International Property Tax Institute

PRESIDENT'S MESSAGE

May 2019

A recent report relating to the impact of the digital economy in Canada highlights a number of issues that are common to most jurisdictions around the world that rely on property taxes.

It points out that municipalities are at the forefront of delivering a growing array of vital services to citizens, ranging from affordable housing, transit and child care to managing large amounts of valuable, and expensive, infrastructure. It goes on to say that many of these services will become increasingly expensive, yet the ability of municipalities to pay their mounting bills is likely to be threatened by the growing gap between how value is created in today's modern economy and the limited revenue tools available to cities and towns.

The growth of the digital economy, in which firms such as Amazon and Alphabet are increasingly dominating key sectors like retail and advertising, poses revenue challenges for all governments. Taxation systems based on residency for corporations and individuals are tough to apply in a borderless world with multinational platforms that employ relatively few workers.

The report indicates that these challenges are particularly acute at the local level, where revenue options are largely limited to land-based tools in the form of property taxes and development charges (in addition to user fees and intergovernmental transfers).

E-commerce is reducing the demand for retail spaces, telecommuting and hot-desking are gaining in popularity, workplaces are shrinking, and the average square footage per employee is declining. Land consumption is increasingly becoming decoupled from economic growth - a problematic development for local governments.

Additionally, the continuing shift from manufacturing and the industrial sector towards the service sector and knowledge economy means the share of revenues from non-residential property is on a downward trend. As a result, reliance on residential ratepayers is increasing.

To add to these challenges, the report states that a fundamental reality facing local governments in Canada is that constitutionally, they are "creatures of the province." Their autonomy in responding to new challenges is limited - any new power, including the ability to introduce new financial tools - requires provincial approval.

Given the tight fiscal position of provinces going forward, largely driven by increased health care and social services costs, the federal government is a vital partner at the table for these conversations about who does what and how it is funded.

The report looks at municipal finances in the new economy and suggests it is vital that governments review their existing revenue sources and core responsibilities. By way of example, it goes on to state that for every household tax dollar paid in Ontario, municipalities collect only nine cents, which doesn't begin to match their ever-increasing list of responsibilities.

The report suggests some short-term options that municipalities should consider include introducing progressive property taxes, with higher rates applied to more valuable properties. To avoid burdening house-rich but low-income households with high property tax bills, deferral programs that delay payment until the property is sold could be introduced or expanded. Introducing "teleworking" and "co-working" space classes of property tax could also be considered to reflect the changing nature of work.

Tapping into the increase in digital economic activity could also provide new revenue streams for municipalities. Some options include a tax on Airbnb rentals, as Ottawa and Toronto have introduced, or fees per kilometre travelled for ride-sourcing firms such as Lyft or Uber, as in the Brazilian city of Sao Paolo, which expects to raise $15 million a year for infrastructure needs through this levy.

As the world continues to evolve, the report says Canada must modernize its approach to taxation and revenue generation. More than 80 per cent of Canadians live in large and medium-sized cities and the vibrancy of these urban centres is not assured going forward. Sustained prosperity will require significant investments in transit, affordable housing and other core social services. Canada's cities and towns need modern arrangements that reflect their place at the centre of the new realities of the modern world.

As I have already indicated, although this report focusses on the position in Canada, the same issues are affecting most other jurisdictions around the world and it is clear that solutions need to be found to deal with the changing nature of our use of property and the impact that is having on property tax revenues.

Looking back over April, IPTI has been involved in a number of interesting activities. Work has continued on a number of projects and we have held various events.

We had a meeting of IPTI's Board of Advisors and the newly-appointed Commissioner of the Rating Valuation Department, LY Choi, was welcomed to his first meeting of the Board. Among other matters, the Board discussed land value capture, land value taxes and wealth taxes.

