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The Political Economy of Property Tax Reform

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THE POLITICAL ECONOMY OF PROPERTY TAX REFORM

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ABSTRACT

Property taxes are generally considered by economists to be good taxes, and many countries are being advised to increase and improve their property taxes. In practice, however, property tax reforms have often proved to be difficult to carry out successfully. This paper discusses why property taxes are particularly challenging to reform and suggests several ways in which efforts to reform this tax may become more successful in the future. After a brief introductory section on the 'disconnect' between the economics and the politics of property tax reform, Section 2 summarizes recent experiences in five OECD countries with property tax reform. Against this background, Section 3 sets out the key elements of a good property tax reform and Section 4 discusses several aspects of property tax reform that seem to have derailed or distorted reforms in practice. Unfortunately, some of the solutions countries have adopted to deal with such problems are themselves problematic, either because they do not really solve the problem or because they hamper rather than work towards the establishment of a good property tax. Fortunately, as Section 5 outlines, it is possible to devise strategies for property tax reform that incorporate more acceptable solutions to most problems. As Section 6 concludes, good property tax reform is not easy. But it can definitely be achieved if an appropriately designed reform package is properly introduced and implemented.

Key words: property tax, political economy, tax reform
JEL codes: H24, H25, H71, D78

Property taxes are generally considered by economists to be good taxes, and many countries are being advised to increase and improve their property taxes (IMF 2013b). In practice, however, property tax reforms have often proved to be difficult to carry out successfully. This paper discusses why property taxes are particularly challenging to reform and suggests several ways in which efforts to reform this tax may become more successful in the future. After a brief introductory section on the 'disconnect' between the economics and the politics of property tax reform, Section 2 summarizes recent experiences in five OECD countries with property tax reform. Against this background, Section 3 sets out the key elements of a good property tax reform and Section 4 discusses several aspects of property tax reform that seem to have derailed or distorted reforms in practice. Unfortunately, some of the solutions countries have adopted to deal with such problems are themselves problematic, either because they do not really solve the problem or because they hamper rather than work towards the establishment of a good property tax. Fortunately, as Section 5 outlines, it is possible to devise strategies for property tax reform that incorporate more acceptable solutions to most problems. As Section 6 concludes, good property tax reform is not easy. But it can definitely be achieved if an appropriately designed reform package is properly introduced and implemented.

1. Economics vs. Politics in Property Tax Reform

Economists consider taxes on immovable property good taxes, especially for local governments, for a number of reasons. It is difficult to evade the tax because property is immovable: the tax base cannot shift location in response to the tax and it cannot be hidden. In addition, the property tax is considered to be efficient because it distorts the allocation of resources less than other taxes. Since changes in property taxes are, to a large extent, capitalized into property values their impact on economic behaviour is likely to be smaller than other taxes such as income and sales taxes.[1]

Where property taxes are levied largely by local governments they promote local autonomy and accountability owing to the connection between many of the services provided at the local level (for example, schools, roads, transit, parks) and property values. When local property taxes finance local services, public sector decisions will tend to be more efficient because taxpayers will presumably support those activities for which the benefits received exceed the taxes. Property values will increase to the (usually significant) extent that benefits and taxes are capitalized into property values (Fischel 2001).[2] Residential property taxes are especially appropriate to fund local government spending because they are largely borne by local residents who use local services.[3]

Despite its virtues, however, the property tax is not popular with taxpayers and politicians. It has been characterized as the "tax everyone loves to hate" (Rosengard 2013). It is criticized for many reasons: as unfair, because it is unrelated to ability to pay or to benefits received, as unsuitable because it supports services that are not related to property and as inadequate because it does not provide sufficient

1 As Johansson et al. (2008) show, property taxes do not affect the decision to supply labour, invest in human capital, produce, invest, and innovate as much as do other taxes.

2 This conclusion rests on several assumptions that may be met to varying degrees in different countries: that local property taxes finance services that benefit property values; that the main burden of such taxes falls on local residents; that those who wish to "buy" other combinations of services and taxes 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 (Bird and Slack 2007). A competing view sees the property tax as essentially a tax on capital which discourages investment with differing effective rates in different localities resulting in further distortions in the housing market, in business location decisions, and in local government fiscal decisions (Zodrow 2001). Like the benefit-based view, this capital tax approach generally has some validity. Others consider the residential property tax as a form of wealth tax (Kitchen 1987).

3 In some countries (e.g. Poland) most property taxes are collected not from residents but from businesses. Often, property taxes imposed on business exceed the benefits businesses receive from local services. Moreover, businesses are more mobile than residents and thus more responsive to property tax changes, and business taxpayers do not vote. For these and other reasons, the residential property tax is a much better tax for local governments than the non-residential property tax. We mention some aspects of this important distinction briefly in this paper: for a more detailed discussion, see Bird, Slack, and Tassonyi (2012).

revenue to meet local expenditure needs. It has also been criticized for its negative effects on housing, land use, and urban development.[4]

Although the property tax is levied for the most part, by local governments, it is often not a truly local tax – that is, one for which the local government decides whether to levy the tax or not; determines the precise base of the tax; sets the tax rate; administers (assesses, collects, enforces) the tax; keeps all the revenue collected; and may grant tax allowances or reliefs to individuals and firms (Bird 2011). In many OECD countries, local governments have more discretion with respect to property taxes, which provide about 30 per cent of local revenue, than they do other taxes. Nonetheless, local governments have full discretion on rates and reliefs with respect to only 16 per cent of their property tax revenue, although they have full discretion on rates for another 22 per cent, and rate discretion within a limited range for another 38 per cent (Blöchliger and Rabesona 2009). Property taxes do not meet all of the criteria listed above in any country.

