International Property Tax Institute

PRESIDENT'S MESSAGE

August 2020

Inevitably, the coronavirus, COVID-19, and the measures being taken to limit the spread of the virus, continues to create challenges for individuals, businesses and governments around the world. It is also one of the main issues for those involved in property tax systems either as taxpayers - many of whom are struggling with financial hardship as individuals or businesses - or as the body responsible for collecting the tax to fund essential services which are being stretched by the increase in demand from those requiring support to help deal with the crisis. Unfortunately, although the initial spread of the virus appears to have been brought under control in many parts of the world, there is a worrying resurgence in particular localities which reminds us that it has not gone away and, until an effective vaccine has been developed, COVID-19 will continue to affect the way we live.

However, life does go on, and property taxes do continue to attract headlines. In Australia, the debate continues about whether or not stamp duty should be abolished and replaced by an extension of the existing land tax system. One interesting and detailed article I read on this topic recently started with the statement that property stamp duties are entirely pegged to market conditions, and therefore are an inherently unstable revenue source for the states and territories. Its critics say stamp duty is an unstable revenue source that creates inefficiencies in the housing market because it is substantial and can influence people's decisions to sell and buy property.

The author wrote that, last financial year, across Australia, state and territory governments collectively reaped about A$19 billion in property transfer tax revenues, otherwise known as stamp duties. Charged to the buyer whenever a property transaction is settled, and calculated on the sale price, stamp duties remain a lucrative source of government income, especially for the country's most populous states.

For New South Wales, property stamp duties generated A$7.4 billion in 2018-2019, while they brought in A$6 billion for Victoria, and A$3 billion for Queensland over the same period. Other state/territory governments took in an additional A$2.6 billion between them.

However, as large as these revenue numbers were, they also highlighted an underlying problem with transaction-based revenue streams. The figures were all lower than those that had been recorded from the previous financial year, simply because of a softening in property values from 2017-2018, and reduced market turnover.

With the economic fallout from the COVID-19 pandemic in 2019-2020 placing both the residential and commercial property sectors under severe strain, it is highly likely that government stamp duty revenues will fall once again as sale prices slip in some regions and overall transaction volumes drop.

At present, every Australian state and territory has a different stamp duty calculation method, although each uses some form of sliding scale based on the transaction price. For example, New South Wales, Victoria and the Northern Territory all apply fixed percentage rates in a tiered structure, depending on a property's sale price. Queensland, South Australia and the ACT charge set dollar amounts based on the sale price, plus additional fees for every A$100 over certain price brackets. Tasmania and Western Australia also charge flat stamp duty dollar rates based on the sale price, and then additional fees are levied on a percentage basis for amounts over certain transaction values.

A senior lecturer in political economy at the University of Sydney believes there is a strong case for tax reform in the way state and territory governments approach revenue generation from property. "It's especially acutely felt by first home buyers, because it massively adds to the kind of deposit that's required for people buying their first homes," he says. "Retirees also can be reluctant to move from their homes, knowing they will likely need to pay out tens of thousands of dollars in stamp duty when they make another purchase, even though some states have introduced concessional rates for pensioners."

However, there are already changes taking place on the stamp duty front. In 2012, the ACT government began a 20-year tax reform program that will ultimately result in transfer duties on property being abolished in favour of higher annual property rates. This year, the New South Wales government announced a potential phasing out of stamp duty as part of a broad taxation review.

Residential stamp duty rates have been progressively reduced every year and, from 1 July 2018, duty was completely abolished for all commercial property transactions of A$1.5 million or less. First home buyers in the ACT also no longer have to pay stamp duty on property transactions as long as their household income is less than A$160,000. However, progressive reductions in residential stamp duty in the ACT have led to sharp increases in property rates to compensate, with Canberra homeowners facing average fee hikes of 7 per cent in each of the next three financial years.

