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The Property Tax – in Theory and Practice

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The Property Tax – in Theory and Practice¹

Enid Slack

Abstract

The property tax is considered to be a good tax for local governments, mainly because of the connection between the types of services funded at the local level and the benefit to property values. Yet property tax revenues rarely account for more than 3 percent of Gross Domestic Product (GDP) in any country. This paper explains why the property tax is under-used by highlighting some of the problems with the tax, such as its unpopularity, its inelasticity, erosion of tax base, and poor administration. Reforming the property tax is difficult, however, because no matter how economically desirable the long-run outcome of reform may be, its transitional effects may be highly undesirable in political terms—there will inevitably be winners and losers. Even if the property tax is used more heavily, it will never be able to do the whole job, especially for local governments that are delivering more than property-related services.

Key words: property tax, tax reform, international comparisons

JEL classification: H70, H71

1. An earlier version of this paper was presented at the 6th Symposium on Fiscal Federalism: Financing Local Governments, Barcelona, June 14–15, 2010.

The Property Tax – in Theory and Practice

Almost all local governments worldwide rely, at least to some extent, on property taxation to pay for local services. Economists have long argued that the property tax is a good tax for local government because it is fair (in relation to the benefits received from local services), it is difficult to evade, and it promotes local autonomy and accountability (Bird 2001). Yet a review of OECD data shows that property tax revenues rarely exceed 3 percent of Gross Domestic Product (GDP) in any country and are often much less than that. The under-use of the property tax leads one to ask whether the property tax is such a good tax for local government and, if it is, why is it not used more heavily? Are there ways to increase property tax revenues?

This paper explores the role of residential and non-residential property taxes in theory and practice. Although most of the literature talks about “the” property tax as if it were one tax, it is really two different taxes—a tax on residential property and a tax on non-residential property. The economic case for the residential property tax is quite strong; the same cannot be said of the non-residential property tax. In practice, however, in most countries where property taxes are levied, the tax rate is higher on non-residential properties than on residential properties.²

The outline of the paper is as follows: the first part reviews the case for residential property taxes at the local level. The second part describes the economics of the non-residential property tax. The third part provides a quantitative overview of property tax revenues in OECD countries (where the two taxes are lumped together because the available information does not differentiate them). The fourth part suggests some of the problems with the property tax that may account for its being under-used. The final part addresses the question of whether property taxes can be reformed to increase revenues.

I. The Residential Property Tax Is a Good Tax for Local Government—in Theory

Economists consider residential property taxes to be appropriate as a source of revenue for local governments, in large part, because of the connection between the types of services funded at the local level (for example, good schools, access to roads and transit, and so on) and the benefit to property values (Fischel 2001). To the extent that people understand that their property taxes are being used to pay for local services, there is a link between the benefits and costs of local services that encourages them to make efficient fiscal decisions (Oates 2010, 13). Both the benefits derived from local services and the taxes are capitalized into property values. Because taxpayers are willing to pay more for better services, the value of

2. See, for example, Bird and Slack (2004), which shows that for 24 of the 25 countries studied, the non-residential property tax rate is higher than the residential rate.

these services translates into higher property values. Higher taxes, other things being equal, translate into lower property values, because purchasers faced with two similar houses will offer less for the house with higher taxes.

Of course, this analysis is based on the following assumptions: that local property taxes do in fact finance services that benefit property values; that the main burden of such taxes falls on local residents; that both tax rates and service levels are decided by local residents; that those who wish to “buy” other combinations of services and tax rates are free to move to other jurisdictions; that—impelled by their sensitivity to property values—people will act rationally in response to such signals; and that local governments do what voters want them to do. The strength and validity of many of these assumptions varies across countries (Bird and Slack 2006).³

A competing view sees the property tax as a tax on capital that distorts the housing market and local fiscal decisions (Zodrow 2001). The property tax (based on the market value of land and improvements) discourages building and results in the under-utilization of land. That is, the amount of capital per unit of land is less than the economically efficient amount.

Both the benefit-based and capital tax views have some validity.⁴ The property tax is not purely a benefits tax, because homeowners who improve their houses face higher taxes, which would, in theory, discourage them from doing so. At the same time, the benefits of local programs are reflected in local property values.

