International Property Tax Institute

PRESIDENT'S MESSAGE

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The US-based Tax Foundation recently published what it calls the "International Tax Competitiveness Index 2020". It contains some interesting views about various taxes, including property taxes to which I will return shortly.

The report states: "The structure of a country's tax code is an important determinant of its economic performance. A well-structured tax code is easy for taxpayers to comply with and can promote economic development while raising sufficient revenue for a government's priorities. In contrast, poorly structured tax systems can be costly, distort economic decision-making, and harm domestic economies."

It goes on to state: "The variety of approaches to taxation among OECD countries creates a need for a way to evaluate these systems relative to each other. For that purpose, we have developed the International Tax Competitiveness Index to compare the ways that countries structure their tax systems."

The Tax Foundation explains: "The International Tax Competitiveness Index (ITCI) seeks to measure the extent to which a country's tax system adheres to two important aspects of tax policy: competitiveness and neutrality."

Using this approach, the index ranks Estonia as the OECD country at the top of the table with the overall most competitive tax system; Estonia is also number 1 on the property tax competitiveness index. Just picking out a few of the largest countries on the overall table, Australia is at number 9, Germany is 15, Canada is 18, the USA is 21, the UK is 22, France is 32, and Italy is bottom of the table at number 36.

Moving on to look at property taxes in particular, the report states: "Many property taxes are highly distortive and add significant complexity to the life of a taxpayer or business. Estate and inheritance taxes create disincentives against additional work and saving, which damages productivity and output. Financial transaction taxes increase the cost of capital, which limits the flow of investment capital to its most efficient allocations. Taxes on wealth limit the capital available in the economy, which damages long term economic growth and innovation."

It goes on to state: "Sound tax policy minimizes economic distortions. With the exception of taxes on land, most property taxes increase economic distortions and have long-term negative effects on an economy and its productivity."

Interestingly, the report continues: "Real property taxes are levied on a recurrent basis on taxable property, such as real estate or business capital. Although taxes on real property are generally an efficient way to raise revenue, some property taxes can become direct taxes on capital. This occurs when a tax applies to more than just the value of the land itself, such as the buildings or structures on the land. This increases the cost of capital, discourages the formation of capital (such as the building of structures), and can negatively impact business location decisions.

When a business wants to improve its property through renovations or expanding a factory, a property tax that applies to both the land and those improvements directly increases the costs of those improvements. However, a tax that just applies to the value of the land would not create an incentive against property improvements.

Countries that tax the value of capital as well as land receive the worst scores on the ITCI. Some countries mitigate this treatment with a deduction for property taxes paid against corporate taxable income. These countries receive slightly better scores. Countries receive the best possible score if they have either no property tax or only have a tax on land.

Every OECD country except Australia, Estonia and New Zealand applies its property tax to all capital (land and buildings/structures). These three countries only tax the value of land, which excludes the value of any buildings or structures on the land. Of the 33 OECD countries with taxes on real property, 25 allow for a deduction against corporate taxable income."

I should point out that the report is not quite right with regard to its comment about New Zealand only taxing land value. From recent research, IPTI is aware that most councils in New Zealand are now using capital value as their rates (recurrent property tax) base.

Back to the report, it continues: "Property tax collections measure property tax revenues as a percent of a country's private capital stock. Higher tax burdens, specifically when on capital, tend to slow investment, which damages productivity and economic growth.

Countries with a high level of collections as a percent of their capital stock place a larger tax burden on taxpayers and receive a worse score on the ITCI. Nine countries in the OECD have property tax collections that are greater than 1 percent of the private capital stock.

Leading this group are the United Kingdom (1.93 percent), the United States (1.62 percent), and Canada (1.52 percent). Austria, Czech Republic, Luxembourg, Mexico, and Switzerland have a real property tax burden of approximately 0.1 percent of the private capital stock."

The report also measures other types of property tax, i.e. wealth, gift and estate taxes; property transfer taxes; corporate asset taxes; capital duties; and financial transaction taxes.

The property taxes table, which is different to the overall tax table, ranks Estonia in top slot. New Zealand is number 2 on this table with Australia number 3. Germany is number 11, Canada is 22, the USA is 28, France is 29, the UK is 33, Spain is 35 and, at the bottom of the table, number 36 is Italy.

As with many such reports, it would be unwise to attached undue importance to the particular scores and rankings allocated to each country. And views will differ on whether taxing land only is better than taxing capital improved values for the purposes of recurrent property taxes.

However, taxation is clearly important and competition between countries, particularly in terms of their relative attraction from the perspective of business taxation, is a real issue and one which is likely to increase due to the continuing impact of the coronavirus pandemic.

IPTI has always maintained that recurrent property taxes in different jurisdictions/countries should not be viewed and compared in isolation; they should be looked at as part of the "basket" of taxes payable by individuals and businesses to provide an informed context about the relative burden they produce.

That is one of the reasons why the report from the Tax Foundation is welcome and helpful in attempting to provide an overall picture of the burden of taxation in the countries to which it refers.

