IIFI
IPTI
International Property Tax Institute

PRESIDENT'S MESSAGE

January 2020

I hope you all enjoyed a relaxing break over the festive period and are looking forward to what 2020 has to offer; on behalf of IPTI, I wish you all a very Happy New Year.

I recently read a very interesting paper on property tax, parts of which I would like to share with you. The paper is titled "Property Taxes in Canada: Current Issues and Future Prospects" and has been written by Harry Kitchen, Enid Slack, and Tomas Hachard. The paper has been published by the Institute on Municipal Finance and Governance (IMFG) which is an academic research hub and non-partisan think tank based in the Munk School of Global Affairs and Public Policy at the University of Toronto. Although the title and content of the paper relate to the position in Canada, many of the authors' views apply to property tax systems around the world which is why I think they will be of interest to a wider audience.

The Executive Summary of the paper states: "Canadians today pay for local services in the same way that citizens did a century ago – with local property taxes (and user fees) levied by local governments. The rate of increase of property taxes is a source of perennial debate, while other elements of property tax policy get less attention.

Residents and businesses in different provinces in Canada may have access to different exemptions and incentives, and to different tax breaks, schemes, and programs meant to address the supposedly regressive and volatile nature of the property tax. Different municipalities may be subject to different policies on how tax rates are set. And in some jurisdictions, policymakers have started implementing new types of property taxes to improve housing affordability.

This paper examines these broader issues through a cross-Canada review of property tax policies. It finds that cities across the country are facing similar issues on when and how to tax different kinds of properties differently, whether to apply progressive property tax rates, the volatility of property taxes, the benefits and drawbacks of using property tax incentives to attract businesses, and the role of provincial property taxes.

The paper further finds that in some cases, existing policies across the country that relate to these challenges are affecting the fairness, accountability, and efficiency of the property tax. This is particularly true when it comes to exemptions, differentiated tax rates, and tax capping.

Other proposals, particularly those for progressive property tax rates, clash with the central role of the property tax, namely, to fund shared municipal services such as policing, parks, fire services, and roads, rather than to act as a redistributive wealth tax.

The paper proposes five steps that governments in Canada should take to ensure a fair and efficient property tax system:

1. Remove exemptions that do not have a sound and explicit public policy rationale.

2. Reduce the difference between residential and non-residential property tax rates.

3. Remove redistributive services from the property tax base and avoid progressive rates.

4. Avoid capping and land averaging to prevent inequities in property taxation.

5. Eliminate provincial property taxes."

Later, the paper states: "Vigorous debates about property tax increases are a healthy part of civic life. But they should not obscure other elements of property tax policy that need improvement. This paper shows how addressing these other elements can improve the fairness and effectiveness of the property tax system, and strengthen the fiscal health of cities as a whole."

The paper contains some interesting data on property taxes in Canada. For example, it shows that municipal property taxes as a percentage of municipal revenues in 2017 varied from 32% in Saskatchewan to 60% in Québec with an average across Canada of 46%. In the same year, it shows that municipal property taxes per capita varied from $345 in Prince Edward Island to $1,732 in Alberta with an average across Canada of $1,132.

On the issue of taxing different types of property in a different manner, the paper states: "Setting different rates for different property types requires balancing different principles and priorities, including fairness, efficiency, accountability, and competitiveness." It goes on to look what it describes as "four particularly thorny issues for municipalities in this respect, namely exemptions, the over-taxation of non-residential (commercial and industrial) properties, proposals for special taxation of small businesses, and the taxation of vacant properties."

On the issue of exemptions, the paper states: "Exemptions are difficult to justify on the basis of fairness. Exempt properties use municipal services just as other properties do and, hence, should be taxed. Exemptions narrow the tax base, so that taxes must be higher than they would be otherwise on non-exempt properties, or service levels must be reduced. Differential tax treatment can affect location decisions, choices about what activities to undertake, and other economic outcomes."

On the issue of the taxation of business properties in comparison to residential properties, the paper states: "The general practice in Canada and around the world is to levy higher property tax rates on commercial and industrial properties than on residential properties."