Another reason that the property tax is regarded as a good tax for local governments is that property is immovable—it cannot shift location in response to the tax—and it cannot be hidden. Even the owner of a vacant property is taxed under the property tax. These characteristics make it difficult to evade. Although a change in property tax may be capitalized into property values in a particular community, and in the long run tax differentials may affect where people locate, these effects are smaller than the distortions created by income and sales taxes at the local level. This characteristic of the property tax makes it somewhat easier to levy and collect than other taxes and thus offers municipalities the potential to raise significant revenues.

To the extent that the property tax is levied only by local governments, it can be an important instrument of local autonomy. To ensure local autonomy, however, the tax cannot be used to any significant extent by other levels of government and tax rates must be set locally and not by a senior level of government. The extent to which local governments have exclusive rights over the property tax contributes to its role in promoting local autonomy (Oates 2010, 13).

The property tax is a highly visible tax. Unlike the income tax, for example, the property tax is not withheld at source. Rather, taxpayers generally have to pay

3. This argument becomes particularly tenuous when it comes to explaining the commonly found phenomenon of higher taxation on non-residential property. The over-taxation of non-residential property is discussed below.

4. A third view is that the property tax is a wealth tax. See, for example, Kitchen (1987).

it directly in periodic lump-sum payments. As a result, taxpayers tend to be aware of the property taxes they pay.⁵ The property tax also finances services that are highly visible, such as roads, garbage collection, and neighbourhood parks. Indeed, studies show that residents are more willing to pay for local services when they rate their government and service provision highly (Simonsen and Robbins 2003, 850). Visibility is clearly desirable from a decision-making perspective because it makes taxpayers aware of the costs of local public services. This awareness enhances accountability, which is obviously a good thing from both economic (hard budget constraint) and political (democratic) perspectives. At the same time, visibility restricts the ability of local governments to raise or reform the tax.

2. The Non-Residential Property Tax is Not a Good Tax for Local Government—in Theory

Non-residential properties include a wide variety of property uses, including commercial uses (such as offices, banks, retail outlets, restaurants, and hotels), industrial uses (such as mines, manufacturing plants, and shipyards), and special uses (such as pipelines and railway rights-of-way). As noted earlier, the effective property tax rate (property taxes relative to market value) is generally higher on non-residential properties than on residential properties. This differential is difficult to justify, at least according to economic theory.

Differential tax rates do not necessarily reflect the differential use of services by different property types. Users of non-residential property often provide many of their own services, such as garbage collection, security, and fire protection. Kitchen and Slack (1993) reviewed property taxes and municipal expenditures in eight municipalities in Ontario, Canada, in 1990 and concluded that non-residential property taxes ranged from 28 to 51 percent of total local property taxes, but accounted for only 31 to 40 percent of municipal expenditures. A U.S. study estimated that the business-related share of state/local expenditures in the United States is less than the business-related share of state/local tax revenues (Oakland and Testa 1995). The ratio differed from state to state, however. Although a case can be made on benefit grounds for taxing non-residential properties at a lower rate than residential properties, this rarely occurs.

It has also been argued that property taxes should be heavier on those components of the tax base that are least responsive to a tax increase (least elastic in supply). Since businesses tend to be more mobile than homeowners (in other words, they are more responsive to tax changes), efficiency arguments dictate that non-residential property should be taxed more lightly than residential property. Differentially higher taxation also distorts land use decisions by favouring residential use over commercial and industrial use (Maurer and Paugam 2000).

Non-residential property taxes at the local level can also result in tax exporting, whereby the tax on commercial and industrial properties is shifted on

5. The exception would be homeowners whose property tax payments are included with their monthly mortgage payments to financial institutions.

to consumers and owners of capital who may not live in the taxing jurisdiction. Although non-residents who are commuters or visitors to the taxing jurisdiction use some services and therefore should pay some tax, there is a tendency to tax them more than the cost of those services.

Tax exporting is inequitable, because the same benefits of local expenditures require different tax prices in different jurisdictions, depending on the degree of exporting. It is inefficient, because a jurisdiction that can export taxes can provide greater net benefits (expenditures minus taxes) and will be able to attract development. When an area exports its tax burdens, citizens will demand more services than they themselves are willing to pay for through their taxes. The result is an oversupply of public services. It is not accountable, because those bearing the burden of the tax are not the same as those enjoying the benefits.