A recent report from the Organisation for Economic Co-operation and Development (OECD) on tax reforms during the past year reveals a tendency towards higher property taxes, often in the form of base broadening, tax rate increases, or both.

The OECD states: "Even though countries have increasingly targeted property taxes as a source of revenue, on average, they still only account for 5.6 percent of total tax revenue among OECD countries. Property taxes, especially those on real property, can be a relatively efficient way to raise revenue. This is because real property is not easily hidden from tax authorities and often has sufficient benchmarks for valuation purposes. Other types of property taxes that are common among countries include estate, gift, and inheritance taxes and taxes on financial and capital transactions. Net wealth taxes are less common.

As countries reform their property taxes, they shouldn't miss the opportunity to implement reforms that spur investment and economic activity and follow the four principles of sound tax policy. Countries have an opportunity to improve the structure of real property taxes and eliminate transaction taxes, especially financial transaction taxes that have the potential to negatively impact capital formation, growth, and economic recovery. Last but not least, countries should consider the abolition of net wealth taxes, which harm innovation, reduce investment, and negatively impact long-term growth.

When compared to previous periods, 2019 and 2020 (so far) have registered an increase in the number of real property tax reforms implemented. That said, there is no clear tendency towards increases or decreases. Three countries increased their property tax rates, two decreased them, and reforms in Italy and Germany were essentially revenue neutral.

So two recent reports which, in certain respects, are somewhat contradictory, but very interesting.

Moving on to IPTI world, we have had another busy period of online events and work on existing and new projects. We delivered two "linked" webinars on the use of the cost approach. Module 1 provided an introduction to the use of the cost approach and Module 2 took a more detailed look at the determination of functional and external depreciation within the cost approach. The use of practical examples by our very experienced and expert presenters was particularly appreciated by participants.

IPTI also participated in the virtual annual conference run by Rethink Solutions with members of IPTI's Corporate Advisory Committee delivering two interesting sessions. The first was on "Corporate Challenges: Experience Sharing in Managing Multi-Jurisdictional and Global Properties" where our two corporate experts shared their experience and outlined best practice. The second was concerned with the "Use of Technology to Support Internal Collaboration and Management Processes". This session involved an interview with a very experienced inhouse corporate property tax director which highlighted many practical issues that need to be considered in connection with the topic. Both sessions were very well received by participants and we are grateful to Rethink Solutions for providing this opportunity for IPTI.

Another virtual annual conference in which I participated during October was one organised by the Institute for Revenues, Rating and Valuation (IRRV) in the UK. My topic was "Reforming Business Rates – International Influences" which, as the title suggests, involved looking at key aspects of the UK property tax system and making comparisons with systems in other countries. My presentation was pre-recorded but was followed by a "live" question and answer session. I was also involved in a panel session with IRRV colleagues which focussed on various aspects of the current review of business rates (the annual property tax paid in respect of non-residential properties) being undertaken by the UK government.

Also in October we delivered another online workshop in our series on mass appraisal. This one focussed on income modelling and our three expert presenters took participants through fair market rent models and gross income models created in both SPSS and R software.

Looking ahead, we have a wide range of online events coming up in November and December and into next year; as always, full details can be found on our website: www.ipti.org

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

Starting in Canada, a recent report by the Altus Group provides some interesting insights into the comparative burden of property taxes. In particular, the report analyses the differing tax ratios between commercial and residential properties. The report found that, for the third consecutive year, eight of the 11 cities surveyed have a commercial tax rate which is at least double the residential tax rate. The average commercial-to-residential tax ratio for the cities surveyed in 2020 was 2.65, a positive trend reflecting a 6.56% decrease from 2.84 in 2019. This decrease was largely driven by significant reductions in the Vancouver and Calgary ratios, dropping -36.84% and -22.05% respectively. However, Montreal saw the largest increase in the survey of 4.45%, rising above a 4.00 ratio for the first time in 17 years.

Altus commented: "COVID-19 has accelerated the need to reduce the commercial-to-residential tax ratio given the significant added pressure currently facing businesses. Municipalities should recognize that bringing down the commercial-to-residential tax ratio will not only help provide some much-needed relief to struggling businesses during this time but will also make their cities more appealing to businesses going forward. This, in turn, will help foster job growth and lead to sustainable revenue for the city."

The report also provides an in-depth analysis into the tax ratios of the 11 cities surveyed to deliver greater visibility into what is driving their ratios. The total tax rate in each city, for both commercial and residential properties, is comprised of two components: 1) a rate for Municipal Taxes and 2) a rate for Provincial Taxes (primarily funding public education). By calculating separate tax ratios for each of these two components, the report provides better insight into which level of government (municipal or provincial) is primarily responsible for the high ratio or is to be credited for the lower ratio in a city.

The report continues: “In 2020, Calgary, Edmonton, Montreal, Quebec City and Halifax all have higher than average tax ratios that are being driven by the Municipality. Meanwhile, in Toronto and Ottawa, it is the Province (specifically the Provincial Education levy) that is increasing their ratios. Without significant downward movement in the Provincial ratio, both Toronto and Ottawa will be challenged to bring their overall ratios down.”

