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## **The Property Tax ... in Theory and Practice**

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## The Property Tax ... in Theory and Practice\*

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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 (based on the benefits received from local services), it is difficult to evade, and it promotes local autonomy and accountability (Bird R. M., 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-utilization 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 about 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.<sup>1</sup>

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 turns to 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 it being under-used. The final part addresses the question of whether property taxes can be reformed to increase revenues.

### 1. 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 thus a link between the benefits and costs of local services that encourages them to make efficient fiscal decisions (Oates, 2010, p. 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 these services translates into

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<sup>1</sup> See, for example, (Bird & Slack, 2004) which shows that for 24 of the 25 countries studied, the non-residential property tax rate is higher than the residential rate.

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higher property values. Higher taxes, other things being equal, translate into lower property values.

Of course, this analysis is based on a number of assumptions such as that local property taxes do finance services that benefit property values, that the incidence of such taxes is 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 links varies across countries (Bird & Slack, 2006).<sup>2</sup>

A competing view sees the property tax as a tax on capital that results in distortions in the housing market and in local fiscal decisions (Zodrow, 2001). The property tax (based on the market value of land and improvements) discourages building and results in the underutilization of land. The amount of capital per unit of land is less than what is economically efficient. Both the benefit-based and capital tax approach have some validity. The property tax is not purely a benefits tax because homeowners who improve their houses will face higher taxes and will therefore be discouraged from doing so. At the same time, the benefits of local programs are reflected in local property values.<sup>3</sup>

Another reason that the property tax is regarded as a good tax for local governments is that property is immovable – it is unable to 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 provides the potential to raise significant revenues.

To the extent that the property tax is only levied 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, p. 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 it directly in periodic lump-sum payments. As a result, taxpayers tend to be much more aware of the property taxes they pay.<sup>4</sup> The property tax also finances services that are highly visible, such as roads, garbage collection, and neighborhood parks. Indeed, studies show that residents are more willing to pay for local

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<sup>2</sup> 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.

<sup>3</sup> A third view is that the property tax is a wealth tax. See, for example, (Kitchen H. M., 1987)

<sup>4</sup> The exception is where mortgage institutions include property tax payments with monthly mortgage payments.

services when they rate their government and service provision highly (Simonsen & Robbins, 2003, p. 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 an economic (hard budget constraint) and political (democratic) perspective. 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, hotels), industrial uses (such as mines, manufacturing plants, shipyards), and special uses (such as pipelines and railway rights-of-way). As noted earlier, the effective property tax rate (property taxes relative 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 services on their own such as garbage collection, security, and fire protection. Kitchen and Slack 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 (Kitchen & Slack, 1993). A US study estimated that the business-related share of state/local expenditures in the US is less than the business-related share of state/local tax revenues (Oakland & 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 is rarely the case.

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 distorts land use decisions favouring residential use over commercial and industrial use (Maurer & 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 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 thus reducing democratic accountability.

Notwithstanding the efficiency arguments against tax exporting, “politicians have a strong political bias toward exporting tax burdens” (Brunori, 2003, p. 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, p. 38).

### 3. Property Taxes are Not Widely Levied in OECD Countries

Notwithstanding the 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 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 UK, close to 3 percent in the US 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 vary across jurisdictions, however, 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.<sup>5</sup> 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 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 UK).

Dependence on the property tax also depends on the degree of freedom local governments have with respect to property taxation (for example, the authority they have with respect to setting the 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.

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<sup>5</sup> The data source for Tables 1 and 2 is different so not all countries appear in both tables.