Notwithstanding the efficiency arguments against tax exporting, “politicians have a strong political bias toward exporting tax burdens” (Brunori 2003, 43). Political leaders “prefer to meet constituent service demands without incurring the risk of placing the burden of paying for those services on those constituents” (Brunori 2003, 38).

3. Property Taxes are Not Widely Levied in OECD Countries

Notwithstanding strong justifications—at least for the residential property tax at the local level—an overview of property taxes in selected OECD countries suggests that the tax is not widely used. Table 1 shows property taxes relative to GDP for selected years from 1965 to 2008 for some federal and unitary countries. The real property tax refers only to recurrent taxes on property (residential and non-residential) and not to other property-related taxes, such as land transfer taxes (stamp duties), charges on developers, and other non-recurrent taxes on property. Property taxes relative to GDP are over 3 percent in the United Kingdom, close to 3 percent in the United States and Canada, and just over 2 percent in France, Japan, and New Zealand. In the remaining OECD countries in Table 1, the property tax represents an even smaller proportion of GDP. With few exceptions, the property tax has not been increasing as a proportion of GDP over the last 40 years.

Reliance on the property tax as a source of local government revenue does not seem to vary according to whether the country is federal or unitary. Property taxes do, however, vary across jurisdictions according to the expenditure responsibilities assigned to local governments and the other revenues available to them (such as other taxes, intergovernmental transfers, and user fees).

Table 2 provides a breakdown of local expenditures and shows that, for those countries in which local governments have a significant responsibility for redistributive services such as social protection and health (Austria, Denmark, Finland, and Germany), dependence on the property tax is low.⁶

6. The data sources for Tables 1 and 2 are different, so not all countries appear in both tables. Local income taxes are more widely used in each of these countries. In other words, it appears that the property tax is used to pay for “property-related” services and not “people-related” services.

Table 1: Recurrent Property Taxes as a Percentage of GDP, Selected OECD Countries (%)

	1965	1975	1985	1995	2005	2007	2008
Federal Countries:							
Australia	1.42	1.36	1.32	1.35	1.37	1.37	
Austria	0.51	0.34	0.30	0.26	0.25	0.23	0.21
Belgium	0.01	0.23	0.29	0.38	0.41	0.39	
Canada	3.05	2.70	2.63	3.20	2.71	2.72	2.77
Germany	0.46	0.39	0.38	0.38	0.46	0.44	0.43
Mexico			0.05	0.20	0.18	0.17	
Spain	0.08	0.07	0.62	0.63	0.70	0.66	0.66
Switzerland	0.12	0.16	0.14	0.16	0.18	0.17	0.17
United States	3.39	3.17	2.48	2.82	2.86	2.89	2.90
Unitary Countries:							
Czech Republic				0.26	0.17	0.15	0.14
Denmark	1.47	1.55	0.86	1.01	1.13	1.12	1.24
Finland			0.09	0.46	0.46	0.47	0.48
France	0.67	1.14	1.50	1.97	2.14	2.16	2.19
Greece	0.00	0.07	0.06	0.17	0.10	0.11	
Hungary				0.11	0.27	0.28	0.31
Iceland		0.90	0.88	1.26	1.36	1.58	1.67
Ireland	3.90	2.20	0.90	0.80	0.65	0.66	0.75
Italy	0.44	0.05		0.79	0.82	0.83	0.64
Japan	0.94	1.21	1.56	2.07	2.01	1.93	2.03
Korea		0.42	0.45	0.66	0.58	0.94	0.96
Luxembourg	0.40	0.20	0.19	0.11	0.09	0.08	
Netherlands	0.34	0.30	0.76	0.77	0.83		
New Zealand	2.10	2.00	1.99	1.73	1.78	1.85	2.01
Norway	0.18	0.16	0.19	0.30	0.23	0.28	0.31
Poland				1.01	1.29	1.17	
Portugal				0.36	0.56	0.63	0.66
Slovak Republic					0.46	0.40	0.37
Sweden	0.01	0.00	0.42	0.84	0.92	0.85	0.76
Turkey					0.18	0.17	0.15
United Kingdom	3.41	3.76	3.85	2.96	3.27	3.21	3.27

Source: OECD (2009))

Table 3 shows that local governments that rely relatively heavily on the property tax have limited or no access to other taxes (for example, Australia, Canada, and the United Kingdom).

