

The Role of the Property Tax in Financing Local Government



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THE PROPERTY TAX PLAYS AN IMPORTANT ROLE IN LOCAL GOVERNMENT

- Source of revenue for local governments
 - Ability to deliver services
 - The extent of local control affects local autonomy
- Impact on land use
 - Property tax can shape urban development patterns
- Impact on other economic and social goals
 - Property tax can influence business location
 - Property tax relief can help relieve property tax burden on low-income taxpayers

PRESENTATION OUTLINE

- The residential property tax is a good tax for local government ... according to economic theory
- The non-residential property tax is not as good a tax for local government ... according to economic theory
- Property taxes are not widely used in many OECD countries
- What are the problems with the property tax in practice?
- Can it be fixed? What needs to be done?

THE RESIDENTIAL PROPERTY TAX IS A GOOD TAX ... ACCORDING TO ECONOMIC THEORY

- Immovable: difficult to evade tax
- Benefits received: connection between local services and property values
- Local autonomy: to the extent that only local governments levy the tax
- Visibility and accountability: visibility makes governments accountable



THE RESIDENTIAL PROPERTY TAX IS A GOOD TAX ... ACCORDING TO ECONOMIC THEORY

- Argument for local taxation to finance local public services
- Where user charges are not appropriate (e.g. parks, local streets, fire, police), a residential property tax is sensible



DIFFERENT SERVICES – DIFFERENT REVENUE TOOLS

Private

Water

Sewers

Garbage

Transit



User fees

Public

Police

Fire

Local parks

Street lights



Property tax

Redistributive

Social assist.

Social housing



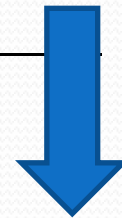
Income tax

Spillovers

Roads/transit

Culture

Social assistance



Transfers

THE NON-RESIDENTIAL PROPERTY TAX IS NOT A GOOD LOCAL TAX ... ACCORDING TO ECONOMIC THEORY

- Benefits received: taxes generally exceed the benefits received from local services
- Capital mobility: business more mobile than residents
- Accountability: tax exporting reduces accountability
- Tax competition to attract business (diverts tax base from poorer areas)



THE NON-RESIDENTIAL PROPERTY TAX IS NOT A GOOD LOCAL TAX ... ACCORDING TO ECONOMIC THEORY

“Every fiscal tub should be required to stand on its own bottom, and no fiscal unit should be allowed or encouraged to reach out and tap other people’s pocket books in order to finance expenditures whose benefits are confined to residents of the taxing area.”

(Wayne Thirsk, 1982)

BUT THEORY AND PRACTICE DIFFER

“Tax policy is the product of political decision making, with economic analysis playing a minor supporting role.”

