PROPERTY TAXATION: ISSUES IN

- The tax yield should be stable and predictable over time.
- The tax should not be one that is easy to export to non-residents (in other words, should be borne by taxpayers in the taxing jurisdiction).
- The tax should be visible to ensure accountability and transparency.
- Taxpayers should see the tax as being reasonably fair.
- The tax should not create harmonization problems with taxes of senior levels of government nor should it create harmful competition between local governments.
- The tax should be easy to administer.

Of possible tax alternatives for local governments, the property tax meets these criteria better than any other tax. Its tax base is largely immobile. Revenue is generally predictable and stable in that it does not vary with the cyclical swings in economic activity as much as personal income and consumption based tax revenues. The part of the tax that is on residential property is unlikely to be exported. It is highly visible and fair as long is it covers the cost of providing those services that provide collective benefits to the local community. If the property tax is a local tax only (senior levels of government not involved), harmonization problems and wasteful tax competition should not be a problem. Finally, it is likely to be more expensive to administer than a local tax that is piggybacked onto an existing federal or regional tax, but this may be a small price to pay if local governments are to have autonomy and flexibility in setting tax policy, both important ingredients of responsible, efficient and accountable local government.[5]

C. IMPLEMENTATION ISSUES

Recognizing that a property tax is a good local tax, there are a number of implementation issues that must be decided. These are discussed in the remainder of this paper.

C.1 Property Identification

The following steps are required in the taxation of real property.[6] All taxable properties must be identified and described on the assessment roll with each property assigned a roll number. This number is important for linking assessment information with tax billing and property transfer records.

The assessment roll should include the address of the property, its owner, building and lot size in square metres or hectares, the age of the building and information on renovations or improvements. This information will be used to assign an assessed value to the property, especially if the tax base is market value and the property has not recently been sold. Furthermore, this information should be reported in a consistent way and a process should be established to update assessment annually[7] or as frequently as administratively possible. Once assessed values have been determined, local tax rates must be set, tax bills issued, responses must be made to assessment appeals, taxes must be collected, and arrears must be addressed.

Property identification is often more difficult in developing countries and transitional economies.[8] For example, maps for property identification may not exist; property ownership data may not be provided because of disputes over who owns what; information on improvements may be missing; building permit

[5] Bird (2001), supra footnote 3, p. 3.

and not linked; and tax records may be considered secret.

C.2 Choice of Tax Base

There is no uniform tax base that applies

Table 1: Base for property Taxes			
Tax Base	Definition	Measure Used	Examples of countries where used

commercial space; the increase in land taxation had, however, enabled the city to avoid increases in other taxes, increases that might have impeded development. An earlier study had concluded that Pittsburgh's modified form of site value tax did not constitute a sufficient penalty to encourage owners of under-developed or undeveloped property to develop. The city's development boom was instead a response to market conditions (demand for office space or buildings for corporate headquarters) and government incentives, including tax abatements and federal income tax credits. In general, moreover, property taxes were not a factor in firms' decisions to locate in Pittsburgh.[19]

Some cities have claimed that a switch to graded assessment has brought them new development, but the evidence put forward to support these claims must be treated with caution. The usual practice is to claim that all new development is a consequence of the adoption of the graded tax system and to ignore factors such as changing market conditions, changes in the local labour market, the receipt of state or federal grants - factors that appear to have been important in driving the development in Pittsburgh's case. To the extent that a graded system does encourage development, much of this development tends to be at the expense of neighbouring communities that have not adopted a similar system.

Replacement of the current property tax system with either a system that taxed land alone or a graded system would generate windfall gains and losses in the short run as tax bills rise for certain properties and fall for others.[20] One study has suggested that the reduction in taxes on buildings that accompanies a shift to a graded system will be capitalized into higher property values and the offsetting increase in the tax on land will be capitalized into lower values.[21]

c. Unit-Value or Area Assessment

Under unit-value or area assessment, the tax base is a combination of building area and lot area. For each property, assessed value is the sum of lot area times an assessment rate per square metre of lot area plus building area times an assessment rate per square metre of building area.[22] I For0 12 700.0005 3.0005 Tc0.0009 Tw[asse)-3.7(0.0005 3

---

[19] This study involved an analysis of real estate and assessment data in Pittsburgh from 1975 to 1985. See Michael Weir and Lillian E. Peters, "Development, Equity and the Graded Tax in the City of Pittsburgh" (June 1986), 5, *Property Tax Journal*, 71-84.