Dependence on the property tax also depends on the degree of freedom local governments have with respect to property taxation (for example, their ability to

set tax rates), the size and growth of the property tax base, and their willingness and ability to enforce such taxes. The next section considers some of these factors in more detail.

4. Problems with the Property Tax—in Practice

This section explains why the property tax is underutilized: the unpopularity of the tax, the inelasticity of the tax base, the erosion of the tax base through exemptions and limits, and inadequate administration.

4.1 Unpopularity

The property tax is often regarded as the “most hated” tax (Brunori 2003, 7). It is disliked by taxpayers, in part because it is a visible tax. As noted earlier, property taxes are not withheld at source and they finance very visible services such as roads, policing, and garbage collection. Visibility makes governments accountable for the tax and the services it provides (“I paid \$3,000 in taxes and my garbage was not picked up!”), but it makes the tax difficult to sell politically and even more difficult to increase or reform relative to other taxes.

Unpopularity also stems from the tax’s potential for volatility and unpredictability given its dependence on market value (Sheffrin 2010). Suppose a local government collects a fixed amount of property tax revenue to provide a certain package of services. If the size of the tax base in the municipality increases, the tax rate will fall to maintain the same amount of total revenue. But revenue neutrality for the municipality does not mean that an individual taxpayer’s property taxes will not increase (or decrease). If the relative share of a homeowner’s property value in the community increases, the property tax will increase—even if the tax is revenue-neutral. In some years, the tax could go up; in other years, it could go down.

Why would a property value increase more than average? Additions and renovations increase the value of property, but so do changes in the neighbourhood that are beyond the direct control of individual taxpayers. For example, the location of a new (and desirable) business may make the neighbourhood more attractive and increase the value of houses in the vicinity. With market value assessment, there is the risk of annual variation in the distribution of the property tax burden at times when property values are rising rapidly but not uniformly (Haveman and Sexton 2008). Different neighbourhoods will be “hot” in different years.⁷

Although the market value system provides a uniform and clear standard for distributing property taxes among taxpayers, this uniformity may be at the expense

7. Some have argued that the problem of increasing market values is exacerbated because the increased wealth is not realized until the asset is sold, so that property taxes may increase without the homeowners’ having accrued additional income to pay them (Fisher, Bristle, and Prasad 2010, 196). The holdings of other forms of property (e.g., stocks or other financial assets) are taxed only upon realization of the value of the property.

Table 2: Distribution of Local Government Expenditures, Selected OECD Countries, 2006 (%)

	General public services	Public order and safety	Economic affairs (mainly transport)	Environmental protection	Housing and community amenities	Health	Recreation and culture	Education	Social protection	Total expenditures
Federal Countries:										
Australia	24.4	2.6	26.7	9.5	13.7	1.2	15.7	0.4	5.8	100.0
Austria	16.9	2.1	14.2	2.6	2.8	16.3	7.1	16.7	21.3	100.0
Canada	8.7	9.2	13.2	5.9	7.8	1.5	6.9	41.2	5.5	100.0
Germany	17.4	5.4	13.5	6.8	7.7	2.3		7.2	39.7	100.0
Spain	33.4	7.8	14.5	10.0	9.6	1.2	10.9	4.5	8.1	100.0
Switzerland	14.3	4.7	8.7	5.3	2.5	20.5	5.6	21.7	16.2	100.0
Unitary Countries:										
Czech Republic	14.5	1.7	21.4	7.3	9.1	2.2	7.5	27.5	8.7	100.0
Denmark	6.1	0.3	4.7	0.9	0.4	20.4	2.7	12.9	51.5	100.0
Finland	14.0	2.1	6.1	0.7	0.4	28.4	4.6	20.5	23.3	100.0
France	19.2	2.8	13.1	6.9	15.2	0.6	10.2	16.2	15.8	100.0
Hungary	19.3	1.2	5.7	3.9	6.9	15.4	4.8	29.9	12.8	100.0
Iceland	10.2	0.9	11.7	2.4	4.5	0.8	17.3	37.2	15.0	100.0
Ireland	11.4	3.2	23.8	8.7	22.7	0.0	4.1	20.7	5.4	100.0
Italy	14.6	1.5	14.8	4.6	4.7	43.9	3.0	8.3	4.5	100.0
Luxembourg	20.9	1.7	15.9	12.1	7.6	0.3	13.1	24.6	3.9	100.0
New Zealand	18.3	0.5	35.0	21.3	7.3	0.0	12.1	0.0	5.5	100.0
Norway	10.7	1.0	6.5	3.6	4.2	15.2	4.8	28.4	25.6	100.0
Poland	9.4	1.8	14.8	4.0	5.6	15.3	5.2	29.6	14.2	100.0
Slovak Republic	17.5	1.0	15.9	6.2	9.9	0.3	7.1	35.4	6.6	100.0