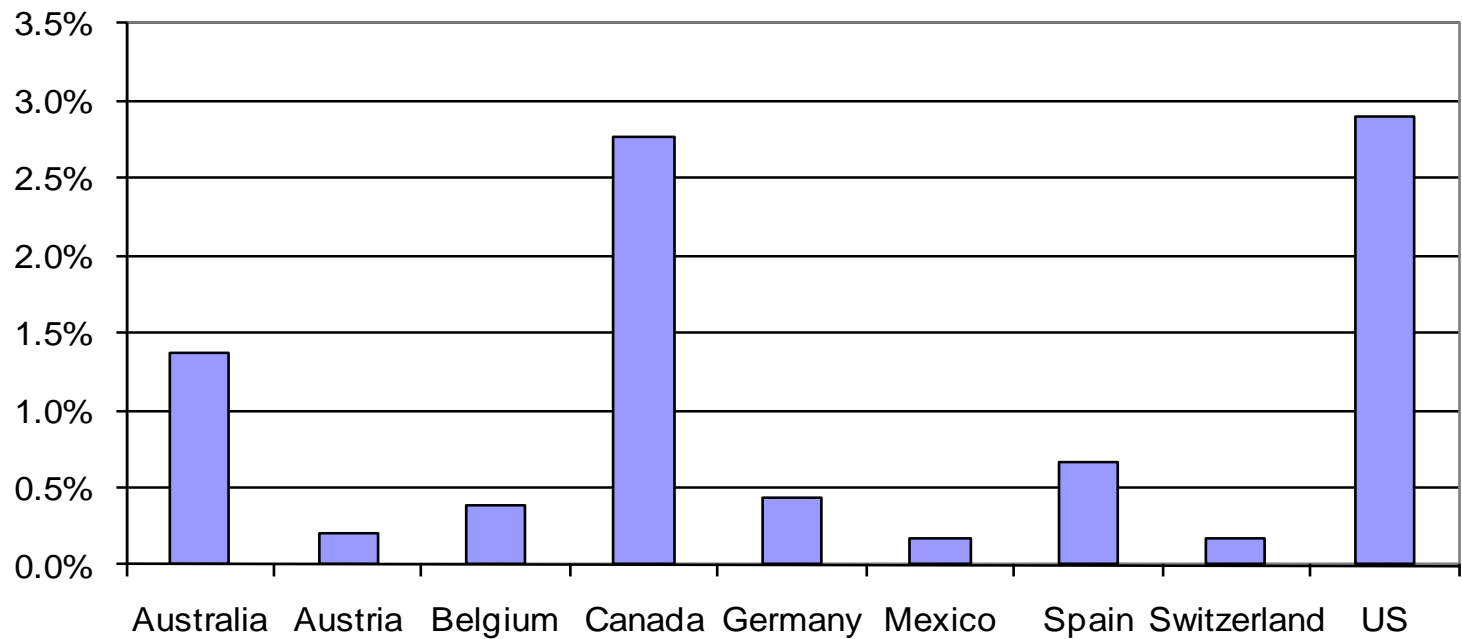
(Randall Holcombe, 1998)



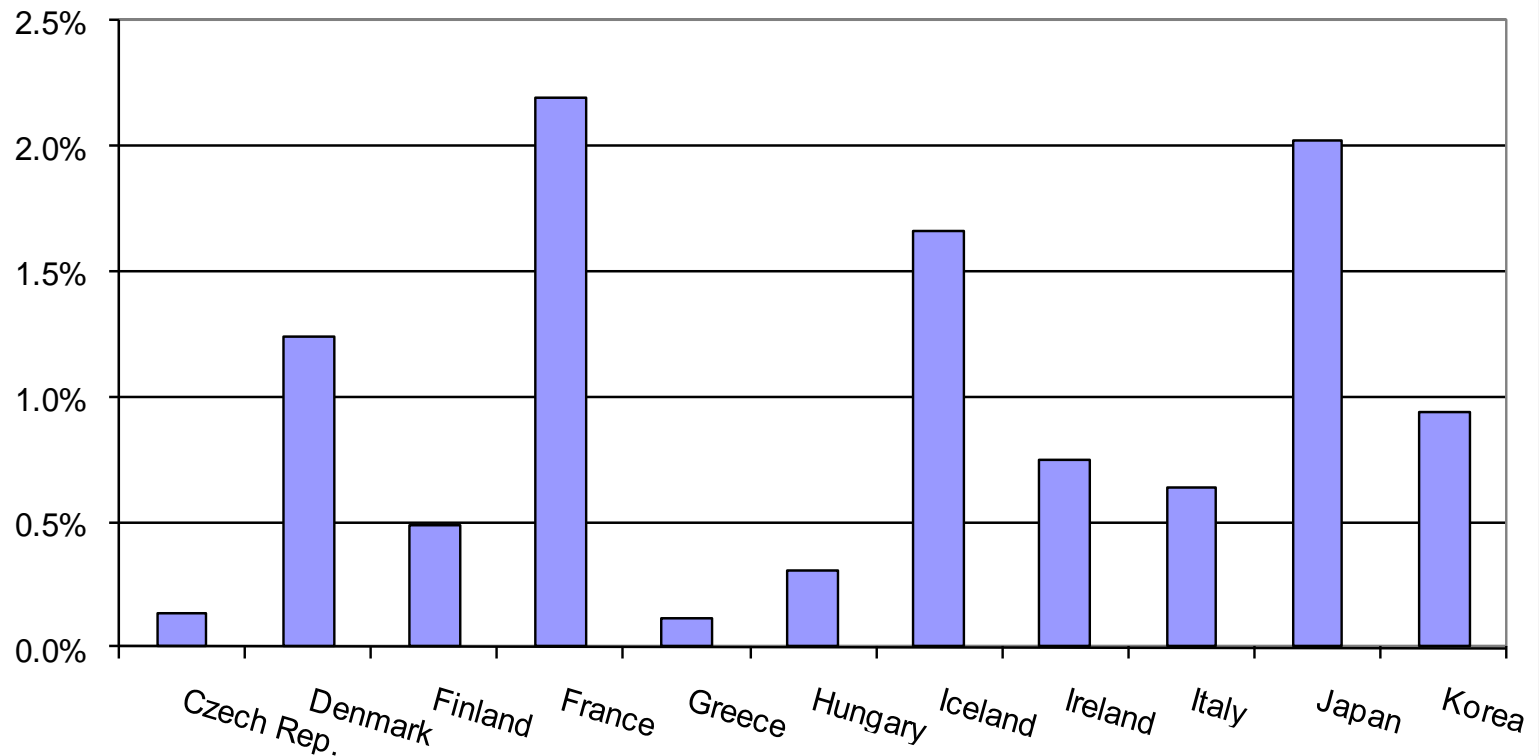
PROPERTY TAXES ARE NOT WIDELY USED IN OECD COUNTRIES