Even when there is some local discretion, in most countries higher level governments play a significant role in the design and operation of the local property tax. For example, they may specify how assessments should be performed or take over the assessment function. Assessment of property values at a higher level may achieve economies of scale and ensure uniformity in assessment practices. One US study, for example, found that the use of county rather than local assessors resulted in more uniform residential assessments (Strauss and Sullivan 1998).[5] At the very least, the central government should set the rules for assessments, provide assessment manuals, and take some responsibility for training assessors. In terms of setting tax rates, sometimes property tax rates are set by the central government.[6] Sometimes there is some local discretion, within centrally-set limits.[7] Sometimes there is complete local discretion. Even where rates are locally determined, they are often limited by the central government to avoid tax competition and tax exporting.

The extent to which local property taxes achieve the idealized outcomes sketched above thus depends importantly on how intergovernmental fiscal structures – the spending and taxing powers assigned to local governments as well as intergovernmental fiscal transfers -- are designed. Accountability works in part through electoral democracy. If local electors do not like what their local government does, or does not do, they can (try to) throw the rascals out at the next election. If they do not do so, local electors should, in a properly designed system, bear the consequences of their inaction. The freedom to make mistakes, and to bear the consequences of one's mistakes, is an important component of local autonomy in any country. If those who fail to collect local taxes or to spend revenues efficiently are bailed out by discretionary transfers, the rascals may not be thrown out but rather re-elected for their success in obtaining more transfers.

Equalization transfers intended to enable different jurisdictions to respond equally to incentives must be carefully designed to ensure that, at the margin, the costs and benefits of local fiscal decisions are borne locally, while taking inter-jurisdictional spillovers adequately into account (Bird and Smart 2002). Consistent application of these rules with respect to both local revenues and transfers will impose a hard budget constraint on local decision-makers and hence make them fully accountable for the consequences

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4 For example, a tax on property value will, other things being equal, discourage investment in property and hence reduce urban density. Similarly, the differentially higher taxation on non-residential properties found in many countries favours residential over commercial and industrial uses of land.

5 Another study suggests that any economies of scale in the assessment function are more likely to be achieved at the central (state) government level (Sjoquist and Walker 1999).One way to achieve economies of scale while maintaining local assessment is by contracting out the assessment function (Bell 1999).

6 In most Latin American countries, for example, property tax rates are often legislated at the State or Department level but administration is local (Ahmad, Brosio, and Jimenez 2013).

7 In Germany, the federal government is responsible for property tax legislation and the calculation of the property tax and the state governments are responsible for assessing the property and setting the base tax rate to determine the standard tax. Municipalities can apply individual local multipliers to the standard property tax (Färber, Salm, and Hengstwerth 2013).

of their decisions. It is critical that such transfers do not reduce the accountability of local decision-makers for the consequences of their own actions by reducing the cost to them of failing to develop their own tax bases or increase tax rates (Blöchliger and Vammalle 2012). Local decision-makers (and their constituents) are not happy to be subject to such a budget constraint: it is always easier and more pleasant to spend 'other people's money' (Bird and Slack 2013).

This paper explores the disconnect between the economics and the politics of the property tax and considers how property tax reform may nonetheless be not only a good idea but a feasible one. Some problems facing property tax reform are inherent in the nature of the tax such as its salience and the inherent arbitrariness of determining the tax base, while others are more political in nature and similar to those encountered with any tax reform (Brys 2011). We begin with a summary review of the very different recent experiences with property tax reform in five OECD countries -- the United Kingdom, Canada, Ireland, Greece, and Italy. An overview of the role of the property tax in OECD countries is provided in the appendix.

2. Recent OECD Experiences with Property Tax Reform

Renewed interest in the property tax has led a number of countries to undertake major property tax reforms in recent years (Norregaard 2013). Five such reforms in OECD countries, two some years ago and three more recent, highlight some of the issues and problems around reforming the tax.

United Kingdom

Prior to 1990 in the UK, all properties (residential and non-residential) were subject to property taxes (rates) on the occupants.[8] Each property was assessed by a central government agency on the basis of its estimated annual rental value. The last revaluation in England was in 1973. Revaluation from 1973 values to more current values was expected to result in significant (and politically undesirable) shifts among residential property taxpayers. To avoid the anticipated opposition to a reassessment, the residential property tax was replaced in 1990 by a poll tax (community charge) on all adults 18 years of age and over.[9]

However, the unpopularity of the poll tax combined with low collection rates led to its abolition in 1992 and its replacement with the current residential property tax (the council tax). The council tax was more like the previous property tax (domestic rates).[10] The main differences were that the valuation base was changed from annual rental value to capital value and a banding system was introduced. As before, valuations are performed by a central government agency (Valuation Office Agency). Under the banding system, there is no individual valuation. The market value as of April 1, 1991 was determined for each residential property and then the property was assigned to one of eight value bands. Tax rates increase with increasing value bands, making the structure of the tax more progressive.[11] By assigning properties

[8] This section draws in part on Bird and Slack (2004b).