Source: International Monetary Fund (2007), Table 7

Table 3: Distribution of Local Government Tax Revenues,
Selected OECD Countries, 2007 (%)

	Taxes on income, profits, and capital gains	Taxes on payroll and work- force	Real property taxes	Other property- related taxes	Taxes on goods and services	Other taxes	Total tax revenue
Federal							
Countries:							
Australia	0.0	0.0	100.0	0.0	0.0	0.0	100.0
Austria	31.2	20.7	5.1	5.9	32.4	4.7	100.0
Belgium	71.4	0.0	16.5	0.0	11.8	0.3	100.0
Canada	0.0	0.0	86.8	7.6	2.2	3.4	100.0
Germany	80.0	0.0	14.6	0.0	5.3	0.1	100.0
Mexico	0.0	0.2	52.2	36.4	1.5	9.8	100.0
Spain	22.8	0.0	21.0	8.0	44.3	3.9	100.0
Switzerland	84.6	0.0	2.5	12.7	0.2	0.0	100.0
United States	5.8	0.0	70.9	0.0	23.3	0.0	100.0
Unitary							
Countries:							
Czech Republic	55.7	0.0	2.6	0.0	41.7	0.0	100.0
Denmark	90.4	0.0	9.5	0.0	0.1	0.0	100.0
Finland	94.7	0.0	5.2	0.0	0.0	0.1	100.0
France	0.0	6.8	40.4	10.5	18.4	23.9	100.0
Greece	0.0	0.0	26.1	30.3	43.6	0.0	100.0
Hungary	0.0	0.2	11.5	9.0	79.2	0.0	100.0
Iceland	73.6	0.0	15.4	0.0	10.9	0.0	100.0
Ireland	0.0	0.0	100.0	0.0	0.0	0.0	100.0
Italy	21.5	0.0	11.7	1.4	29.5	36.0	100.0
Japan	55.5	0.0	24.7	1.2	17.7	0.9	100.0
Korea	17.0	1.4	14.5	33.3	21.8	11.9	100.0
Luxembourg	90.1	0.0	4.5	3.2	1.5	0.7	100.0
Netherlands	0.0	0.0	55.6	0.0	44.4	0.0	100.0
New Zealand	0.0	0.0	88.7	0.0	11.3	0.0	100.0
Norway	87.5	0.0	4.5	6.3	1.7	0.0	100.0
Poland	62.0	0.0	25.0	0.6	7.4	5.0	100.0
Portugal	21.6	0.0	28.5	26.0	23.1	0.9	100.0
Slovak Republic	73.0	0.0	12.4	0.0	14.6	0.0	100.0
Sweden	100.0	0.0	0.0	0.0	0.0	0.0	100.0
Turkey	31.4	0.0	8.5	3.5	41.6	15.0	100.0
United Kingdom	0.0	0.	100.0	0.0	0.0	0.0	100.0

Note: Data for the Netherlands are for 2005.

Source: OECD (2009), Tables 139–168 and OECD (2007), Table 157.

of tax volatility. Anderson (2006) argues that homeowners consider it unfair that property tax bills can change with potentially no change in the value of their house or the services they receive. These events to some extent underlie the demand for assessment and tax limitations. Taxpayers regard assessment limits as insurance against large property tax increases (Anderson 2006). Another consequence of volatility is low tax rates—tax rates tend to range from only 0.5 percent to 1.0 percent of market value.