We delivered another webinar in partnership with the Institute of Municipal Assessors (IMA). This IMA-IPTI webinar was on the topic of "Determination of Assessed Values of Income Producing Properties - Determination of Fair Market Rents, Vacancy and Operating Expenses" and was well-received.

We also held an IMA-IPTI workshop in Canada on the subject of the "Preparation and Writing of Expert Reports - Board and Advocates' Expectations" which provoked some interesting discussion. It is clear that this topic creates a number of "challenges" for practitioners and IPTI will continue to provide training in this important area of professional practice.

I am pleased to report that the COST-IPTI International Property Tax Scorecard is currently at the printers and will be available shortly.

An article I wrote on the “International Perspective” was published in the latest edition of the “Valuer” magazine, a publication produced by the Institute of Revenues, Rating and Valuation (IRRV). IPTI is currently working on a project in partnership in Ireland with the IRRV and we continue to enjoy a good working relationship with that organisation.

Looking forward we have another IMA-IPTI webinar in May on the topic of “Determination of Equitable Assessments - Value and Equity Considerations”. A further IMA-IPTI webinar is also being held in May, this time on the topic of the “Importance of Function and Utility in the Application of the Cost Approach”. IPTI works closely with the IMA in connection with training events and this is an important relationship.

Another event I am looking forward to in May is the first CBI-IPTI business rates conference which is being held in London. The CBI is the Confederation of British Industry and is a large and powerful organisation representing businesses in the UK. We are putting on this high-level conference at a time when the business rates system (the annual property tax paid by occupiers of non-residential properties in the UK) is both topical and controversial. I am pleased that we will have a senior minister from the UK Treasury speaking at the event along with a member of the Parliamentary Treasury Committee which is currently reviewing the impact of business rates on businesses. The CBI is providing input from businesses and IPTI is providing input from international property tax experts.

Also in May, we are working closely with Rethink Solutions in relation to a conference they are holding in Miami, Florida on the subject of “Property Tax Transformation: Unifying Process and Technology”. IPTI provided an independent report for Rethink Solutions on the way in which large corporations manage their property tax liabilities and the conference will give us an opportunity to present our findings and invite discussion on the issues that arose. Efficient management of property tax liabilities, particularly across many different jurisdictions, is a major challenge for large corporations, and there can be expensive penalties incurred if this task is not carried out effectively.

Looking a little further ahead, we have our annual Mass Appraisal Valuation Symposium (MAVS) in Slovenia in June. We have a great line-up of topics and speakers for the MAVS and I hope as many of you as possible will be able to join us in the beautiful location of Lake Bled.

Beyond that, we are running a property tax training course in Sao Paulo, Brazil during August; we are involved in the annual Property Tax Workshop run by COST in Las Vegas during September; we have our annual RICS-IPTI Caribbean conference in the Bahamas during October; and we are running a Local Government Conference in Melbourne, Australia in November.

As usual, more information about all IPTI’s 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 in selected countries around the world.

Germany has published its proposals for property tax reform. As with many countries, municipalities in Germany develop building areas, secure water supply, install street lamps and build roads leading to houses. Homeowners and others have to contribute to these costs by paying property tax. Property tax A is payable on agricultural and forestry property. Land tax B applies to developed or developable land and buildings. In general, tenants also pay the property tax via their utility costs - so far this has averaged 19 cents per square metre, i.e. 19 euros per month for 100 square metres. Back in April 2018, the German Federal Constitutional Court declared the previous assessment bases unconstitutional. The unit values (*"Einheitswerte"*) have not been updated since 1964 (in East Germany even since 1935). This was contrary to the universal principle of equality the judgment stated. Legislators have until the end of 2019 to reform the property tax. By 2025 at the latest, the new valuation principles will have to be applied. In Germany, property tax is the third most important source of income for towns and municipalities after trade tax and wage, income and value added tax. It provides some 15 percent of municipal tax revenues. However, in comparison with other OCED countries, property tax in Germany is very low. In 2017, the total revenue from property tax was around 14 billion euros. The property tax A (forestry and agriculture) accounted for around 400 million euros and the property tax B for 13.56 billion euros. At present, three factors have to be taken into account to calculate property tax - the unit value (*Einheitswert*) multiplied by the property tax measurement number (*Grundsteuermesszahl*) multiplied by the assessment rate (*Hebesatz*). Each municipality can determine the assessment rate and thus the actual amount of the tax itself.

