multiple homes, and poorly designed tenancy laws coupled with a slow dispute resolution system incentivise owners to leave additional homes vacant. Property taxes make it costlier for owners to have additional vacant properties that are purely speculative. In rural India, property tax may also be an avenue to tax wealthy farmers without unduly burdening poor farmers, since agricultural income is not taxed at all.

Currently, India barely relies on property taxes, with a property tax to gross domestic product (GDP) ratio of 0.2%. For other developing countries, though data varies greatly, the rough estimate is 0.7%. By comparison, the average property tax to GDP ratio for OECD countries is almost 2%. India should actively consider exploring property taxes as an important source of revenue to develop increased citizen participation for public goods infrastructure.

Whilst most people who are involved in property tax systems are well aware of what the professor is outlining in terms of the advantages of property tax, it is interesting to read his comments both because he is an academic and he is referring to such a large country as India. I should add that IPTI recently researched property taxes in parts of India in connection with a project we were undertaking for a large global corporation, and we found that property tax systems in the States we looked at were fundamentally sound, but could be significantly improved if the political will existed to make such enhancements.

Moving on, and just looking back briefly at 2017, from IPTI's perspective it was a very busy and diverse year with lots of different events we either organised or in which we participated, and with many projects that covered a wide range of topics.

In terms of recent events, in December last year, we held a meeting of IPTI's European Corporate Advisory Committee (ECAC) in London at which we had speakers from the Department for Communities and Local Government (DCLG) and the Valuation Office Agency (VOA) talking to ECAC members. As this was a relatively informal meeting, the DCLG and VOA speakers probably felt able to discuss issues concerning business rates (the UK property tax relating to non-domestic properties) in a more open and relaxed way than might otherwise have been the case. ECAC members certainly appreciated the opportunity to hear about some of the more controversial issues currently impacting their businesses and have the opportunity to ask questions of two of the key people responsible for implementing the system. IPTI will be following up this meeting through partnership with other organisations whose members are likely to appreciate the opportunity to have this type of interaction with both the DCLG and the VOA.

Also in December, we delivered another in the series of web classes we provide in partnership with the Royal Institution of Chartered Surveyors (RICS). This one was on the subject of "Preparing Expert Reports for Valuation Disputes" and, I am pleased to say, that I was one of the presenters along with a very experienced lawyer who is based in the USA. We looked at how to prepare an expert report for use in valuation disputes and, in particular, what needs to go into such a report and how the report should be structured. We focussed on the facts that need to be included in the expert's report, how those facts should be analyzed, and how to present the conclusions drawn from the analysis of the factual information collected. We also looked at particular issues that arise in connection with the valuation of several different types of property.

I am pleased to report that IPTI had input into a new guide issued by the United Nations Food and Agriculture Organisation (UNFAO) entitled "Valuing land tenure rights". This is a technical guide on valuing land tenure rights in line with the Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests. Dr. Jan Brzeski represented IPTI and attended meetings of the group of experts who contributed to this UNFAO guide, parts of which relate to valuation for property tax purposes. The guide states *"Many countries regard land and property as a legitimate source of tax revenue, particularly for local government expenditure such as medical, police and fire services, and maintenance of infrastructure and amenities. Land and property value is widely used as a means of allocating tax liability fairly among owners and occupiers of rural and urban tenure rights. Regular revaluations can be undertaken to ensure fairness is maintained as values change over time and public access to these tax valuations means that taxpayers can appeal against their payment liability if they wish to."*

In late December, I had a meeting with Dorothy Jacks, the new President of the International Association of Assessing Officers (IAAO). Dorothy and her husband were in the UK to spend Christmas with friends and we took advantage of this opportunity to meet up. Dorothy will be participating in a number of IPTI events during 2018 and I will also be speaking at IAAO events. As many of you will be aware, the IAAO and IPTI jointly publish the "Journal of Property Tax Assessment and Administration" and it is important that the two organisations continue to work together on areas of common interest.

Looking ahead, in January I will be speaking at the annual RICS Rating Conference which is being held at the St James' Court hotel in London. Although the main focus of the conference will be on business rates in the UK, I will be bringing an international "flavour" to the event by comparing and contrasting property tax in the UK with other jurisdictions around the world.