- Property taxes relative to GDP
- Distribution of local tax revenues

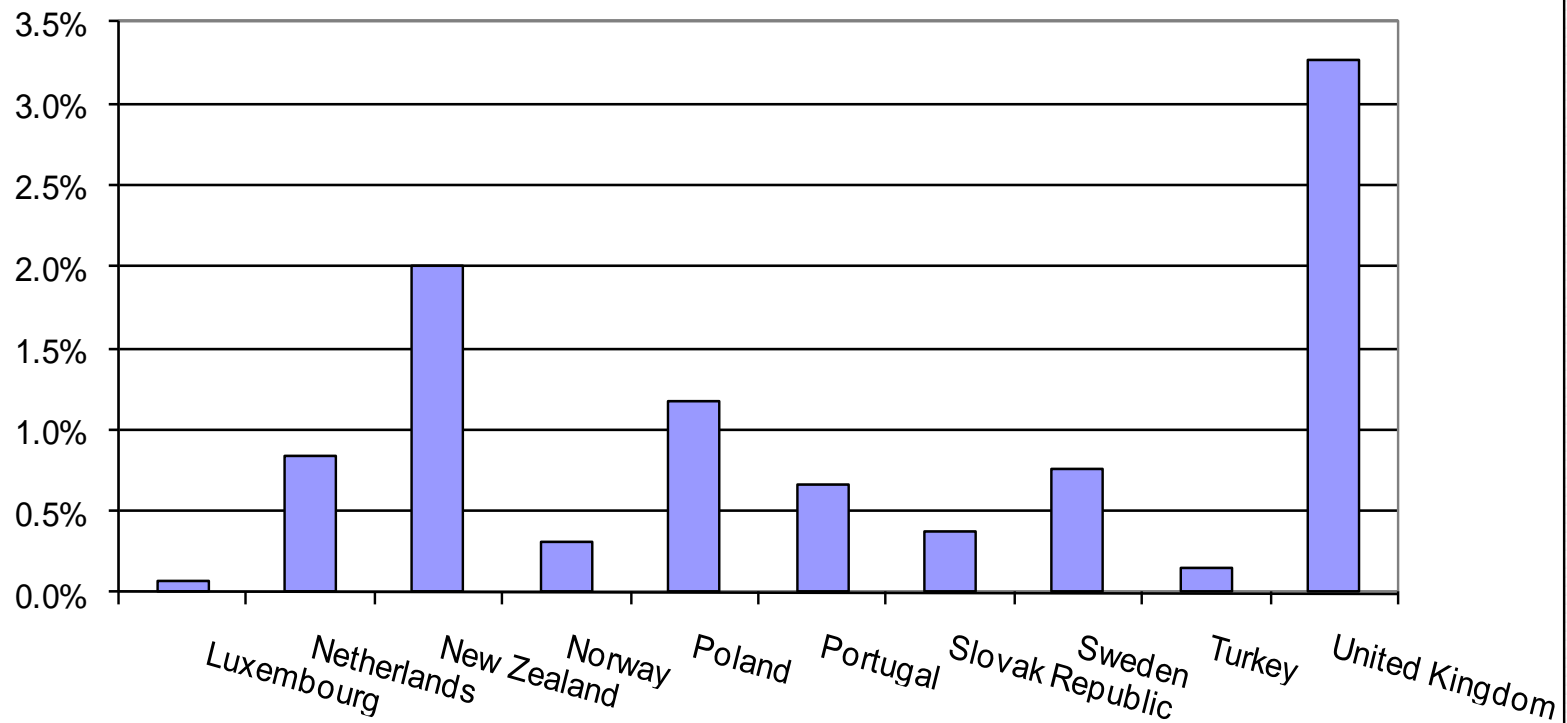
Property Taxes Relative to GDP, Federal OECD Countries, 2008