[9] Exemptions were given to people who were severely mentally handicapped, convicted prisoners, people living in homes and hostels, and 18-year old school children. Full-time students in higher education received an 80 percent exemption. Low-income households could qualify for rebates of up to 80 percent.

[10] The present tax is imposed on the occupant of the dwelling and assumes there are two adults in the dwelling. If there is only one adult, the council tax is reduced by 25 percent. The tax is reduced by 50 percent if the dwelling is not the main home of the occupant, if it is vacant, or if it is a second home.

[11] Individual properties may be re-banded only under a few circumstances. If the local area changes for the worse, all homes in the area may be placed into a lower band. If a home is expanded, it will be re-banded only after it is sold; if a home decreases in value because part of it is demolished, it may be re-banded immediately. If the property increases in value because the occupier has carried out improvements, such as an extension, it will be re-banded but again not until it is sold.

to broad categories rather than assigning a taxable value to each property, the council tax attempted to achieve simplicity and stability. This was done at the price of accuracy, however. [12]

Although banding did not freeze residential property taxes in the United Kingdom, it did freeze assessments. Since the council tax used an estimate of market value at a particular point in time (April 1, 1991) and then froze assessments for the foreseeable future, as with any out-of-date assessment system inequities have been increasing. Although frequent revaluations of property and amendments to banding ranges were supposed to keep the base up to date, there has been no revaluation since the tax was introduced in 1993. A revaluation was announced for 2007 (based on 2005 values) but was never implemented, largely because the anticipated shifts were – once again – considered to be politically unpalatable.

The central government took over rate setting for business property taxes (non-domestic rates) in 1990. Taxes are paid into a central pool and distributed to local governments largely on a per capita basis. Unlike the council tax, non-domestic rate revaluations occurred every five years after 1990. However, the 2015 revaluation has been postponed to 2017, perhaps because 2015 is an election year. Although non-domestic rates are now a central government tax in the United Kingdom, since 2009 local authorities have been permitted to levy a supplementary local rate (known as a business rate supplement) in addition to the central tax. Local authorities are required to consult with businesses and provide a detailed prospectus before implementing the supplement. All proposals to impose the supplement and all variations to the original prospectus must be approved by those who are eligible to vote (those who are liable to pay the tax) in a referendum. A national upper limit of 2 per cent of rateable value applies to the supplementary rate. The funds may be spent locally on "economic development" as defined by the central government. [13]

Ontario, Canada

After more than 30 years of commissions, studies, and proposals, a major property tax reform was implemented in Ontario, Canada in 1998. [14] The initial and subsequent assessment operations were major technical undertakings, and the province's ability to launch and maintain the new system provided a major test of the political system. To make matters more confusing, at the same time as it was reforming both assessment and the property tax, the province undertook two other major initiatives that affected local government significantly. First, service responsibilities between the provincial and municipal governments were substantially realigned and the structure of provincial-municipal transfers was significantly changed. Secondly, the province encouraged (to the point of forcing) amalgamations in many municipalities. Between 1996 and 2004, the number of municipalities in Ontario was reduced from over 800 to 445.[15]

The property tax reform had two critical components – market value assessment and variable property tax rates. First, a uniform assessment system based on 'current value' (or market value) was

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[12] See UK Department for Transport, Local Government and the Regions (2000), chapter 5). For a less sanguine view of the new tax, see Giles and Ridge (1995).

[13] The City of London, for example, levies a 2 percent business rate supplement on businesses in the area of the Crossrail with funds going to help pay for the Crossrail (Sandford 2013).

[14] In Canada, local governments are creatures of the provinces. Although the property tax is largely a local tax, most provinces in Canada, including Ontario, also levy a property tax. For a detailed account of property tax reform in Ontario, including all of the twists and turns leading up to the reform and the continuous reform measures subsequent to the initial implementation, see Bird, Slack and Tassonyi. (2012).

[15] In legal terms Canadian provincial governments can, subject of course to political constraints, do more or less whatever they want with respect to their local governments: not only can they change local boundaries, electoral systems, expenditure responsibilities, and revenue and borrowing powers more or less at will, but they have often done so (Tindal and Tindal 2009).

implemented province-wide.[16] Secondly, at the same time, the provincial government established an explicitly 'classified' property tax system. Municipalities, although free in principle to set their own tax rates, were allowed, indeed almost encouraged, to levy different rates on seven different classes of property established by the province: residential, multi-residential, commercial, industrial, pipelines, farms, and managed forests. In addition, municipalities were allowed, if they wished, to adopt several additional optional classes – also as established by the province – such as new multi-residential, office buildings, shopping centers, parking lots, and large industrial properties.[17]

That was not the end of the complexity of the new classification scheme for the property tax. Specific rate reductions were specified in the act for certain sub-classes of property -- vacant commercial (35 percent reduction), vacant industrial (30 per cent reduction), farmland pending development, and, in the City of Toronto, certain theatres. The tax rate on both farms and managed forests is set by provincial legislation at only 25 per cent of the residential tax rate. Finally, both commercial and industrial classes may be divided into three bands according to value, with graduated tax rates applied to each band. Under current law up to 36 separate property classes and sub-classes may have different rates – and this leaves out the banding just mentioned. There is no pretence in Ontario that all real property should be taxed at a uniform rate: this is truly a "classified" property tax!