4.2 Inelasticity

The property tax is an inelastic tax—that is, the base of the tax does not increase automatically over time, because property values respond more slowly to annual changes in economic activity than incomes. Furthermore, very few jurisdictions around the world update property values for taxation purposes every year. The result of lagging assessed values is that, to maintain property tax revenues in real terms or to raise property tax revenues, jurisdictions have to increase the tax rate.

As with visibility, inelasticity leads to greater accountability (taxing authorities have to purposely increase the tax rate to increase tax revenues), but it also leads to greater taxpayer resistance. The resulting imposition of assessment limitations, tax rate limits, and exemptions have further diminished the elasticity and horizontal equity of the tax (Bahl, Martinez-Vazquez, and Youngman 2010, 5).

4.3 Tax Base Erosion

The property tax base is declining in some jurisdictions because of explicit policy decisions to limit the use of property taxes by local governments through exemptions, tax and expenditure limits, and tax incentives (to attract business). Narrowing the property tax base means that tax rates have to be raised to maintain the same amount of revenue. Higher tax rates increase the excess burden of the property tax and make the tax even more unpopular.

In every country, some properties are excluded from the property tax base (Bird and Slack, 2004). Although there is great diversity in exemptions, some properties are exempt in most jurisdictions—government and educational institutions, churches and cemeteries, public hospitals, charitable institutions, public roads, parks, libraries, foreign embassies, and property owned by international organizations. In some countries, agricultural land and principal residences are also tax-exempt.

Exemptions, which reduce the size of the tax base and either result in higher taxes on the remaining taxpayers or a reduction in the level of local services, are inequitable and inefficient. Differential tax treatment means that owners or managers of taxed properties face higher costs than owners and managers of exempt properties. This differential affects economic competition among businesses and between businesses and government (Kitchen and Vaillancourt 1990). To the extent that people working in tax-exempt buildings use municipal services, just as workers in other buildings do, they should be taxed (Bahl and Linn 1992, 100). Differential tax treatment also affects location decisions, choices about

what activities to undertake, and other economic activities. Finally, since the proportion of tax-exempt properties varies by municipality, disproportionate tax burdens are created across communities. This result is especially troublesome when higher-level governments determine what is exempt from local taxation.

Tax and expenditure limits restrict the ability of local governments to raise property taxes by capping increases in assessment, tax rates, tax revenues, or expenditures. Limits are widely used in the United States—most states impose them on local governments—but property tax ceilings and caps are used in European countries as well (Brown and Hepworth 2002). The greater the increase in property values and the lower the assessment increase permitted, the greater the erosion of the property tax base.

Although popular with taxpayers, tax and expenditure limits have severely constrained the growth in property tax revenue in local jurisdictions in the United States, resulting in limited spending on local public schools and lowered educational outcomes (Yuan and Cordes 2009). Moreover, tax and expenditure limits are probably the least effective, equitable, and efficient strategies for providing property tax relief (Sexton 2009). Assessment limits are inequitable because properties with similar market values may not pay the same taxes. Assessment limits shift the property tax burden from properties with rapidly increasing values to properties with stagnant values (Slack 2010). Assessment limits that apply until the time of sale shift the property tax burden from those who have owned property for a long time to recent buyers (Winters 2008).

Assessment limits also complicate the administration of the property tax and create confusion among taxpayers, because the taxes paid are no longer calculated simply as a tax rate multiplied by the tax base. Moreover, there is less incentive to review one's assessment if it is not being used to calculate taxes. If volatility is caused in part by assessment errors, these errors will never be corrected. Finally, it is very difficult to remove a freeze: "once a freeze is imposed, the process of thawing may be too painful to bear" (Youngman 1999).

Property tax incentives designed to stimulate economic growth are also used widely in the United States; more than 40 states allowed for these incentives in 2007 (Wassmer 2007). The goal of most of these incentives is to increase employment and income generated in the jurisdiction and, in many cases, to increase the property tax base of the jurisdiction and property tax revenues.