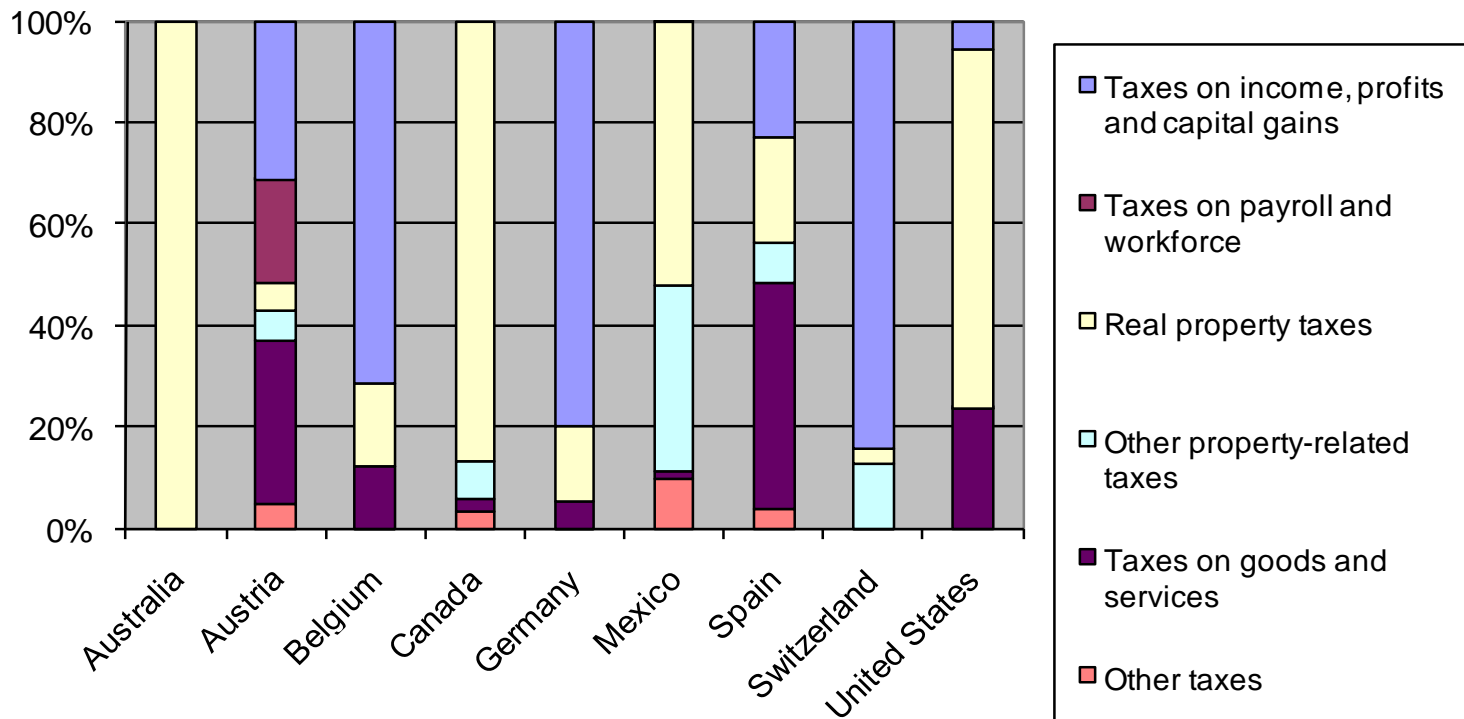
Property Taxes Relative to GDP, Selected Unitary OECD Countries, 2008