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.

Also in February, I am pleased to say that I have been invited by the British Retail Consortium (BRC) to represent IPTI 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. It will be interesting to see how the BRC use this information in making their case for reform of the present UK business rates system.

On 24th April we will be holding a one-day workshop in Chicago on the subject of "Managing Property Tax Portfolios - Multi-Jurisdictional and Global Challenges". Hosted by IPTI's Corporate Advisory Committee, 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.

Looking a little further ahead, our 2018 Mass Appraisal Valuation Symposium (MAVS) will be held in Halifax, Nova Scotia, Canada on 5th and 6th June 2018 in cooperation with the Property Valuation Services Corporation (PVSC) of Nova Scotia. We will also be holding a pre-symposium one-day workshop on 4th June 2018 entitled "Addressing Challenges in Property Taxation".

I am pleased to be able to confirm that our annual Caribbean conference, which we run in partnership with the RICS, will be held in Montego Bay, Jamaica on 1st and 2nd November 2018. More information about this event will be available in due course.

So, there is much to look forward to over the coming months. 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.

In Australia, research undertaken by the Australian Housing and Urban Research Institute (AHURI) indicates that, whilst States and Territories are able to raise billions of dollars from property taxes each year, diverging stamp duties, tax rates, thresholds, and exemptions lead to reduced administrative and economic efficiencies. AHURI's research has identified a pragmatic and incremental framework for property tax reform. Key recommendations include: developing consistent valuation methods for residential property and creating a national register of ownership; creating a single 6% transfer duty, with a carefully designed and state-specific duty-free threshold that would be applied to all residential property transactions; instituting the longer-term, incremental replacement of property-related transfer duties with a broad-based reoccurring property tax of between $47 and $130 per annum for a median value dwelling - this would be gradually increased to fund the abolition of transfer duties over a 10- to 20-year period. A spokesman said, "As with any base-broadening reform - especially if designed to be revenue neutral, as ours is - it is unavoidable that, over the longer term, some households will have to pay slightly more tax." He went on to say, "Yet the pathway to reform proposed in this report is designed to ensure that tax increases are very modest and fall on wealthier households. This is a small price to pay for a fairer and more sustainable housing system.

In Africa, the Rwandan government has introduced legislation intended to enable those on low incomes to be able to acquire decent homes by exempting them from building tax on the value of an affordable house. The new legislation also seeks to increase the tax rate on immovable property such as land and buildings. The minister said studies show that Rwanda's current immovable property tax rate of 0.1 per cent was too low compared to other countries in the region. MPs urged caution, but still accepted the general rationale of the new draft law that revises the 2011 law establishing sources of revenue and property of decentralised entities and governing their management. In the draft law, the tax rate on buildings was increased from 0.1 per cent to 1.0 percent of the market value of a residential building; and from 0.1 percent to 0.5 per cent of the market value of a commercial building. But the tax rate is maintained at 0.1 per cent of market value for industrial buildings and those owned by small and medium enterprises so as "to support the development of the industrial sector and that of nascent enterprises" it was stated. There is an additional tax to discourage inefficient land use and undeveloped parcels of land. To encourage efficient use of land, the normal tax rate will increase by 50 per cent on every square meter of land in excess of the allowable standard size of a parcel of land for residential and commercial buildings. An additional tax rate of 100 per cent to the ordinary tax rate will be applied to any undeveloped parcel of land. In addition, it is proposed that some existing exemptions on land and immovable property tax in the current law will be removed. Exemption of immovable property exclusively used for medical services, research and religious activities is to be removed.