It is not clear how effective or equitable these incentives are. Some authors believe that tax incentives are justified because the firms that receive them provide benefits to the community that exceed the costs to the municipality both for business services and environmental degradation caused by the businesses (Garcia-Mila and McGuire 2002; Glaeser 2002). Others believe that property tax incentives can result in a zero-sum game whereby development at one location occurs at the expense of development at another location and incentives are wasted on firms that would have chosen the same location anyway (Wassmer 2007).

Moreover, tax incentives can cause unfair competition among businesses and can lead to a situation in which no major investments occur without them. Tax

competition can result in inefficiently low taxes and reduced public services. A number of studies argue that lowering non-residential property taxes for all businesses in a municipality is preferable to tax concessions to any specific business (Wasylenko 1997). In any event, tax incentives reduce the size of the tax base and necessitate tax rate increases to maintain tax revenues.

4.4 *Poor Administration*

How well land and property taxes are administered affects not only how much revenue is collected, but also the equity and efficiency of the tax. Three key steps are involved in the process of taxing real property: (1) identification of the properties being taxed; (2) preparation of a tax roll (which contains a description of the property and the amount of assessment) and responding to assessment appeals; and (3) issuing tax bills, collecting taxes, and dealing with arrears.⁸

For the costs of local government to be shared fairly among taxpayers, property taxes have to be based on assessments that are uniform within each jurisdiction. Although manuals have been developed to guide the process, property assessment is inherently arbitrary. People do not perceive the assessment system to be uniform or fair. As Bahl and Martinez-Vazquez (2008) note, “a proposed increase in the tax rate on a base that is determined in uncertain or even mysterious ways is bound to provoke negative reactions” (43). Fair and productive property taxes require not only a good initial assessment, but also periodic revaluation to reflect changes in value. Frequent valuations maintain the legitimacy of the tax and reduce the risk of sudden, dramatic shifts in tax burdens from large increases in assessed values. For these reasons, the valuation cycle needs to be fairly short.

Table 4 compares the characteristics of the property tax in several European countries. In most of these countries, both land and buildings (or “improvements”) are taxed. In some countries, machinery (or “tangible business assets”) is also taxed. In all of these countries, properties are assessed on the basis of market value or rental value. Area-based assessment (where the assessment is based on the size of the land and building) is not used in Western Europe, although it is widely used in Eastern Europe.⁹

Table 4 highlights the great diversity across countries with respect to the frequency of reassessment, ranging from annual to infrequent. The general range is from three to ten years. Of course, the time periods listed in the table are those specified in legislation; in many instances, the actual pace of revaluation is much more ad hoc.

Many countries have no provision for regular revaluations of the tax base or have postponed revaluations. In Austria, for example, the assessed value is only

8. For more details on the administration of the property tax, see Bird and Slack (2004).

9. See Bird and Slack (2004) for more information on the advantages and disadvantages of value-based versus area-based taxation.

Table 4: Comparison of Property Tax Systems in Selected European Countries

Country	Tax	Taxable item			Basis of valuation			Revaluations
		Land	Buildings	Plant	Rental	Capital	Area	
Austria	Real estate tax	X	X			X		Values are indexed
Belgium	<i>Revenu cadastral</i>	X	X	X		X		10 years; postponed
Denmark	County real estate tax	X				X		4 years; annual
	Municipal real estate tax	X				X		indexation
	Tax on commercial bldgs.		X			X		
Finland	Real property tax	X	X			X		Annual
France	Property tax		X	X		X		3 years, but
	Property and land tax	X	X		X	X		revaluations have been post-
	Business tax		X	X	X	X		poned; annual indexation
Germany	Real estate tax	X	X			X		6 years, but no revaluation
Ireland	Rates	X	X	X		X		since 1964
Italy	Communal real estate tax	X	X		X			5–10 year rolling revaluations
Netherlands	<i>Onroerend-Goedbelasting</i>	X	X			X		Not specified
	<i>Waterschap</i> levy	X	X			X		4-year rolling
Portugal	Immovable property tax	X	X	X				revaluation
Spain	Local property tax	X	X			X		Annual indexation
Sweden	Real estate tax		X			X		Annual indexation
Switzerland	Municipal business tax	X	X				X	4-year rolling revaluations
								Annual, based on rent
England and Wales	Non-domestic rates Council tax	X	X	X		X		and profit
Scotland	Non-domestic rates	X	X	X		X		5 years
	Council tax	X	X	X		X		Not specified
			X			X		5 years
								Not specified

Source: Brown and Hepworth (2002) and Almy (2001).

between 10 and 20 percent of the market value. As a result, assessed values bear little relationship to market value or annual rental value (Brown and Hepworth 2002, 40). Indexing (e.g., by the rate of inflation) is common in continental Europe, but it is not as good as a full-scale reassessment, because property values change at different rates in different neighbourhoods and for different property characteristics. Fairness is not achieved when property assessments are merely increased by a common factor on an annual basis and the lack of regular revaluations undermines the confidence of taxpayers in the property tax system.