In Saudi Arabia, where IPTI delivered some training for professional valuers in the recent past, there is a new real estate transactions tax. A Royal Decree has exempted all real estate transactions involving ownership and sale from the 15 percent value-added tax (VAT), replacing it with the new tax of 5 percent of the value of a property at the time of sale. The new tax will be imposed on the value of the property that is to be sold or transferred regardless of its condition or form. It includes the land and what is constructed on it. The tax has to be paid before or during the transaction or documentation process. Exceptions include cases of forcible removal of a property when expropriation is in favor of the public benefit or temporary seizure of the property (topics on which IPTI delivered training). Procedures have been defined for payment of the tax based on a valuation of the property by the General Authority of Zakat and Tax (GAZT). Transactions can only be processed by a notary after paying the tax. The final step is to document the contract and the seller is then notified of the completion of the process.

In the Czech Republic, the real estate acquisition tax has been abolished retrospectively from 31 March 2020. One key aim of abolishing the real estate acquisition tax is an increase in investments into immovable property as a result of savings incurred on the part of acquirers (who will no longer pay the 4 percent real estate acquisition tax). Even during the current pandemic crisis, investments into Czech real estate have risen by as much as 6.5 percent, but the government wants to further stimulate the market. Other intended benefits of the changes include an elimination of tax filing or tax proceedings costs for property buyers. Saved financial resources can be invested in other areas by the buyer or will simply not burden them unnecessarily when buying immovable property. In terms of the Czech state, the government hopes that the abolition of the tax will help ease the administrative burden and help create a more transparent and balanced tax environment with less space for tax exemptions. However, repealing the 4 percent real estate acquisition tax also means the state - already reeling under record deficits - will lose an estimated 13.8 billion CZK per year in revenue and will seek funding from other sources.

In India, the Ministry of Home Affairs has changed the law enabling the government of the Union Territory of Jammu and Kashmir to impose property tax through municipal corporation and committees. One major amendment in the J&K Municipal Act, 2000 whereby the Municipal Councils and Committees have been established, now states: “Unless exempted under this Act or any other law for the time being in force, Property Tax shall be levied on all lands and buildings or vacant lands or both situated within the Municipal area. The Property Tax shall be levied at such percentage not exceeding 15 per cent of the taxable annual value of land and building or vacant land or both as the Government may, by notification, from time to time specify”. The new provisions also state: “The taxable annual value of land and buildings or vacant land assessable to taxes under this Act shall be calculated by multiplying the corresponding unit area value with the total build-up area of a building or the total area of land, as the case may be, minus depreciation, at such rates as may be prescribed, depending on the age of the building”. The Property Tax payable is to be reduced by 25 percent in respect of a self-occupied building used for residential purpose and such class of self-occupied non-residential building as may be notified by the Government on the recommendation of the Municipality.

In the USA, many jurisdictions are reported to be preparing for a surge in assessment appeals by COVID-ravaged businesses. For example, one county in Pennsylvania is bracing for what it describes could be a budget-wrecking spike in property assessment appeals by hotels, shopping centers and other commercial property owners ravaged by COVID-19 - a situation that could cost towns and school districts already hit hard by the pandemic even more tax revenue. Signs of the surge in appeals are already being seen in neighboring counties who have earlier deadlines, and some government officials in the region are bracing for the potential cascading effect - perhaps even a renewed need for countywide property assessments once things start to return to some version of normal. “It’s the perfect storm,” said the special tax counsel to the Pittsburgh Public Schools. Another lawyer stated that, given the way COVID has hammered shopping centers and hotels, it’s not hard to make a case for an assessment reduction that would lower their municipal, county, and school district tax bills. He noted that shopping centers either have lost tenants because of COVID or have been forced to slash rents. Some hotels have been closed since mid-March. Others only recently reopened. “These properties aren’t worth what they were prior to COVID because the economic realities have changed,” he said. Another commentator referred to office buildings and said “A lot of them have seen increased vacancies, a lack of income coming from tenants, and more difficult prospects in renting space. People are hesitant to commit to long-term tenancies given the uncertainties. It’s very challenging for the landlord to find someone who is going to commit to space long term in this environment.” The same situation is being experienced in many countries around the globe.

And finally, the Wisconsin Tax Appeals Commission recently clarified the applicability of the state’s property tax exemption for machinery, tools, and patterns (“MTP”). At issue in this appeal was which of a taxpayer’s property items were eligible for the exemption, which applies to all MTP unless the property is “used in manufacturing.” The taxpayer was a cheese producer and claimed the MTP exemption for various items of property that were not exclusively used in manufacturing. The Department argued that all property owned by a manufacturer or located at a manufacturing site was “used in manufacturing” and ineligible for the MTP exemption. The Commission held that property was not eligible for the MTP exemption if it had any use in the cheese manufacturing process, even if the manufacturing use was non-exclusive, indirect, or occasional. Therefore, the parties had to re-examine the taxpayer’s property to determine which property was not used at all in the cheese manufacturing process.

Sounds to me like a case of “tough cheese” for the taxpayer!

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