In the next three years the provincial government introduced seven pieces of legislation affecting local property taxes. It kept on doing so throughout the next decade. Many of the changes were attempts to deal with public concerns by softening the impact of the 1998 system in yet other ways – phase-ins and deferrals, capping tax increases and clawing back decreases on business properties, restrictions on how much tax rates could be increased on business properties, changing the assessment cycle from annual reassessments to every four years with a phase-in, and more.

Much of the public discussion, as is usual in most countries, understandably focused on housing. However, the business community, which had clearly been relatively over-taxed under the old tax system, also ensured that its concerns and interests were heard in provincial political circles. As a result, many of the provincial measures were explicitly intended to reduce the ability of municipalities to tax business more heavily than housing.

Ireland

Ireland abolished the residential property tax in 1978 but kept the local rates on commercial property.[18] It was not until 2012 that it introduced an annual lump sum household charge (EUR 100 per house regardless of size) but only for one year. In July 2013, the annual household charge was replaced by a residential property tax. A half-year property tax applies for 2013 and the property tax will apply on a full-year basis beginning in 2014.

Several aspects of the current reform are worth noting. First, the local residential property tax system uses a banding approach like that in the United Kingdom, with 19 different bands. Since the last assessment of residential properties in Ireland was in 1845, the impact of the new tax would in all likelihood have been unpalatable without the introduction of banding to provide some stability and predictability to taxpayers (McCluskey 2013).

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16 The term current value assessment as used in Ontario should not be confused with the term 'value in current use.' Current value, which is the same as market value, refers to the highest and best use of the property. Value in current use reflects the existing use whether or not it is highest and best.

17 Subsequently, professional sports facilities (in 2000) and resort condominiums (in 2005) were added to this list.

18 The non-residential property tax base had not been updated since 1852 but it is now the subject of rolling revaluations by the Irish Valuation Office (IVO).

Secondly, property values are self-assessed because there are no up to date survey records. Property owners are required to determine the market value of their property (as of May 1, 2013) and choose the correct value band. Values are valid until the end of 2016. Owners have a number of options for determining market value. An online interactive guide provides information on average market values of properties in a given locality and offers an indicative valuation band for properties depending on type of property (detached, semi-detached, apartment, etc.), age (built before or after 2000), and location but does not provide market values for individual properties. If a property has unique features -- for example, it is smaller or larger than the average property in the area or if it is in a worse state of repair -- these differences have to be factored into the assessment. Other options for taxpayers to assess the value of their property include turning to the register of residential property sales based on stamp duty data or to a professional valuer. Revenue (the central government finance department) has the ability to raise the assessment if it believes the assessment does not accurately reflect the market value.[19] Self-assessment of course reduces the budgetary cost of reassessment, although its net effects clearly depend on the extent to which the central government needs resources to verify assessments.

Thirdly, the residential property tax rate is set centrally. For 2014, the tax rate will be 0.18 per cent for properties up to a market value of EUR 1 million. Residential properties over EUR 1 million will be taxed at 0.18 per cent on the first EUR 1 million of value and 0.25 per cent on the portion of the value above EUR 1 million (no banding applies over EUR 1 million). Starting in 2015, local authorities will be able to vary these central rates by plus or minus 15 per cent. All revenues from the tax go to the local authorities.[20]

Fourthly, efforts were made to reduce the salience of the property tax by allowing property taxes to be deducted at source. Property owners have the choice of paying their local property tax in one single payment or having the tax deducted at source from salary or occupational pensions. Employers and pension providers are required to make this option available to employees and pensioners, with deductions to be spread evenly over pay periods and remitted to Revenue. Estimates by Revenue indicate that the compliance rate for 2013 (half-year) for all payment options is 89 per cent.

Finally, the cash flow problem some taxpayers may face may be alleviated by opting to defer, or partially defer, payment of the property tax. Taxpayers who have gross income in a year that is below specified thresholds may be eligible to defer property tax payments until their financial circumstances improve or the property is sold. A higher threshold may apply to taxpayers who took out mortgages at the height of the property boom.[21] Interest at a rate of 4 per cent per annum is charged on deferred amounts (Revenue 2013).

Greece

Greece is currently undertaking a major reform to replace two property taxes that expire after 2013 with a unified property tax to be introduced in 2014. The two property taxes are the real estate based wealth tax (FAP) and the property tax that is collected through the Public Power Corporation (PPC). The FAP tax is based on property right holdings of individuals rather than properties.[22] It relies on self-

[19] If there is a disagreement on value (or whether the property is residential, who is liable for the taxes, etc.) that cannot be resolved, Revenue will issue a formal Notice of Assessment or formal decision or determination. The taxpayer can appeal to the Appeal Commissioners.

[20] An earlier report (the Thornhill Report) recommended that a significant proportion of the revenues (approximately 65 percent) should be assigned to the local authorities in which the taxable properties are situated and the remaining proportion should be distributed by the central government in favour of local authorities with a weaker funding base (Inter-departmental Group, 2012). Such a tax would be not so much a local tax as a national tax distributed by formula.