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

	1965	1975	1985	1995	2005	2007	2008
<b>Federal Countries:</b>							
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
<b>Unitary Countries:</b>							
Czech R.				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 R.					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, Revenue Statistics 1965-2008, OECD 2009

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

	General public services	Public order and safety	Economic affairs (mainly transport)	Env'l Protection	Housing and community amenities	Health	Recreation and culture	Education	Social protection	Total expenditures
<b>Federal countries:</b>										
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
<b>Unitary countries:</b>										
Czech R.	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 R.	17.5	1.0	15.9	6.2	9.9	0.3	7.1	35.4	6.6	100.0

Source: International Monetary Fund, *Government Finance Statistics*, Yearbook, 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 workforce	Real property taxes	Other property- related taxes	Taxes on goods and services	Other taxes	Total tax revenue
<b>Federal countries:</b>							
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
<b>Unitary countries:</b>							
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	0.0	100.0	0.0	0.0	0.0	100.0

Note: Data for the Netherlands are for 2005.

Source: OECD, *Revenue Statistics 1965-2008*, 2009, Tables 139-168 and OECD, *Revenue Statistics 1965-2006*, 2007, Table 157.



#### 4. Problems with the Property Tax ... In Practice

This section looks at the reasons 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.

##### Unpopularity

The property tax is often regarded as the “most hated” tax (Brunori, 2003, p. 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 potential for volatility and unpredictability of a tax that is based on market value (Sheffrin, 2010). Suppose a local government collects a fixed amount of property tax revenue to provide 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 potentially large annual swings in the distribution of the property tax burden in times when property values are rising rapidly and not uniformly (Haveman & Sexton, 2008). Different neighbourhoods will be “hot” in different years.<sup>6</sup>

Although the market value system provides a uniform and clear standard for distributing property taxes among taxpayers, uniformity may be at the expense of tax volatility. Anderson 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 are one of the reasons for the demand for assessment and tax limitations. Taxpayers regard assessment limits as insurance against large property tax increases (Anderson, 2006). Another consequence of this

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<sup>6</sup> The problem of increasing market values is exacerbated for those who argue that the increased wealth is not realized until the asset is sold so that property taxes are increasing without additional income to pay them (Fisher, Bristle, & Prasad, 2010, p. 196). The holdings of other forms of property (e.g. stocks or other financial assets) are taxed upon realization.

unpopularity is low tax rates -- tax rates tend to range from only 0.5 percent to 1.0 percent of market value.

### Inelasticity

The property tax is an inelastic tax -- 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 on an annual basis. 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 rate of the tax. As with visibility, inelasticity leads to greater accountability (taxing authorities have to 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 its elasticity ... and the horizontal equity of the tax (Bahl, Martinez-Vazquez, & Youngman, 2010, p. 5).

### 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 higher to collect 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 & Slack, 2004). Although there is great diversity in the use of exemptions, some properties are exempt in most jurisdictions -- government properties, 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 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. Exemptions also are inequitable and inefficient. Differential tax treatment means that owners/managers in taxed properties face higher costs than owners/managers of exempt properties. This differential will have implications for economic competition among businesses and between businesses and government (Kitchen & Vaillancourt, *The Federal Grants-in-Lieu of Property Taxes Program: An Assessment*, 1990). To the extent that people working in tax exempt buildings use municipal services just as workers do in other buildings, they should be taxed (Bahl & Linn, 1992, p. 100). Differential tax treatment also affects location decisions, choices about what activities to undertake, and other economic decisions. 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 limit 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 US – most states impose them on local governments – but property tax ceilings and caps are used in European countries as well (Brown & Hepworth, 2002). The greater the increase in property values and the lower the assessment increase permitted, the greater will be 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 US local jurisdictions and resulted in limited spending on local public schools and lowered educational outcomes (Yuan & Cordes, 2009). Moreover, they 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 be paying the same taxes. Assessment limits shift the property tax burden from those properties whose values are increasing rapidly to those properties whose values are stagnant (Slack, 2010). Assessment limits until 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 when it is not being used to calculate taxes. If one of the reasons for the volatility has to do with assessment errors, these errors will never be corrected. And, it is very difficult to remove a freeze: "once a freeze is imposed, the process of thawing may be too painful to bear." (Youngman, 1999a).