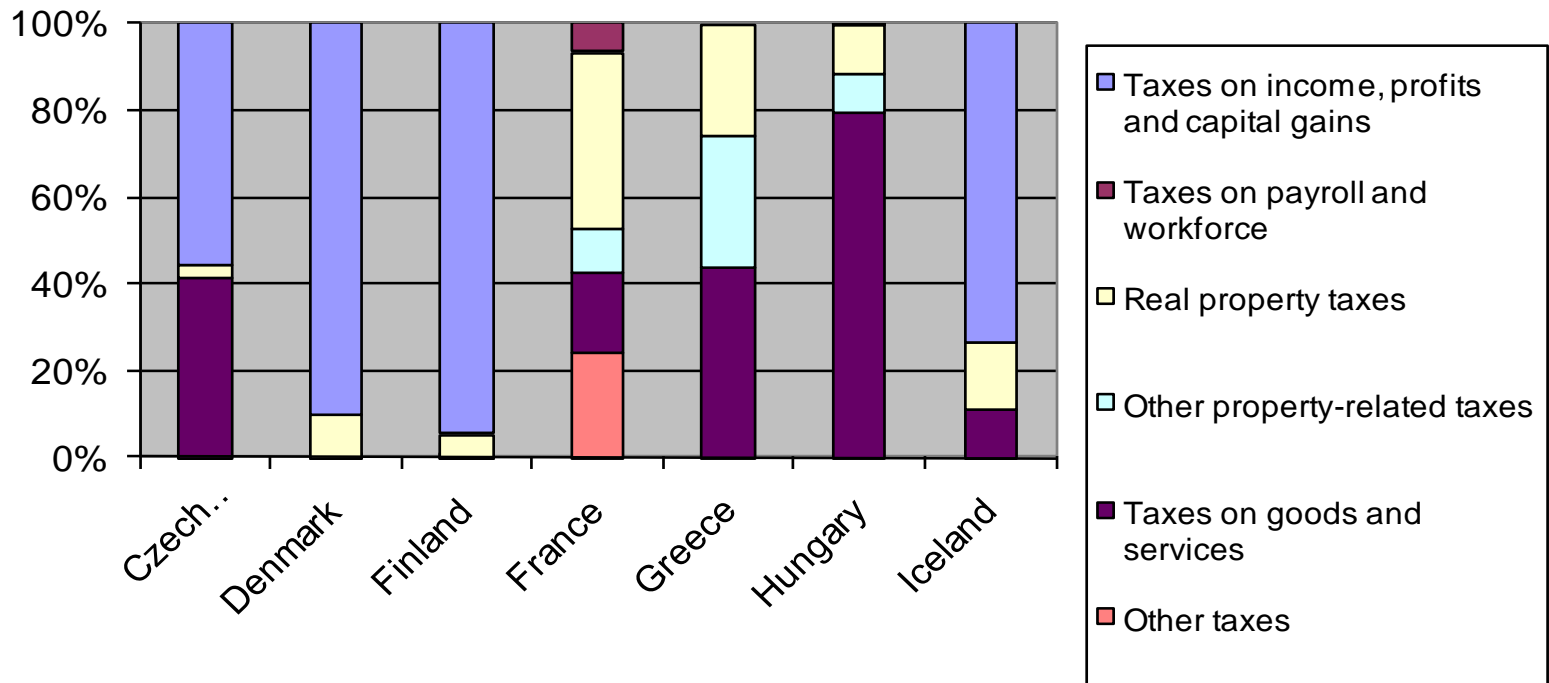
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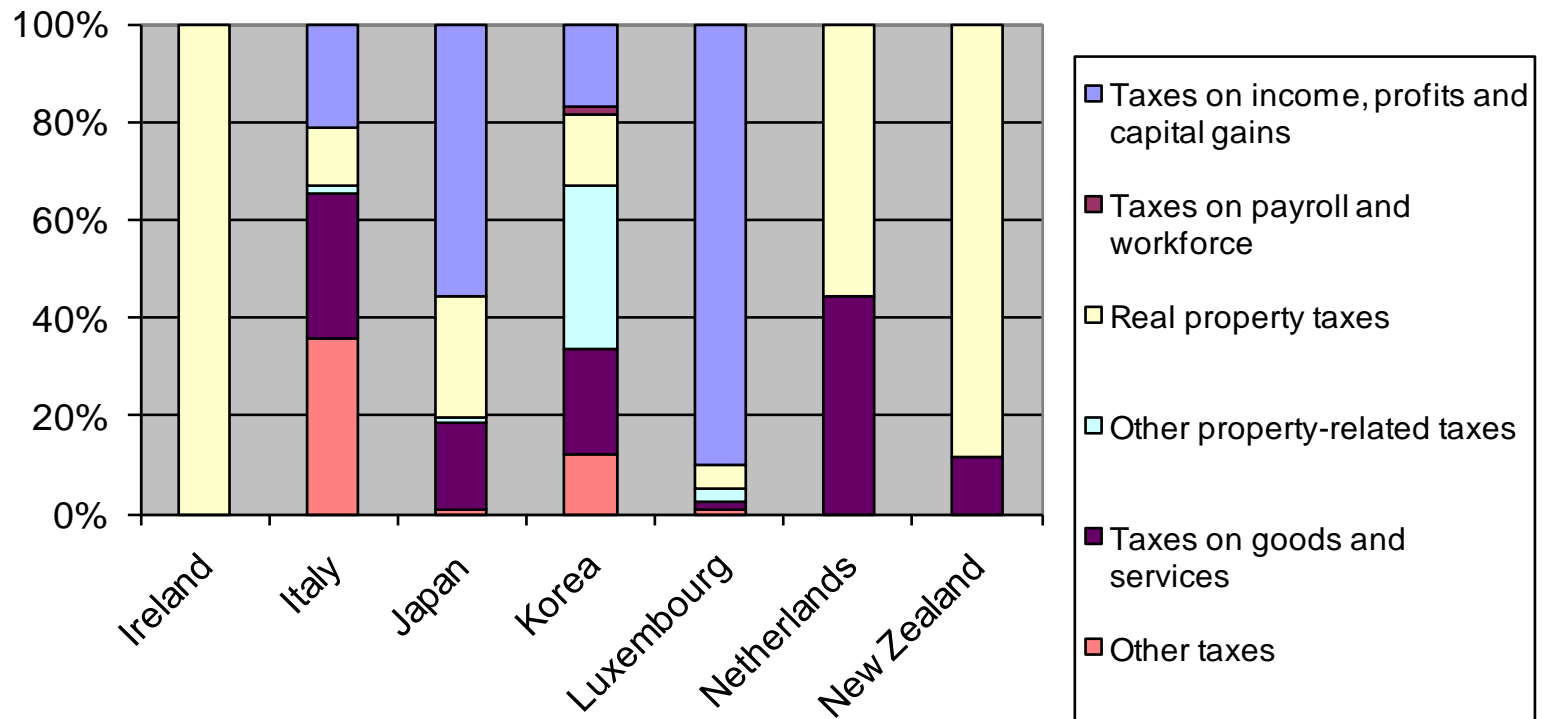
Distribution of Local Government Tax Revenues, Federal OECD Countries, 2007