[21] Deferrals may also be offered under other circumstances. They can be granted to the personal representatives of a deceased liable person where a property has not been transferred or sold within three years of a liable person's death; to a person who has entered into an insolvency arrangement; and to a person who suffers both an unexpected and an unavoidable significant financial loss or expense.

[22] This means that, if two individuals jointly own a property, each individual is assessed on the basis of their ownership share (IMF 2013a).

assessment since there is no property register. The number of taxpayers was estimated to be 170 000 in 2010 and the collection rate was 66.5 per cent (IMF 2013a).

The PPC tax, which was introduced as part of the fiscal reforms resulting from Greece's on-going economic problems, is an area-based property tax levied on the occupants of residential and commercial buildings that are connected to electricity.[23] Collection of the tax is administered by the electricity company and the tax liability appears on electricity bills. Although failure to pay the tax originally resulted in the electrical service being cut off, sanctioning non-payment by shutting off electricity has been deemed unconstitutional (IMF 2013a). Outstanding property tax debts are referred to the Ministry of Finance for collection. The Ministry can garnish wages and pensions and seize and auction properties to pay for outstanding debts. The estimated number of taxpayers at 5.6 million is much larger than with the FAP property tax. Although the collection rate is 85 percent, much higher than for the FAP property tax, the PPC tax is very unpopular (IMF 2013a).

The area-based tax is calculated by multiplying the size of the property in square meters (actually, the size of the lighted area) times a multiplier which decreases with the age of the property times a zone rate which reflects the location of the property (the zone rate ranges from EUR 3 per square meter to EUR 16 per square meter). Each property is placed in a zone that has an official zone rate that reflects the affluence of that zone (Lafakis 2011). There are procedures for correcting the size of the building, the only variable that can be easily challenged.

Exemptions are provided for agricultural and industrial buildings and for unemployed and disabled persons. Families with more than three children under 18 and income below a certain level are eligible to pay a lower rate per square meter (EUR 0.5) under certain conditions (for example, when the property is small and located in a non-affluent area, etc.). Exemptions are also provided for properties owned by charitable organizations, sports clubs, certain religious organizations, and the government.

Greece intends to replace both FAP and PPC property taxes with a single state-level property tax (IMF 2013a). The proposed new property tax will tax properties, not individuals, and will have a broader base that includes residential, commercial, industrial, and agricultural properties. The assessment methodology is expected to be similar to the PPC tax using the zone price of property, size of the building, and an age coefficient. The number of zone bands is to be increased to reflect more accurately the value of the property. Progressivity will be introduced with higher tax rates per square meter in more expensive zones and relief targeted at those facing economic hardship. Finally, the expansion of the tax base to include commercial, industrial, and agricultural properties is expected to reduce the burden on residential properties.

In addition to the obvious political challenges to reforming the property tax, there will also be administrative issues associated with the implementation. For example, achieving good compliance rates given that collection will rely on self-assessment (similar to the FAP property tax), will require significant effort and resources (IMF 2013a).[24] Other implementation tasks include policy design, legal drafting, computer system design, public education and more. It is unclear whether this can all be done by 2014.

Italy

The municipal property tax (*imposta communal sugli immobile*) was first introduced in Italy on a temporary basis in 1992 and was supposedly made permanent in 1993. The tax base included residential,

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23 The new tax measure, "Special Duty on Buildings Powered by Electricity," was legislated by the Greek Parliament in 2011 (Lafakis 2011). If the property is leased, the tenant is liable for the property tax and can deduct it from rent payments.

24 The IMF estimates that 300 additional revenue staff will have to be allocated to property tax collection to ensure a collection rate of 85 percent (IMF 2013a).

commercial, and industrial buildings plus agricultural and residential land (Longobardi 2013). Tax rates were set by municipal governments within the range of 0.4 to 0.7 per cent. Following the 2008 election, the newly elected government excluded primary residences from the tax base and the loss of revenue was compensated by increased grants from the State. The exemption of owner-occupied dwellings lasted until 2011 when, as part of a major package of fiscal reforms, the local property tax was reformed. Interestingly, both the introduction of the property tax in 1992 and the re-introduction in 2011 occurred in the context of a financial crisis (Longobardi 2013). Opposition to property tax reform was overcome in these exceptional circumstances.

In 2012, the Italian Ministry of Finance released a report, the *Delega Fiscale,* which considered reforms to the property tax among other taxes. The *Delega Fiscale* called for an update of cadastral values to reflect market value to achieve equity and to strengthen the use of property taxes in local government finance (Keen et al. 2012). The current taxable values were more than 20 years old with the result that some values had increased sixfold while others had only increased threefold. There are variations in the ratio of assessed to market values within cities and across cities so that the application of a national uniform tax rate would result in shifts among taxpayers and regions. One estimate suggested that a revenue-neutral revaluation would mean that some regions would see increases of 30 to 50 per cent where others would see declines of a similar magnitude (Keen et al. 2012).