Property tax incentives designed to stimulate economic growth are also used widely in the US. A study of property tax incentives in the U.S. indicates that over 40 states allowed for these incentives in 2007 (Wassmer, 2007). The goal set out for most of these incentives is to increase employment and/or 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 these incentives are nor how equitable. 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 (Glaeser, 2002) (Garcia-Mila & Mc Guire, 2002). Others believe that property tax incentives can result in a zero-sum game whereby development at one location is at the expense of development at another location and incentives are wasted on firms that would have located there anyway (Wassmer, 2007). Moreover, tax incentives can lead to unfair competition among businesses and can lead to a situation where no major investments occur without them. Tax competition can result in inefficiently low taxes and public services. A number of studies argue that lowering non-residential property taxes for all businesses in the 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.

### Poor Administration

How well land and property taxes are administered not only impacts how much revenue is collected but also affects 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.<sup>7</sup>

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 based on manuals, property assessment is inherently an arbitrary process. People do not perceive the assessment system to be uniform or fair. As Bahl and Martinez-Vazquez 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” (Bahl & Martinez-Vazquez, 2008, p. 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.<sup>8</sup> 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 3 to ten years. Of course, the time periods mentioned in the table are those specified in legislation and, in many instances, the pace of revaluation in reality 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 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 & Hepworth, 2002, p. 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 a different rate 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 and support, training and availability of in house staff, and 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 & Slack, 2006). Another reason is that opposition from taxpayers who benefit from entrenched inequities encourages

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<sup>7</sup> For more details on the administration of the property tax, see (Bird & Slack, 2004).

<sup>8</sup> See (Bird & Slack, 2004) for a more information on the advantages and disadvantages of value-based versus area-based taxation.

legislative neglect (Almy, 2001). There is a science to the assessment of property but there is also a resistance to follow good assessment practices (Bahl, Martinez-Vazquez, & Youngman, 2010, p. 5).

**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	Revenu cadastral	X	X	X	X			10 years; postponed
Denmark	County real estate tax	X				X		4 years; annual indexation
	Municipal real estate tax	X				X		
	Tax on comm'l bldgs.		X			X		
Finland	Real property tax	X	X			X		Annual
France	Property tax		X	X	X			3 years but revaluations have been postponed; annual indexation
	Property and land tax	X	X		X			
	Business tax		X	X	X			
Germany	Real estate tax	X	X			X		6 years but no revaluation since 1964
Ireland	Rates	X	X	X	X			5-10 year rolling revaluations
Italy	Communal real estate tax	X	X		X			Not specified
Netherlands	Onroerend-Goedbelasting	X	X			X		4-year rolling revaluation
	Waterschap levy	X	X			X		
Portugal	Immovable property tax	X	X	X				Annual indexation
Spain	Local property tax	X	X			X		Annual indexation
Sweden	Real estate tax		X			X		4-year rolling revaluations
Switzerland	Municipal business tax	X	X		X			Annual –based on rent and profit
England and Wales	Non-domestic rates	X	X	X	X			5 years Not specified
	Council tax		X			X		
Scotland	Non-domestic rates	X	X	X	X			5 years Not specified
	Council tax		X			X		

Source: (Brown & Hepworth, 2002), (Almy, 2001)

## 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 (with 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 right... and frequently.

Property tax reform, in countries that have tried it, has been difficult, however (Bird & Slack, 2004).<sup>9</sup> The reason is that, 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 undesirable in political terms to kill it. In short, there will always be winners and losers from tax reform: those who were relatively over-taxed before the reform was implemented will pay less taxes; those who were relatively under-taxed before the reform will pay more taxes. The losers from a change in policy tend to be very vocal (even if they are the minority) because they value their losses more than the winners (even if they are the majority) value their gains. Furthermore, where the losses are concentrated and the gains are dispersed, as is often the case with tax reform, negatively affected interests will be motivated to spend time and resources in political action that can result in permanent, institutionalized groups (for example, office towers, hotels, seniors, waterfront properties) in opposition to reform.

Another problem with tax reform is that there is 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 happened 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 designing 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 would be 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 will never be able to do the whole job, 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 utilized more heavily in most countries than it is at the present time.

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<sup>9</sup> For a discussion of property tax reform in one Canadian province, see (Slack, 2002)

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