The author goes on to say that Australian governments considering property tax reform may be able to take something away from the systems in place in other jurisdictions. In Hong Kong, where a high percentage of property is rented, owners are levied with a 15 per cent flat property tax on the gross annual rental income. Similar to Australia, stamp duty is levied on purchases on a sliding scale. For residential, it ranges from 1.5 per cent for transactions up to HK$2 million, to a mix of set dollar amounts and additional percentage fees for higher amounts. The maximum rate is 8.5 per cent for transactions above HK$21.74 million. Commercial transactions are assessed on a different cost and percentage scale.

In a bid to keep a lid on property prices, rather than imposing higher taxes on citizens, the Hong Kong Government has focused its attention on deterring foreign investors. In 2010, the Hong Kong Government introduced a 30 per cent transactional tax for foreign buyers (known as Buyer's Stamp Duty), as well as further taxes ranging from 10 to 20 per cent if a property is sold within three years (known as Special Stamp Duty).

In Singapore, about 80 per cent of the S$4 billion (A$4.3 billion) in property taxes received by the government annually is from commercial properties. Property tax rates on residential properties are applied on a progressive tax scale, with owner-occupiers taxed between 4 per cent and 16 per cent, depending on the assessed annual rental value (ARV). No tax is payable on the first S$8000 (A$8700). That's the situation for most of the Singaporean population, who live in subsidised public housing. Although they receive an annual property tax bill from the government, there is rarely anything to pay.

Residential property investors also pay tax on a sliding scale, ranging from 10 per cent to 20 per cent, depending on the ARV. Stamp duty is payable on residential transactions under a tiered system that caps out at 4 per cent of the purchase price for properties valued in excess of S$1 million (A$1.1 million). All commercial properties are taxed 10 per cent of the ARV. "In so far as property tax is concerned, the impact is not so great because most people see property tax as a kind of municipal charge," says a local commentator. "Because the amount is not a lot, they're not concerned by property tax when they buy a property. Generally speaking, people are quite prepared in their mind to pay the stamp duty up to 4 per cent. The only problem comes when you buy a second property." For second properties, the duty rate is far higher, at 25 per cent, under what is known as Additional Buyer Stamp Duty.

The author advocates that Australian states and territories move away from transactional stamp duties towards land-based taxation systems. He explains that the first big advantage of a land tax is that it is usually levied on the unimproved, underlying value of land, which does not discourage the development of land. "The second main reason in favour of land tax is that it is progressive, so it is a way of shifting our tax system towards one that is taxing wealth, and therefore addressing wealth inequalities. The third reason is that it is a more stable source of revenue for the state governments around Australia. That's because underlying land values tend to be much more stable than housing prices and the turnover of the housing market."

However, he adds, there should be a distinction between owner-occupiers and investors. "I think there is a much stronger case for removing stamp duty for owner-occupiers than there is for investors. Stamp duty can have a useful counter-cyclical effect on the investment property market." He goes on to state that land tax is an untapped source of revenue waiting for state governments to draw upon, but politics is the thing stopping them. "That's because the idea that there could be a tax on the family home is something that would leave state governments exposed to serious political opposition," he says. "What would need to be done there is a range of options to mitigate those problems, to make it fairer and politically acceptable."

This would include having higher land tax for more expensive properties, having value thresholds for when land tax comes into play, and making sure there are arrangements for people to defer their land tax if required. He added, "Ideally, coordination between state governments would be crucial to the politics of implementing this type of reform."

From IPTI's perspective, it is interesting to see how this debate has unfolded over the last few years and it will be even more interesting to see what happens in future. Of course, many are now saying that tax systems must be urgently reviewed to deal with the post-pandemic world of huge debts; we will see.

Moving on to what IPTI has been doing recently and what we have lined up for the future. As with many organisations, our world has moved online and we continue to provide a series of webinars and workshops that can be booked via our website and accessed via our web platform. I think many people are now finding that online events offer a number of benefits in terms of timing, cost-effectiveness and fitting in with them working from home. I suspect there will be a long-term trend for more online training and education even when current restrictions are finally removed. Personally, I think a mix of online and face-to-face events provides a flexible approach which most people find beneficial.