Nonetheless, in 2012 Italy introduced the *Imposta Municipale Unica* (IMU), a new property tax that fundamentally reformed and increased property taxes. Property taxes on primary residences were brought back into the tax base and cadastral values were scaled up by 49 per cent overall (Keen et al. 2012).[25] The basic tax rate was set at 0.76 per cent but municipalities were permitted to alter the rate within +/-0.3 percent. The tax rate for primary residences was set at 0.4 per cent but municipalities were allowed to alter the rate within +/- 0.2 per cent. Overall, the new measures resulted in a significant increase in property tax revenue. Because the central government was entitled to half the revenue yield from the standard rate, municipalities had little incentive to reduce the tax rate; primary residences were excluded from this calculation, however (Longobardi 2013).[26]

Almost immediately, moves were made to abolish the tax on primary residences; indeed, doing so was a key plank of the political platform of the then Prime Minister and the alliance between his party and the majority Democratic Party. In May 2013, the Italian government adopted draft laws to freeze the property tax and undertake a full review of the tax by the end of August. Pending a total reform of the tax, IMU payments for 2013 were postponed to September (from June).[27] The Economy Minister said that exempting primary residences from the IMU is not justified in terms of fairness or efficiency while the economy undersecretary claimed that, if the government lasts, IMU payments for September will also be waived but a new tax by a different name would be introduced by December.[28] The new tax, known as the service tax, will be modelled after the British council tax and the French system of a *tax fonciere* and a *taxe d'habitation* (Longobardi 2013). The thrust of the reform is to levy a tax on the occupants of the house, whether they are owners or tenants. As usual with property tax reforms, economics and politics point in different directions and the final chapter on property taxes in Italy has yet to be written.

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[25] The property tax reform was also designed, in part, to compensate for abolishing the personal income tax on imputed incomes from real estate.

[26] The financial law for 2013 modified the tax sharing arrangement so that the State receives half the revenue generated from industrial buildings calculated at the standard tax rate.

[27] Jackson (2013) and "Italian property tax reform study causes trouble," *Tax-News*, August 12, 2013.

[28] "Showdown looms within split government over IMU tax," *Gazzetta Del Sud*, August 12, 2013.

3. Elements of a Property Tax Reform

In each of the case studies above, governments had to deal with various aspects of property tax policy design – determining what is included in the tax base, assessing properties, setting tax rates, and administering the property tax system – although the focus was different in different places. This section discusses each of these elements of property tax reform in a little more detail.[29]

Determining the tax base

The first key design question is what should be taxed.[30] Some properties are exempt in most jurisdictions. For example, property owned and occupied by government is generally exempt from property taxes.[31] Other property types that are often exempt include colleges and universities, churches and cemeteries, public hospitals, charitable institutions, public roads, parks, schools, libraries, foreign embassies, and property owned by international organizations. In some countries, agricultural land and principal residences are also tax exempt.

Exemptions have been criticized on a number of grounds. First, since governments use municipal services like others who occupy space, they should be taxed (Bahl and Linn 1992). Second, since taxed properties face higher costs than exempt properties, economic competition among businesses and between businesses and government is distorted (Kitchen and Vaillancourt 1990). Third, differential tax treatment also affects location decisions, choices about what activities to undertake, and other economic decisions. Fourth, exemptions narrow the tax base and either increase taxes on the remaining taxpayers or reduce the level of local services. 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.[32]

Of course, local governments themselves are often tempted to provide tax incentives to attract businesses to their jurisdiction. The usual argument is that property tax incentives will result in job creation, investment in the local area and increased local output (Brunori 2003). Governments often engage in such tax competition to attract and keep taxpayers who are believed to contribute more in local revenues than they consume in government services. Property taxes, at least at the relatively high level found in the United States, do appear to have a small but significant influence on business location (Bartik 1991), but there is little or no evidence that property tax incentives are an effective strategy to achieve economic growth. Indeed, the extensive US evidence suggests that such incentives often lead to a deterioration of the tax base and lower levels of public services (Kenyon et al. 2012).

Generally, lower taxes are offered to new businesses locating in the municipality at the expense of existing residents. Tax incentives are wasted on firms that would have located there anyway. Tax

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29 Bahl (2009) sets out several logical steps in preparing a property tax reform: (1) do a detailed diagnostic of the current system to understand what is working and what is not as well as to determine clearly the objectives of the reform -- revenue mobilization, fiscal decentralization, land use control, etc.; (2) develop an appropriate tax policy design with respect to choice of tax base, rate structure, exemption policies, etc.; (3) design the administrative reforms needed to implement the tax designed such as coverage, valuation, record keeping and collection; and (4) monitor carefully the success of the reform with such quantitative indicators as collection rate, revenue collections, assessed to market value ratios, etc. This advice seems sound but it is unclear that any country has actually done all this and, as the cases in Section 2 above suggest, politics seems to have dominated most country discussions of property tax reform and largely determined the outcomes.

30 Actually, a first question is whether to tax land or improvements or both. Most OECD countries tax both, although the taxation of land only (site value taxation) scores well in terms of both efficiency and equity despite some problems with the administration of a land-only tax: this issue is not discussed further here but see Bird and Slack (2004a).

31 In some instances governments make payments in lieu of taxes on their properties; such payments are generally negotiated between governments and are often much less than the property taxes would be.

32 In Poland, centrally granted exemptions are a hot political issue. Local governments argue that the central government should compensate them for the loss of revenues and the introduction of new exemptions should require local government consent (Swianiewicz and Lukomska 2013).

incentives may lead not only to unfair competition among businesses but also to corruption. All in all, local governments would seem well advised to stay out of the business of giving away their potential tax base. Certainly, when they choose to do so, they should not be rewarded with increased intergovernmental transfers to compensate for the lack of own-source revenues and poor quality services. Nor should one government (the centre) give away the tax base of another government (municipality).