The German Finance Minister presented two proposals for the reform of the property tax that have been drawn up so far. The first option is the value-independent model (*Wum*); in this variant, the property tax is based solely on the size or area of the property and the building. This has the advantage of simplicity and can be adapted to reflect the use of the building, i.e. lower for residential buildings than for commercial buildings. The disadvantage of this variant is that a 200 square meter single family house in the country will pay the same property tax as a 200 square meter villa in the inner city. The second option is the value-dependent model (*Wam*); here the property tax is based on the actual value of the property and the land. The advantage is that more valuable real estates are taxed higher than others. In this case, the 200 square meter villa in the city would be subject to a much higher property tax than the house of the same size in the country. But the concern expressed is that this will result in a higher real estate tax burden for property owners. As a result, rent increases can be expected if landlords pass on the additional costs to the tenants. It is reported that the *Wam* will meet the requirements of the Federal Constitutional Court, a fairer and more realistic, taxation of land in relation to each other, rather than the *Wum*. Although the *Wum* is the simpler solution from a bureaucratic point of view, there are doubts as to whether the principle of equal treatment and the requirements of the German Federal Constitutional Court would be met. Whether one of the proposed models for property tax will prevail remains to be seen.

Another suggestion is that business properties and mixed-use properties should be valued using the capitalised earnings value method, according to a "key issues" paper. Only if there are no actually agreed rents and it is not possible to determine customary local rents, should a simplified tangible value method be applied instead of the capitalised earnings value method.

I have included a more extensive piece on this issue than normal as Germany provides a good example of the problems associated with property tax reform.

In Hong Kong, the proposed "vacancy tax" continues to attract a great deal of attention. Some cities in Australia and Canada have introduced some sort of vacancy tax to motivate owners to put their homes for sale or rental on the market. Vancouver introduced a tax equivalent to 1 per cent of the assessed value of a property deemed to vacant for more than 180 days. The tax was introduced two years ago when 5 per cent of Vancouver's homes either stood empty or were underutilised, amid skyrocketing prices and soaring rents. Although some success has been noted, the city government is seriously considering further raising the tax because owners continue to hold onto their properties and pay the tax in anticipation of ever-rising rentals. To solve Hong Kong's housing crunch, the city's government is introducing a similar tax to spur supply which is now being scrutinised by the Housing Panel of the Legislative Council (LegCo). Unlike Vancouver's tax which is aimed at private individual owners who keep their properties vacant, Hong Kong's levy targets only the developers' first-hand residential flats. According to Hong Kong's government, developers will be subject to a tax twice the rateable value of each newly-completed residential unit deemed unsold for more than a year, or unleased for more than 6 months at or above the going market rate after an occupation permit is granted. It is hoped that developers would be pressured to unload their unsold completed flats faster, thus driving down the overall home prices in Hong Kong. However, critics say that Hong Kong does not have a home vacancy problem. They point out that the overall home vacancy rate out of the total stock was a mere 3.7 per cent in Hong Kong last year, the lowest in 20 years. Some critics also claim that the tax represents unjust government intervention in the market economy. Private developers should have the freedom to decide when to release new flats to the market. They also argue that it is unfair that only developers and their completed housing units on the primary market are targeted, because individual investors who also hoard flats on the secondary market should equally be taxed. The debate will no doubt continue!