The paper goes on to state that “Three basic principles of taxation – fairness based on benefits received from local services, accountability, and efficiency – suggest that governments should tax non-residential properties at *lower* rates than residential properties.”

On the issue of fairness, the paper states: “When the property tax pays for services that provide collective benefits to the local community, fairness dictates that the tax rate should be the same for all properties receiving the same services or levels of service, regardless of property type. For properties that require more services or higher levels of service, the tax rate should be higher.”

On the issue of accountability, the paper states: “Non-residential property owners generally do not have the right to vote in local elections in their capacity as business owners and thus have less ability than residents to hold elected officials accountable for expenditure and tax decisions. In keeping with this principle, residential taxpayers should shoulder a larger share of the tax burden.”

On efficiency, the paper states: “If property taxes on business properties are used to subsidize services consumed by the residential sector, service levels will be set at an inefficient level. In other words, since the residential tax rate is less than it would be in the absence of the subsidy, residential taxpayers may overconsume certain services, potentially creating an over-supply of these services. A higher tax on business properties also creates an incentive for businesses to leave the community – businesses are usually more mobile than residents. To minimize this problem, business properties should be taxed more lightly than residential property.”

On the taxation of vacant properties, in respect of which a number of jurisdictions around the globe are applying a higher property tax rate, the paper states: “The property tax funds a bundle of services provided by local governments. Fairness exists when properties of equal value pay the same amount of property tax, because each of these properties has access to the same municipal services. If vacant properties face a higher tax rate than occupied properties of the same value, fairness is violated.”

On the issue of regressivity of property taxes, the paper states: “A number of studies have disputed that property taxes are regressive. The answer depends on how one views the nature of property taxes. If the property tax is an excise tax on the value of the property, its burden is regressive because it takes a higher percentage of the annual income of a lower-income household than that of a higher-income household. Lower income households spend a greater proportion of their income on housing. If it is considered a capital tax on wealth, its burden is likely to be progressive, because higher-income households are likely to own a disproportionately large share of the stock of capital. If it is treated as a user charge or benefit tax, it pays for services that provide collective benefits to the local community. Benefit taxes are not based on ability to pay, which is the commonly accepted base for measuring regressivity, but on the link, sometimes direct but often indirect, between the benefits one receives from local public services and the taxes paid for these services.”

In a short summary such as this, with reference to only selected extracts, it is not possible to refer to all the issues that the paper covers. However, it will be clear that the authors have identified many of the key issues that affect property tax systems around the world and set out some interesting ideas on how they might be addressed.

Just looking back briefly over December, I am pleased to say that we received comments from the panel of experts to whom we sent IPTI's draft White Paper on "The Potential of Artificial Intelligence in Property Assessment". We are very grateful to panel members for providing us with their comments which we will be carefully reviewing as we prepare an updated version of the paper.

Looking ahead, we have lots of interesting events coming up. These include a number of webinars and workshops in our latest series on mass appraisal; a variety of IMA-IPTI webinars; a workshop organised for our corporate members on the topic of the "Role of Mediation in Valuation Disputes"; a workshop on the "Principles and Challenges of Property Assessment and Taxation"; and our 2020 Mass Appraisal Valuation Symposium (MAVS) to be held in Calgary, Alberta on 3-4 June - the full programme for the MAVS is now available. Our 2020 Caribbean conference is going to be held in Trinidad & Tobago. Full details of all these events are, as usual, available on the website: www.ipti.org

Now, it's time for a quick look at what is making headlines concerning property taxes in selected jurisdictions and countries around the world.