Assessing properties

Once the tax base is decided upon, the second key question is how to determine it in practice. Two distinct assessment methodologies are commonly used for valuing property: area-based assessment and value-based assessment, with the latter being divided into capital and rental value approaches.[33] A few countries (e.g. Ireland) use some variant of self-assessment. The conventional consensus is that capital (or market) value taxation is best, for several reasons. The benefits from services are more closely reflected in property values than in the size of the property. For example, properties close to transit systems or parks enjoy higher property values. Market value also has the advantage of capturing the value added by neighbourhood amenities that have often been created by government expenditures and policies. Finally, any assessment system that fails to take account of changes in relative values over time will result in inequities.[34] Nevertheless, some countries use area-based systems of taxation because they lack the necessary information, expertise, and resources to determine market values (e.g. Greece) or sometimes, as in the case of Poland, because they consider the market-value approach politically unacceptable.[35] Germany, where property tax reform has been discussed for more than 35 years but never implemented, is currently considering three different reform proposals – market value, area-based, and a combination of the two whereby land would be based on market value and buildings would be area-based (Färber, Salm and Hengstwerth 2013).[36]

Some countries use variants of self-assessment, under which property owners place an assessed value on their own property. In the case of Ireland, for example, taxpayers are required to determine the value of their property and choose the correct value band. Self-assessment is an appealing procedure to countries with little administrative capacity. It does not appear to require expert assessment staff, and it seems to be easy to implement. In general, however, self-assessment seems likely to lead to inaccurate estimates of property values, with a tendency toward under-estimation.[37] Since lower-valued properties are generally less under-estimated than higher-valued properties, this approach tends to produce

[33] Under the rental value (or annual value) approach, property is assessed according to estimated rental value or net rent. In theory, there should be no difference between a tax on market value and a tax on rental value. When a property is put to its highest and best use and is expected to continue to do so, rental value will bear a predictable relationship to market value – the discounted net stream of net rental payments will be approximately equal to market value. This relationship does not always hold, however. Gross rents are often used rather than the economically relevant "net" rents that build in an allowance for maintenance expenditures, insurance costs, and other expenses. Furthermore, most countries tend to assess rental value on the basis of current use (actual rents paid) rather than the highest and best use.

[34] In practice, most countries use a mixture of systems. For example, a country employing market-value assessment may tax single-family residences on the basis of values estimated by what is called the comparable sales method, commercial properties on the basis of values estimated by capitalizing some income stream, industrial properties largely on the basis of their estimated depreciated cost method, and rural properties on the basis of a more or less refined area (value per unit) method. For further discussion of the advantages and disadvantages of different ways of determining the property tax base, see Bird and Slack (2004a) and Norregaard (2013).

[35] An area-based system may gradually be shifted to a market-value based system over a period of years as the housing market develops by weighting the area by indicators of quality and location. For example, a tax based on the number of square meters of a structure could be adjusted to reflect the quality of the unit and its location. For location, each municipality could be divided into zones to reflect different market values. A zone located in a desirable neighbourhood would have a higher factor than a zone located in a less desirable neighbourhood. Over time, zones could be defined more narrowly from entire neighbourhoods to sections of neighbourhoods to individual blocks. Eventually, the narrowing of zones would come close to each zone being virtually an individual house and the unit value system would, at that point, approximate market value (Slack, LaFaver and Shpak 1998). Differentiating tax rates by location of properties as a way to link the value of property and the tax burden under the area-based system in Poland has been supported by the Union of Polish Metropolises but has not been implemented (Swianiewicz and Lukomska 2013).

[36] The current property tax in Germany is based on 1964 assessed values in West Germany and 1935 values in the former East Germany.

[37] It is not difficult to conceive of an 'auction' approach that may overcome this bias and indeed such systems have been frequently suggested and, on a few occasions, actually implemented though seldom with much success: for further discussion, see Bird (1984).

regressive results with taxes being relatively higher on low-valued properties. To minimize the obvious problems of under-statement associated with self-assessment, governments must be prepared to obtain (often costly) expert assessments of individual properties in cases where it believes self-assessment is inaccurate.

Setting the tax rate

Three major issues arise with respect to tax rates. Who sets them? Are they differentiated, and, if so, how? And can taxpayers understand how the rate is applied to particular properties?

Sometimes rates are set by the central government. Sometimes there is some local discretion, within centrally-set limits. Sometimes there is complete local discretion. Even where rates are locally determined, they are often limited by the central government. For a local government to make efficient fiscal decisions, it must weigh the benefits (at the margin) of proposed services against the costs of providing them. If local governments do not finance services themselves, the connection between expenditures and revenues is lost and the choice of services will not be based on an accurate perception of their cost (Bird and Slack 2013).[38] Setting local tax rates places accountability for tax decisions at the local level, and increased accountability may lead to better local services (Hoffman and Gibson 2005) and perhaps even to a sounder development path over time (Sokoloff and Zolt 2006).