[20] Richard Bird and Enid Slack, *Urban Public Finance in Canada*, 2nd edition, (Toronto: Wiley, 1993), at 82-83.

because the government owns most of the housing and rents it to occupants.[24]

Second, support has also emerged in response to perceived shortcomings of market value assessment even where fully functioning real property and estate markets exist. First, the market value for tax purposes of a property that has not been sold is a matter of the assessor's judgment and will, inevitably, vary with the competence and experience of the assessor. The result, critics argue, is a property tax system that is often arbitrary and unfair. Unit or area assessment, it is claimed, is free of the subjectivity of market value assessment.

A second argument is that market value assessment penalizes homeowners who improve their properties by imposing higher property taxes on the basis of the improvements. Assessment on the basis of unit value does not generate penalties of this kind.

Finally, market value assessment has been criticized on the ground that rapid increases in market values may increase property taxes beyond taxpayers' ability to pay them. California has addressed this problem of volatility by updating assessments to market value only when the property is sold and increasing assessment, thereafter, by 2 percent annually (noted above). In the United Kingdom, every property was assessed at its market value in April 1991 and placed into one of eight valuation bands.[25] The higher the band, the higher was the tax rate. A property is not reassessed again once it has been placed in a higher band. Changes in value do not affect a property's assignment to a given band unless the size of the property changes. Proponents of unit assessment, however, argue that it is superior to all such modifications of market value assessment, since unlike them it entirely eliminates cyclical swings in taxes and thus creates more certainty for taxpayers.

---

[24] Harry Kitchen and Enid Slack (December 18, 2001), "Providing Public Services in Remote Areas", a paper prepared for the World Bank Institute, Washington, D.C., p. 9.

[25] Slack, supra fc-2 14B-2 14heta f5 f un,0.1(e)6(s. 96(s7.6.71)]TJ1..98 0 0 10.98 234 b(670.9.86Tm0.0008 Tc0.0001 Tw[ohe s cela)- essesment,is -3.9(m)7.7(i)-2.93ri6(aobjct venthatn)7.7(ia1(6(k)-7.98(t value)]TJ0 -1.143 TD0.0008 Tc0.0009 Tw[asse)-3.7(ss)-3.8(amater,of vjudgent,is the tssignm-7.97m67(mtof va ing le)]TJT*0.0013 Tc0.0001 Tw[oalue)o htf uhem thogehere,and thue

treatment of certain properties, then these properties should either be rewarded directly through a system of grants or through the application of differential tax rates (discussed below) applied to a uniform assessment base. In either case, subsidization would be more transparent and subject to review and amendment by the elected representatives according to their interpretation of the public interest.

b. Responsibility for Assessment

Reliance on a centralized uniform assessment manual is critical but the way in which the assessment is carried out may also be important. In Canada, for example, assessors work for a variety of employers. In some provinces, they work for the province; in others, they work for an independent province-wide assessment authority; in another province, they work for a province-wide non-profit corporation; and in a couple of provinces, municipalities hire their own assessors. To emphasize what was noted above and regardless of who carries out the actual assessing, assessors in every province work from a standard province-wide assessment manual. Although the ability of these different agencies/governments to secure uniformity in assessment has not been studied in Canada, one U.S. study concluded that county or regional rather than local assessors leads to more uniform residential assessments.[27]

In addition, a centralized agency (region-wide) responsible for assessment has a further advantage. It is able to benefit from economies of scale that would otherwise not be available to each municipality if each were to carry out its own assessment.[28]

c. Frequency of Assessment

If the assessment base is to be fair and productive, periodic valuations and revaluations must be undertaken to ensure that assessment bases are kept up to date. Frequent reassessments reduce the risk of sudden and dramatic changes in tax burdens that often arise when reassessments are conducted sporadically and infrequently. In Canada over the past decade, every province has moved towards more frequent and up-to-date reassessments – some provinces now complete them annually, most others every three or four years but many of them are moving proe entnt”, nr2.air

[27] Robert P. Strauss and Sean Sullivan (December 21, 1998), “The Political Economy of the Property Tax: Assessor Authority and Assessment Uniformity”, *State Tax Notes*.