In the Philippines, the House of Representatives has approved the real property valuation reform (RPVR) bill, which seeks to generate additional revenues for local government units (LGUs). According to the Department of Finance (DOF), the bill may stimulate the real estate market and attract more investments from the private sector. Lawmakers pointed out this measure will also help speed up the implementation of the President's centerpiece initiative "Build, Build, Build" as the use of a new and uniform "schedule of market values," or SMVs, on real property will address right-of-way (ROW) issues that at times delay the government's acquisition of private lands intended for public infrastructure projects. The bill, also known as Package 3 of the Comprehensive Tax Reform Program (CTRP) of the Duterte administration, proposes the following: the adoption of internationally accepted real-property valuation standards; the use of single valuation for land transactions taxation; the use of SMVs for ROW acquisition; and the strengthening of the valuation arm of the DOF-attached Bureau of Local Government Finance (BLGF). The DOF asserted that Package 3 will broaden the base used for property-related taxes of national and local governments, thereby increasing revenues without necessarily imposing new taxes or increasing existing rates. The DOF expressed hopes the Senate will act on its version of the RPVR bill in the first half of 2020. Currently, LGUs are tasked with preparing an SMV, which is just one of many conflicting values currently used for various government purposes and private transactions. The SMVs are also often outdated and set without standard technical procedures, leading to an eroded real-property tax base for LGUs, the DOF explained.

In the USA, a roomful of experts on New York's property tax system are reported to have gathered recently for a roundtable discussion convened by state lawmakers. They were assembled to discuss solutions to the antiquated and unequal levy system that many want to see tackled in 2020. The issue has been a political "hot potato," to use one lawmaker's words, since the current property tax system was established through state law 40 years ago. Lawmakers, analysts, property owners, and others are now looking ahead to the next legislative session in Albany, which begins in early January, where a number of the issues raised at the meeting are promised to be on the table. The chair of the meeting is reported as stating "What I have found so far as chair of this committee ... is that the real property tax system is confusing, it's complicated, and it's not entirely fair." And later he said, "This system is broken at its core."

Moving onto Australia, the controversial changes to South Australia's land tax have been given the go-ahead by the state parliament, delivering tax cuts to investors. The reform package includes a $189m in tax cuts for investors over three years and tax relief for thousands of “mum and dad” investors. The Land Tax Amendment Bill 2019 slashes the top land tax rate from a national high of 3.7% to 2.4%. While this new rate is still higher than those in New South Wales and Victoria, it is lower than those in Western Australia and Queensland. The Treasurer said these reforms will deliver a “more competitive, investment-attracting environment” to the state and will boost jobs and economic growth. The changes were first introduced during the state budget in June 2019, but the initial proposals were met with criticisms by business groups and investors. After revamping the changes several times, the new measures won the support of both houses. However, the government refuses to compromise on its objectives to introduce changes to aggregation rules. As such, investors will not be able to use separate trust and company structures to avoid paying tax. “This means that no longer will it be possible for an investor to hold $3m in property in seven separate companies and not pay a single dollar in land tax,” he said. A Property Council executive director said the state now “boasts a more competitive land tax regime” that is compelling for investors.

In Turkey, legislation relating to the new Accommodation Tax and Valuable House Tax has been published. The Law - No. 7194 on Digital Service Tax and Amendment of Certain Laws and Law Decree No. 375 - was published in the Official Gazette in December. Through a new article added to the Expenditure Taxes Law, the Law introduced a new accommodation tax applicable to accommodation services provided by hotels, motels, holiday camps, hostels, apart hotels, guesthouses, camping sites and mountain houses, as well as all other services provided in those accommodation facilities (such as food and beverage, activities, entertainment services, and the use of pools, sports, thermal pools and similar areas). Taxpayers of the accommodation tax are those who deliver the above-mentioned services. The accommodation tax rate is 2%. The accommodation tax is declared and paid on a monthly basis. The basis of the accommodation tax is the total value received in consideration for the above services (excluding VAT) in the form of money, goods, or any benefit that can represented in terms of money, or service. The accommodation tax comes into force from 1 April 2020. However, the accommodation tax rate will be 1% until 31 December 2020. In respect of the new valuable house tax, households in Turkey whose tax value or value determined by the General Directorate of the Land Registry is more than TRY 5,000,000 will be subject to the valuable house tax. The tax base is the greater of the tax value or the value determined by the General Directorate of the Land Registry. The tax rate will vary from 0.3% for lower value properties up to 1% for higher value properties. The taxpayer of the valuable house tax is the owner of the household, the holder of any usufruct right on the household or, if neither exists, those who dispose the household as if they are the owner of the household. The valuable house tax is declared annually and paid in two installments by the end of February and August in the relevant year. The valuable house tax comes into effect on 1 April 2020.