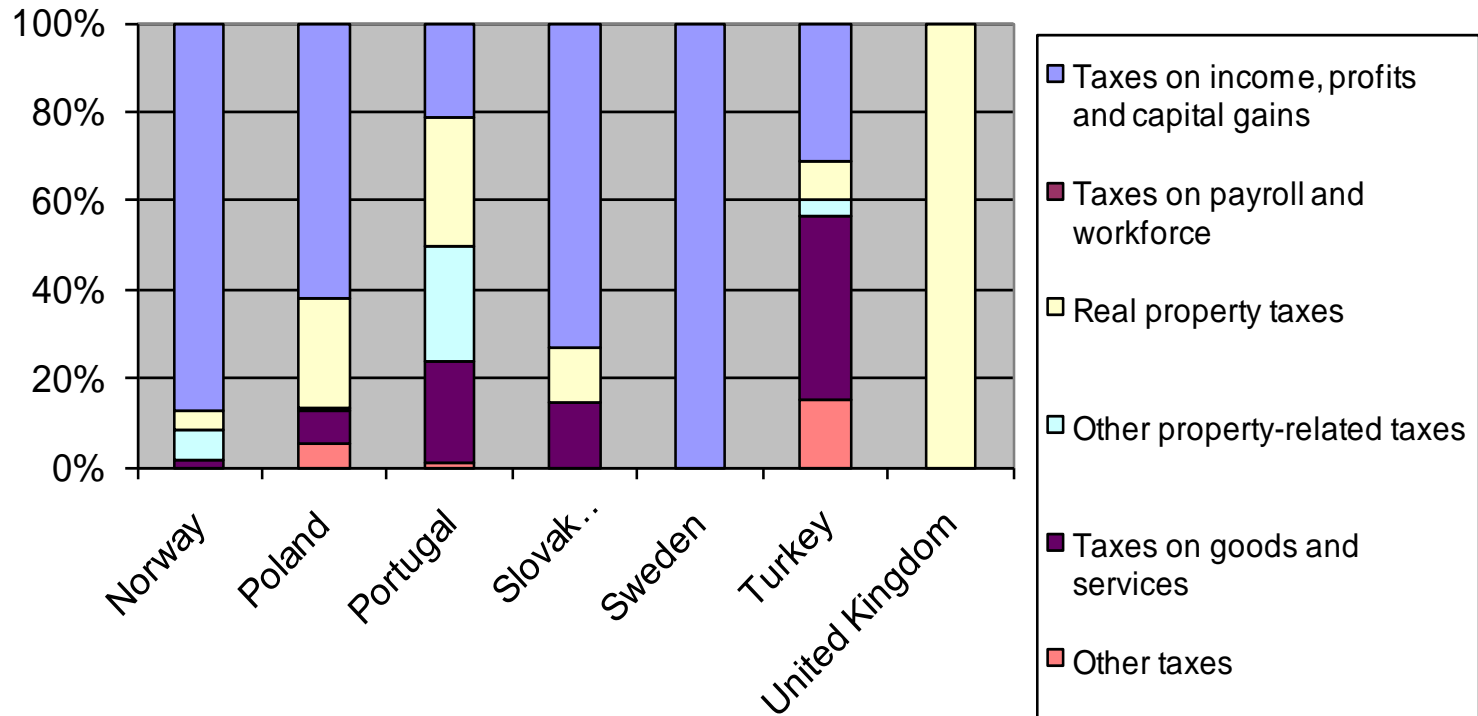
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DEPENDENCE ON THE PROPERTY TAX