Back in July we held the second of our two very well attended webinars on the impact of COVID-19 on property tax systems. These were organised in partnership with the Institute of Municipal Assessors (IMA). The first one looked at policy issues and the second focussed on some of the valuation issues that the restrictions imposed to deal with the pandemic are creating. For the second webinar, our experienced panellists discussed the impact of the restrictions on the market value of different types of property including retail, offices, industrial and hospitality properties, including hotels and long-term care facilities.

We also held a virtual meeting of IPTI's Board of Advisors in July during which we discussed various aspects of the COVID-19 situation in different parts of the world and the measures, including property tax changes, being taken to deal with it.

Looking ahead, we have a wide range of online events coming up and we are continually adding more topics so please visit our website to find the latest details: www.ipti.org

We are also working on a number of projects, including some new ones, many of which are related to the impact that COVID-19 is having on property tax systems.

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 UK, the long-awaited "fundamental review of business rates" (the annual property tax paid in respect of non-domestic properties) has finally taken a step forward with the government publishing a "call for evidence". Although there have been many similar reviews over the last few years which have not resulted in any significant change, the government has stated that this one will be different; only time will tell if this is the case! The UK government has also announced that the next revaluation of properties for business rates will be postponed until April 2023 due to the COVID-19 pandemic. The antecedent valuation date for the next revaluation will be April 2021 which should enable the impact on market values of the restrictions imposed during 2020 to deal with the virus to be taken into account.

In Ireland, it is being argued that the present crisis presents the government with an opportunity to rethink commercial rates (the annual property tax paid in respect of business properties). Commercial rates are a vital source of income for local authorities to fund local public services. With many businesses adversely affected by the COVID-19 pandemic and the subsequent lockdown, revenue from commercial rates for Ireland's 31 local councils will be significantly lower this year that the €1.6bn projected in the 2020 budgets. In March 2020, the government announced that commercial ratepayers impacted by the shutdown could apply to their local authority for a three-month rates deferral. In all likelihood, this would have resulted in some businesses ceasing their rates payments. By May, this temporary deferral of rates transitioned into a rates waiver for ratepayers that were forced to close due to public health requirements. At an estimated cost of €260m to be borne by the central exchequer, this decision may have to be considered again depending on the duration of the economic downturn. City councils that have a large commercial base are heavily dependent on rates income, but smaller rural councils are more reliant on central government grants. In the three Dublin county local authorities, approximately half of their revenue income comes from commercial rates. In small rural councils, less than one fifth of their revenue income is derived from rates. So, although the shutdown negatively impacted all local authorities, the outturn will not be uniform. Given current economic conditions and the inevitable competing calls on a new government for business assistance and enterprise supports, what is needed is a comprehensive and urgent review of commercial rates. As part of this root and branch review of rates, it is argued that the Local Property Tax (paid in respect of residential properties) should also be included, so that all local taxes are considered. This time-limited analysis of the property tax should cover the method of valuation, the central and local rates, the 80/20 split, and the thorny matter of revaluations. It should also look at more substantive issues like alternatives to the tax such as, for example, a site value tax.