There are further indications that China may be planning to roll out a nationwide property tax in respect of residential properties. Commentators says that the property tax will mean a new income source for local governments, which have been highly reliant on land sales revenue for years. In a recent article, the Finance Minister touched upon this sensitive issue. Although his article was not specific, many readers thought he aimed to publish a specific property tax rule in 2019 and implement it in 2020. The Minister first outlined the principles behind a property tax, along with a roadmap to its eventual rollout, in a book that was published to help the public understand the lengthy report that the Chinese President delivered during the recent national congress of the Communist Party. Currently, there are pilot property tax schemes being implemented in Shanghai and Chongqing. But both cities continue to lead other mainland cities in home price rises. Part of the reason may be that there are a lot of exemptions from the property tax. For example, the tax only applies to new purchases after the trial tax scheme became effective. First-time home buyers are exempted. Also, the levy is based on historical transaction value rather than on the, typically much higher, appraised market value. A Shanghai millionaire who already owns a dozen properties before the government rolled out the property tax will not have to pay the tax on his properties. If he has just bought another property at 5 million yuan (US$759,000), his tax bill, at the rate of 0.6 percent, will amount to just 30,000 yuan (US$4,550) per year. Even if the market price of his new property doubles to 10 million yuan a few years later, his tax bill will remain at 30,000 yuan per year.

In the USA, unusually, people have been rushing to pay their property taxes well ahead of time! The reason for this is that they are trying to prepay their 2018 property taxes before the new limits on State and Local Taxes (SALT) deductions kick in. The new legislation caps at $10,000 the amount of state and local taxes that filers can deduct from their federal tax bill. That means those whose tax bills regularly exceed that amount could benefit by paying more property tax in 2017, when the deduction has no limit. Local offices in a number of states saw a busy post-Christmas rush as taxpayers calculated the effects of the new law. The new tax law "is a middle-class tax hike for us, and we're trying to postpone at least some of that for at least one more year," said one resident who was questioned. However, despite efforts by some high-tax states to help taxpayers prepay 2018 property taxes before the end of the year, the US Internal Revenue Service (IRS) issued guidance indicating that prepaid property taxes cannot be deducted if, in fact, the prepayment for the 2018 levy was based on an estimate rather than an actual property tax assessment. Nevertheless, some high property tax states were reported as looking for a work-around. In New York, the Governor issued an executive order requiring local-level authorities to both deliver tax warrants and receive prepayments. New Jersey, on the other hand, issued its tax bills around July 2017; the payments are due in 2018, making it more likely that taxpayers in New Jersey can take advantage of prepayment in order to preserve the federal deduction for the 2018 property tax paid this year.

In the UK, the government have recently published a consultation paper on how it plans to “reverse” the impact of a Supreme Court decision. This decision set out guidance on what constitutes a “separate property” (known as a “hereditament” in the UK) in terms of assessment for property tax purposes and resulted in the VOA having to “split” the assessments of some properties that were “contiguous” and occupied by the same business (e.g. offices on different floors in the same building) and had been assessed as a single property because they were contiguous and in one occupation. The Supreme Court stated that *“… a hereditament is a self-contained piece of property (i.e. property all parts of which are physically accessible from all other parts, without having to go onto other property), and a self-contained piece of property is a single hereditament.”* The VOA’s action meant that, in some cases, businesses found themselves having to pay more business rates (property tax) than previously, with the increases being backdated for several years. Unsurprisingly, the businesses concerned were unhappy about this situation and there was a media campaign launched seeking change. The UK Chancellor of the Exchequer announced in his Budget in November 2017 that there would be a change and the consultation paper that has been recently issued outlines the proposed way in which this will be achieved. The government are introducing legislation not to “overrule” the Supreme Court decision, but to give ratepayers the right to request that its impact be reversed in certain cases. The proposal is that ratepayers (property taxpayers) will be given a right to make a retrospective appeal which, effectively, requires the VOA to reverse the impact of changes that they have made in accordance with the Supreme Court decision to put them back in the same position they were in previously. It will be interesting to see how this is implemented.

And finally, we know that some people will try to minimise their property tax liability by any means possible. However, in a somewhat extreme example of this, it is reported that two heterosexual Irish men got married in order to avoid inheritance tax on a property. One of the men, who is 83 years old, intends to leave his house to his friend and carer who is 58 years old, but this would have left the carer with a €50,000 tax bill which would mean he would have to sell the property to pay the tax. Same-sex marriage was legalised in Ireland following a referendum in May 2015. The older man explained that he could not afford to pay the carer, but decided that he would “pay” him by leaving him the house. By getting married, the carer will pay no tax when the older man dies. A pragmatic solution to a property tax problem!

Paul Sanderson

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