[28] David L. Sjoquist and Mary B. Walker (1999), “Economies of Scale in Property Tax Assessment”, *National Tax Journal*, Volume 52, Issue Number 2, pp. 207-220.

a. *Should municipalities use variable tax rates or uniform rates?*

The issue here is whether a local taxing jurisdiction should apply a single uniform property tax rate to all properties within its taxing jurisdiction or whether variable tax rates should be used; that is tax rates that vary with the cost of servicing different properties by type or by location within a municipality. Traditionally and historically in Canada as in most other countries with a history of property taxation based on property values, the practice has been to apply a single tax rate to all residential properties and a higher tax rate to all commercial and industrial properties. More recently in Canada, but not everywhere, this practice has changed. All municipalities in the provinces of Alberta, British Columbia, and Ontario are now permitted to use variable property tax rates. Other countries have also moved in this direction.

Variable tax rates should be designed to capture cost differences across properties, property types and municipalities or neighbourhoods within a city or city-region. For example, if some properties or property types are more expensive to service, a case can be made for using differential property tax rates. Here, higher tax rates are assigned to properties that are more expensive to service.

Variable tax rates have a number of advantages.[31] First, they are fair on the basis of benefits received as long as the rates are set to capture the cost of municipal services used up by different property types or property location. Second, they are efficient if designed to recover the cost of local public services consumed - no incentive would exist for a household or firm to alter its behaviour or location to avoid the tax as long as it matched the cost of services consumed. Third, variable tax rates have a further advantage in that they could be used to distort decisions deliberately to achieve certain municipal land use objectives. For example, if higher tax rates slow development and lower tax rates speed up development, a deliberate policy to develop certain neighbourhoods instead of others might be achieved through different tax rates for different locations.

b. *Should business properties be taxed at higher rates than residential properties?*

The taxation of business properties (commercial and industrial) at higher tax rates than residential properties is generally done in one of two ways; either through the practice of assessing business properties at higher values than residential properties with the same tax rate applied to both property types; or through the simple application of higher tax rates on business properties. Higher taxation of business properties creates a number of efficiency and equity

[31] Enid Slack (2002), "Property Tax Reform in Ontario: What Have We Learned?" vol. 50., No. 2 *Canadian Tax Journal*, pp. 576-85.

business sector, it concluded that the latter is over-taxed and the residential sector under-taxed.

The second study was completed in the mid-nineties on properties in the City of Vancouver

Concern over the kinds of distortions noted above with the property tax on commercial and industrial properties has prompted at least one suggestion for reform in Canada.[43] Specifically, it has been argued that revenues from a portion of the non-residential property tax should be replaced with revenues from a new business value tax (BVT). This BVT would be a value-added tax.[44] It would be levied on business income. It would be on production and not consumption. This would make it an origin, not destination based tax; hence, it would tax exports and not imports. Further, it is suggested that it be a provincial tax with municipalities having the opportunity to set local rates that are 'piggy-backed' onto the provincial rate. The province could even impose limits on local surcharges to prevent excessive locational distortions. Because the BVT is a value-added tax (essentially sales less cost of goods purchased), it would eliminate a number of the distortions created by the current over-taxation of business property. This type of local business is used in Germany and Japan.

c. Should property taxes on commercial and industrial properties be exported?

The opportunity[45] for the
commercial/industrial sec()its on local surcTT2 1 T c0.Ue(sIalue-added)TjT0iF.zIu6xnO(ndustrial smerc(nd2TJ1 4comm7

d. Can property taxes lead to sprawl?

Since the tax is levied on property, any investment that increases the value of the property (such as any improvements including an increase in density) will subject it to a higher tax. For this reason, higher property taxes are expected to discourage density. If, on the other hand, higher property taxes reflect higher levels of service, it is unlikely that there would be any impact on location or land use. To the extent that

iU.S.subggest tc

f. Should limits be imposed on property tax rates?