In Canada, Calgary may see a shift in the outlets from which it collects revenue. Recommendations from a Financial Task Force suggest deviating from the reliance on property tax and instead maximizing revenue from other sources. This includes potential revenue generators that already exist or will be new in the future due to a transitioning economy. The task force addressed Calgary's cyclical economy and the impact of the decline in the value of non-residential properties. "Our reliance on property tax as a primary revenue vehicle makes it very difficult," said the city's chief financial officer and member of the financial task force. "We anticipate the world economy changes now coming even faster as it responds to working from home." Among the wide variety of matters considered, the task force looked at investing in infrastructure for broadband to gain long term dividends, partnerships with the telecommunications industry; data and other exchange value assets for private sector services or dollars to limit cost pressure; exploring franchise fees or local access fees for services that don't pay property tax; advertisement charges for billboards, digital ads, etc.; licensing charges for business vehicles provides opportunity for targeted relief when needed for businesses; extend business licensing requirements to a variety of home-based businesses; extension of user fees; licenses for new economy modes of transport such as e-scooters, ride-sharing; vehicle permitting charges with the transition to driverless cars; and a variety of taxes including taxes for tourists and visitors that use City services, a separate property tax for non brick-and-mortar businesses, taxation for e-commerce that generates revenue through local goods and services, tax for home-based small businesses that will increase due to the new economy transition and a different tax rate if a home is used as an office. Inevitably, councillors' views differed in response to the recommendations to develop strategies related to short-term mitigation measures, long-term solutions, and new revenue options that would improve the financial resiliency of the city. One said, "Calgarians need these new taxes like they need a hole in the head."

Moving on to New Zealand, Auckland Council's economists have been investigating the idea of changing the rating valuation process to focus solely on land values. They say that the COVID-19 pandemic has impacted employment and preferences about where people choose to live or work. Auckland Council has requested that the three yearly revaluation of properties be delayed a year to allow the re-establishment of the market. Auckland currently uses a capital value (land value plus improvement value) based ratings system to collect property rates. The variable component of the rates bill is based on the capital value of the property. They say that this does not incentivise the most efficient use of land. Landowners who use land efficiently by developing on it pay higher property rates because the more improvements you add, the more you pay. They argue that a land value based rates system approach has several strengths: it incentivises the efficient use of land and doesn't reward those who do not develop their land; it is easy to administer; it is difficult to evade; it doesn't distort production in the economy - land is fixed and a tax on it won't mean less of it is produced; it better aligns timing between infrastructure provision and take-up of that infrastructure; and it is progressive, i.e. those with more valuable land pay more. From IPTI's perspective, this type of debate has been going on since the time of Henry George - a 19th century economist - and the pros and cons of some form of land value tax, or land value capture, will no doubt continue to be discussed around the world.

In India, as COVID-19 puts large cities under strain, it is argued that municipalities must rethink finance strategies and look at land-based financing tools, property taxation reforms and capital market-based solutions to help cash-strapped municipalities gain fiscal autonomy. Municipalities in India raise finances through a variety of sources: they generate their own revenues from property tax, stamp duty, entertainment tax and other local cesses; they get grants from the state and central government, they take loans from banks and other institutions, as well as by raising municipal bonds. They also have revenues from sundry sources such as rents from entities that use public premises, unclaimed security deposits, fines from contractors who fail to fulfil contracts and more; however, property tax dominates the revenue basket of India's local governments accounting for almost 60% of their revenues. Revenue from property tax has been declining over the past few years. This is due to several factors, such as undervalued properties, the lack of current data on taxable properties and non-compliance. Pressure is mounting on the Indian government to support hard-pressed municipalities and give them new tools.

And finally, I have two brief stories to share. The first concerns the "righting of a wrong" and refers to a decision of the Michigan Supreme Court in the USA. In short, the court unanimously concluded that a county government may not seize the entire value of a property in order to collect just $8.41 in delinquent property taxes. The court concluded that such a tax "forfeiture" qualifies as a "taking" under the Michigan state constitution, and the government therefore must pay the owners compensation equal to "any proceeds from the tax-foreclosure sale in excess of the delinquent taxes, interest, penalties, and fees reasonably related to the foreclosure and sale of the property; no more, no less." The court's ruling is an important victory for constitutional property rights and, in my view, for basic decency and fairness.

The second story just made me smile. An assessor in the USA recently announced a series of measures intended to mitigate some of the impact of the pandemic on property taxes. The article contained a photo of the assessor with a wide smile; his name is Mr Smiley. Smiley by name and smiley by nature!

Paul Sanderson

President, International Property Tax Institute