In Canada, the Vancouver city council has voted to increase the empty homes tax by 25 per cent in 2020. That will raise the levy from one per cent of a home’s assessed value to 1.25 per cent. The motion also opens the door to additional 25 per cent hikes in 2021 and 2022. The tax hike came despite cautions from city staff in a report to the council which noted that the current tax “appears to be performing in line with its stated policy objectives.”

On the same topic, it seems that overseas owners of homes in Alberta, Saskatchewan, Manitoba and the rest of Canada, outside of parts of British Columbia, could soon be subjected to a national vacancy tax for the first time. The first of its kind, the national equity tax proposes to “penalize” overseas-based real estate buyers by one per cent on the property's assessed value, per calendar year. The parliamentary budget office expects the tax would produce revenues of $217 million in the first year. The tax would apply to all residential properties owned by non-Canadians who are not resident in Canada - including corporations and trusts - but houses, condos and townhomes that are rented to tenants who are not immediate family members will be exempt. Overseas owners of homes in some areas of British Columbia are already charged a two per cent annual Speculation and Vacancy Tax by the B.C. government. Canadian owners of unoccupied or underused second homes in those areas of B.C. are also charged the tax, at 0.5 per cent per year. This is on top of the one-time-only 20 per cent foreign buyer tax that overseas buyers have to pay on the purchase of a home in certain parts of B.C. and Ontario. It is not yet clear whether Canada's new federal vacancy tax on foreign homeowners would be added on top to B.C.'s Speculation and Vacancy Tax, or whether it would replace it. The B.C. and Ontario foreign buyer taxes shifted the attention of Chinese buyers - the largest group of foreign homebuyers in Canada - from Vancouver and Toronto to other centres, according to a China-based real estate portal. As of 2018, Chinese inquiries for residential purchases in Montreal grew by 35.7 per cent year-over-year. Calgary had a considerably greater increase of 234 per cent it reported.

Returning to Australia, it is now almost exactly ten years ago that Dr Ken Henry published a “wish list” of tax reforms to set Australia up for the 21st century. The 783-page tax tome has since been gathering dust, but, in a recent interview, Dr Henry said the tax system now is worse overall than it was when he undertook his review a decade ago. Dr Henry said a reform that would enhance the allocation of resources would be replacing property transfer stamp duties with a broad-based land tax. Like almost all economists, Dr Henry has nothing but scorn for stamp duty, describing it as “a diabolical tax”. “This is a terrible tax, property stamp duties, it's completely indefensible and it can be replaced, we know how to replace it,” Dr Henry said, referring to the ACT's move to phase out stamp duties in favour of land taxes over two decades. “It would be a good reform for all of the states and all of the territories, it would deal with a lot of the volatility in their budgets, but it would also be a productivity-enhancing reform.”

And finally, it seems that an unusual problem has arisen in the USA. In Utah it is reported that a taxpayer’s home was “accidentally” valued at $1.4 billion in what was described as an “horrific typo”. It is said that a member of the assessor’s staff dropped their mobile phone on a keyboard which caused the dramatic overvaluation of a house that should have been valued at around $300,000. It sounds a rather incredible explanation, but it had serious consequences. The mistake resulted in a county-wide overvaluation of properties which, once the error had been corrected, led to a funds shortage for a variety of public bodies that rely on property tax revenue. It is not clear why nobody spotted the mistake and one can only assume that the assessor’s quality control systems are inadequate. Perhaps they are in need of the kind of advice that IPTI can provide on quality assurance in connection with property tax valuations!

Paul Sanderson

President, International Property Tax Institute