The practice of imposing tax limits on municipal governments by a senior level of government is more prominent in some countries than in others. In the U.S., for example, thirty-two states impose limits on tax rates for local government.[51] In Canada, provincial governments do not place limits on municipal tax rates, although there has been a recent call for tax and expenditure limits in Canada.[52]

These limits are intended to control and restrict the growth in municipal government spending and hence, property taxation. Recent research on the success of these limits has addressed three main questions. First, have property tax limits reduced property tax revenues? Based on the evidence, the answer is yes. Property tax revenues have declined in constant dollars if not in current dollars. In California, proposition 13 led to an immediate decrease of about 45 percent. In Massachusetts, the initial impact was a decrease of 18 percent.[53] Overall in the U.S., it has been estimated that local property taxes per capita fell by 3 percent after tax limits were imposed.[54]

Second, have reductions in property tax revenues been offset by increases in other local revenues? The evidence here is not as compelling but it does indicate that other local revenue sources have generally been substituted for property tax decreases.[55] Greater reliance is now placed on local user fees, permits, licences, and so on.

revenues? The8llivt, 00(6h)-1.fo4(cut.0)5.6(6h)-1.g9(7 Tc-t i

---

51 O'Sullivan, supra footnote 10, p. 178.

52 Jason Clemens, Todd Fox, Amela Karabegovic, Sylvia LeRoy, and Niels Veldhuis, (October 2003) *Tax and Expenditure Limitations: The Next Step in Fiscal Discipline*, Critical Issues Bulletin (Vancouver: The Fraser Institute).

53 Ibid, p. 189-190.

54 Ronald J. Shadbegian (1999), "The effect of tax and expenditure limitations on the revenue structure of local government, 1962-1987", *National Tax Journal*, vol. 52, No. 2, PP. 221-238.

55 O'Sullivan, supra footnote 10, p 189-191.

a fixed amount (determined by the local council) of market value assessment from property taxation. It works quite simply. After all properties are assessed at market value, a fixed amount of assessment is deducted form the total assessed value.[68] Use of assessment credits applied to each piece of property would convert the property tax into a progressive tax rate. While this may appear to have merit on the surface, it would be a suspect device unless all properties owned by any particular individual were aggregated. Use of assessment credits would also result in a reduced assessment base overall. When compared with the system before the assessment credit is introduced, an equivalent amount of property tax dollars would be generated, then, through the imposition of higher property tax rates. For those properties with relatively low assessed values, the value of the assessment exemption would offset the higher tax rates and these taxpayers would be better off financially. For properties with relatively high values, the higher tax rates would more than offset the taxes saved from the availability of the assessment motorboats, aircraft, and other vehicles except automobiles, motorcycles and other self-propelled vehicles. Tax rates may vary by type of structure with the rates set by local governments but subject to (low) maximum federal limits. For vehicles, the tax is levied according to engine power.

The enterprise property tax applies to the annual average balance sheet value of assets (fixed, intangible, and inventories) of legal entities. Assets used for agricultural production are exempted from property taxation. Rates are set by regional legislatures and can vary by type of producing asset. The maximum tax rate is 2 percent with tax revenues being spilt between regional and local governments.

Tax reform has been on the agenda of the federal parliament in Russia since 1999. As part of this reform package, the draft *Tax Code* provides for the introduction of a western style real estate tax at the regional level with all revenues shared with local governments. Once enacted, this tax is intended to replace the three existing property taxes – land tax, individual property tax, and enterprise property tax.

D.2 Summary

From the discussion in this paper, it is apparent that the most efficient, uniform, accountable and transparent municipal property tax systems around the world exist where the following conditions are met.

- All taxable properties are identified, described and recorded on the assessment roll.
- The property tax base, whether assessed value or area value, is determined in a uniform and consistent manner across a region (as opposed to local) if not across an entire country.
- Assessment is updated as frequently as possible, ideally on an annual basis, so that the tax base is current, uniform, consistent and fair.
- Property assessment (determination of property values or property area) is the responsibility of an arms-length regional assessment authority in order to avoid local distortions created by local pressure groups.
- Each level of government using property tax revenues to fund expenditures is responsible for setting its own property tax rate(s).
- Variable tax rates are used when the cost of providing municipal services varies by property type and location.
- Variable rates, as opposed to a uniform rate, are more likely to discourage urban sprawl and to minimize the extent to which the local property tax is exported to other jurisdictions.
- Business properties (commercial and