- Dependence on property tax varies with:
 - Expenditure responsibilities assigned to local government
 - Other revenues available (intergovernmental transfers, user fees, other taxes)
 - Size and growth of tax base
 - Degree of freedom local governments have with respect to property taxation (tax base and rates)
 - Willingness to enforce tax

WHAT ARE THE PROBLEMS WITH THE PROPERTY TAX IN PRACTICE?

- The property tax is inelastic:
 - Greater accountability but greater taxpayer resistance
- The property tax rate is low:
 - Rates generally between 0.5% and 1.0%
 - The property tax is unpopular
 - Visibility
 - Volatility of market value system



WHAT ARE THE PROBLEMS WITH THE PROPERTY TAX IN PRACTICE?

- The property tax may be badly administered:
 - Arbitrary process of assigning values to properties in market value system
 - Infrequent reassessments
 - opposition from taxpayers who benefit from status quo
 - cost of reappraisals

WHAT ARE THE PROBLEMS WITH THE PROPERTY TAX IN PRACTICE?

- The tax base is being eroded:
 - Exemptions (e.g. churches, government)
 - Assessment limits; tax limits
- Enforcement can be costly in terms of resources and politics



WHAT CAN BE DONE?

- Good administration e.g. assessment, billing, collection, appeal mechanism
- Regular reassessments
- Phase in of tax increases arising from reassessments BUT resist assessment limits

WHAT CAN BE DONE?

- Public education:
 - assessment increase overall does not necessarily mean tax increase
 - services funded by property tax
- Property tax relief for low-income taxpayers