Why are assessments so out of date in so many countries? One possibility is the cost associated with regular reassessments, which includes computer software; support for, training of, and availability of in-house staff; and the training and availability of local contract appraisers (Dornfest 2010). It should not be surprising that the process of obtaining valuations that are close to market value on a regular basis is expensive. Indeed, to administer a property tax at the same level of fairness as most other major taxes is a relatively costly operation (Bird and Slack 2006). Another reason is that opposition from taxpayers who benefit from entrenched inequities encourages legislative neglect (Almy 2001). There is a science to the assessment of property, but there is also a resistance to the use of good assessment practices (Bahl et al. 2010, 5).

5. Can the Property Tax be Reformed?

The residential property tax is a good tax for local governments, yet it is not a major source of revenue for local governments in many countries. Political pressure to keep property taxes down and to favour certain types of properties over others (through exemptions or lower tax rates) has resulted in low tax revenues. Added to low tax rates and tax base erosion are poor assessment practices that have reduced many of the potential benefits of the property tax. Taxpayers have to have confidence in the assessment system, so efforts need to be devoted to doing it well—and frequently.

Property tax reform, in countries that have tried it, has been difficult, however (Bird and Slack 2004).¹⁰ No matter how economically desirable the long-run outcome of property tax reform may be in terms of the equity and efficiency of the tax, its transitional effects may be sufficiently politically undesirable to forestall any attempt at reform. In short, there will always be winners and losers from tax reform: those who were relatively overtaxed before the reform was implemented will pay less taxes; those who were relatively undertaxed before the reform will pay more taxes. The losers from a change in policy (even if they are the minority) tend to be very vocal, because they value their losses more than the winners (even if they are the majority) value their gains. Furthermore, as the losses tend to be concentrated and the gains dispersed, as is often the case with tax reform, negatively affected interests will be motivated to spend time and resources in

10. For a discussion of property tax reform in one Canadian province, see Slack (2002).

political action that can result in permanent, institutionalized groups (for example, seniors, or the owners of office towers, hotels, and waterfront properties) that oppose reform.

Another problem with tax reform is the widespread suspicion that any change in tax policy will be used by governments to raise the aggregate level of taxes so that the number of losers and the magnitude of the losses outweigh the number of gainers and the magnitude of the gains. In short, the public perception is that tax reform is not revenue-neutral—a perception which, at least in the cases where the goal of reform is to increase revenues, is often correct.

The success of property tax reform will depend on public education—taxpayers need to understand how their assessments are calculated. They need to know what will happen if their assessment increases. Will property taxes automatically increase or does it depend on what happens to other assessments in the city? Will tax rates decrease if assessment increases? What services are funded by the property tax?

If property tax reform is expected to result in major tax shifts among taxpayers, the success of the reform will also depend on the introduction of some form of phase-in mechanism. Phase-ins are almost invariably politically necessary to cushion the impact of reform. Some form of relief is also needed for low-income taxpayers. Property tax credits (or “circuit-breakers”) that relate property taxes to income are best at providing relief to low-income taxpayers. For elderly taxpayers who have seen their property values increase but their incomes remain fixed, some form of tax deferral is appropriate.

The property tax, at least the residential property tax, is a good tax for local government, but there is room to improve the tax and increase the revenues collected. Property taxes are difficult to reform, however, because politics generally outweighs economics in this very visible tax and the losers from tax reform tend to be more vocal than the winners. In any event, the property tax can never be the sole municipal tax, especially for local governments that are doing more than providing property-related services and where a mix of taxes is appropriate. It can, however, be used more heavily in most countries than it is at the present time.

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