In Australia, an Assembly committee has recommended the establishment of a task force to review the commercial rates system in the ACT after it found businesses were hurting from its one-size-fits-all approach, anomalies, inflexibility and an onerous objection process. It also found that the system remained fundamentally flawed due to a mass appraisal approach that did not take into account the complexities of land use within individual leases, throwing up inequities that cast doubts on its fairness. Among 25 recommendations, the committee urged the connection between the revenue and valuations offices be broken, so that the valuations were not performed in the same area responsible for collecting revenue; and introduce another mediation process to deal with objections as a cost-effective alternative to the ACT Administrative and Civil Appeals Tribunal (ACAT). The committee found the system was unresponsive and lacked transparency, producing uncertainty for businesses which also found objecting to valuations difficult and expensive. It found that the location of the ACT Valuations Office within the Revenue Office amounted to a conflict of interest and also made it harder for businesses to pursue objections. It also believed that the system was having a chilling effect on commercial activity and investment in the Territory, and possibly driving businesses across the border. Smaller property owners, in particular, were hurting and increased costs were being passed on to tenants and their customers. The committee also recommended that the Government consider compensating ratepayers who have experienced sudden large increases in rates due to long-term retrospective rates reassessments or have been required to pay rates on the basis of unactivated uses. A spokesperson said the Government would review the inquiry's recommendations and respond in detail in the coming months.

In Greece, it is reported that the property value "gap" is growing between different zones. The Finance Ministry's blueprint for the adjustment of properties' taxable rates (known as "objective values") provides for increases to the zone rates in the centre of Athens and reductions in less well-off areas of the capital. Sources say that ministry officials intend to lighten the tax load on property owners in districts such as Perama, Korydallos, Nikaia and Keratsini, while raising rates in Syntagma, Pangrati, Kolonaki and even Ambelokipi, due to the great increase in demand recorded over the last 12 months. This is despite the fact that the existing objective values, adjusted last year, are in most cases higher than the market rates. With this move, the government will continue to place a greater burden on the owners who are already paying the bulk of the Single Property Tax (ENFIA), while making ownership even cheaper in other areas. However, the plan is awaiting the approval of the country's creditors, who have asked the government to adopt last year's recommendations by commissioned property surveyors that were not used after all during the 2018 adjustment. The creditors are insisting on that because the rates proposed by the surveyors provided for hikes in several districts in the southern and western suburbs of Athens where the construction costs for new homes are above the ministry's zone rates. Likewise, the recommendations for zone rate hikes in several other cities and towns around the country were rejected to avoid an increase in ENFIA dues. Ministry officials concede that the new rates are almost ready but have not ruled out a significant delay in their publication, possibly around the end of the year's third quarter. Although the new values will only come into force in 2020, their upward adjustment is expected to offset to a great extent the benefit from the promised 30 percent reduction of ENFIA. According to the government's agreement with its creditors, the objective values will have to match market rates by 2020.

The New Zealand government has announced that it would not proceed with the proposal to impose a capital gains tax due to lack of public support. The CGT was recommended in February by the Tax Working Group, which the government spent $2 million on to review inequities in the nation's taxation system. The proposed capital gains tax covered assets such as residential rental homes, investment properties, land and buildings, business assets, intangible property and shares. But due to no consensus being reached within the Coalition government and poor public support, the CGT proposal was abandoned. The Finance Minister said that while the government has canned the proposed capital gains tax, other recommendations from the Tax Working Group would be considered for inclusion in its tax policy work programme. "We intend to direct the Productivity Commission to include vacant land taxes within its inquiry into local government funding and financing," he said.

And finally, the Governor in a state in the US is reported to be under federal criminal investigation for a property tax "scheme" which involved removing toilets from the Governor's mansion which saved the family more than $331,000 in property taxes. It seems that workers were instructed to remove toilets from the mansion in order to declare it uninhabitable which resulted in the property tax breaks. There will no doubt be many who say that, instead of being "flushed with success" by this property tax mitigation scheme, the Governor is likely to be "down the pan"!

Paul Sanderson

President, International Property Tax Institute