Local determination of tax rates is particularly important in countries in which a senior level of government determines the tax base. Local tax rates may have to be set within limits, however, to avoid distortions. A minimum tax rate may be needed to avoid distorting tax competition. Richer local governments may choose to lower tax rates to attract business. With their larger tax bases, they can provide equivalent services at lower rates than poorer competing regions. Even when the resulting location shifts are not allocatively distorting they are generally politically unwelcome. A maximum rate may also be needed to prevent distorting tax exporting, whereby local governments levy higher tax rates on industries in the belief that the ultimate tax burden will be borne by non-residents (Boadway and Kitchen 1999). Such tax exporting severs the connection between payers and beneficiaries and renders decentralized decision-making about taxing and spending inefficient. Political leaders prefer providing services to their constituents without placing the burden of payment on them. When they do so, however, there may be increased demand for more services from those who do not have to pay for them.

Variable tax rates (or other differentiation of property taxes among property classes) may be justified on a number of grounds.[39] For example, the benefits from local public services are different for different property classes. In particular, a case can be made on these grounds for taxing non-residential properties less than residential properties (Kitchen and Slack 1993). Since business capital tends to be more mobile than residential capital, efficiency arguments also lead to the conclusion that business property should be taxed more lightly than residential property. In reality, however, lower rates are most often applied to residential properties, presumably for political reasons.[40] There is little economic rationale for higher taxation of non-residential property. Differentially higher taxation distorts land use decisions and favors residential use over commercial and industrial use (Maurer and Paugam 2000). Special taxation of one factor of production (real property) may also distort productive efficiency by inducing a different choice of factor mix in producing goods and services.[41] However, politics often produces such discrimination: homeowners are much more likely to vote in local elections than tenants and, while the incidence of non-residential taxes is seldom clear, non-resident owners and consumers who may bear some of the burden of

[38] This argument assumes that any externalities of local taxing and spending decisions have been appropriately offset by intergovernmental transfers (Bird and Smart 2002).
[39] Whether property tax rates should be progressive is discussed in Section 4 below.
[40] In Poland, for example, the commercial tax rate is more than 30 times the residential tax rate (Swianiewicz and Lukomska 2013), although property taxes overall are not very large.
[41] For a proposal for a more neutral form of local business taxation, see Bird (2003).

such taxes have no vote (although political contributions and connections may give them some voice in the local political process).

Farm properties are favoured in the property tax system in many countries as part of a more general policy of protecting farmland.[42] Favourable treatment of agricultural land is usually designed to preserve it from conversion to urban use. It may be, however, that basing the property tax on value in current use is not sufficient to preserve farmland because, given the generally low effective tax rates on land, the resulting tax differential is unlikely to be large enough to compensate for the much higher prices that would be paid if the land were converted to urban use (Maurer and Paugam 2000). Favourable treatment of rural land can increase speculation at the urban fringe and increase urban land prices.

Property tax rates may be visible, but can taxpayers understand how the tax rate has been applied to their property? When central governments set local property tax rates, local accountability is clearly reduced. Under this system, however, it is simple to understand why one's tax burden increases since the only possible reason is that the assessed value of one's property has increased. One need not accept this result as either correct – it is, after all, a presumptive assessment, no matter how carefully it may be done – or fair, since it is by no means evident that increases in assessed values correlate tightly with any accepted fairness principle (Sheffrin 2008). Nonetheless, one can understand what is going on.

However, when property tax rates are – as in North America – determined annually by local governments, although in principle the system is more conducive to local accountability to residents, it is much less clear to any taxpayer why his tax bill changes in any year. Suppose, for example, that local government budgets must be balanced, as is usually the case. The additional amount that any locality must raise from property taxation in a particular period is determined not only by changes in local expenditures but also by changes in transfers from other levels of governments and other revenues: it is the residual resulting from this calculation that must be financed by property taxes. The change in that residual divided by the assessment base yields the average property tax rate increase that must be imposed. However, the base itself changes with a market-value assessment system, with some values changing very differently from others. The tax imposed on any particular property in any year thus depends not only on the overall change in the tax demand and in the assessment base but also on the extent to which the change in the valuation of that property is greater or smaller than the average change in assessed values. It is hard to believe that many people can actually figure all this out. This system may be more accountable than one in which tax rates are determined centrally but it is certainly far from transparent.

Running the system

No form of taxation is more dependent on administration than the property tax. How well property taxes are administered affects not only their revenue but also their equity and efficiency. Poor tax administration is an impediment to implementing the property tax. Sometimes, local authorities simply do not have the capacity to administer the tax. Many administrative functions are performed manually rather than being computerized. Sometimes, the revenue base does not include all taxable properties, collection rates are low, and enforcement is almost non-existent. Even countries with relatively good property tax administration often have problems updating values on a regular basis. Recognizing the difficulty of local administration, many countries involve higher-level governments in some aspects of property tax administration, notably assessment. Even then, however, the results may leave much to be desired, since

[42] A common way to favour farm properties is to assess them at the value in current use rather than market value which reflects the highest and best use. This means that the value of a farm is determined by its selling price if it were to continue to be used as a farm. Alternative uses of the farm, or its speculative value, are not considered in the determination of value. Other ways of favouring farm properties include providing exemptions for part or all of the farm property, lowering tax rates on farms, or providing farm tax rebates.

higher-level administrations often have little incentive to respond to the needs of local governments for up-to-date and accurate tax base information.

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. The first step in levying a property tax is to identify the property and to determine the owner (or other person responsible for tax liability). A cadastre is an inventory of all properties with a unique property identification number for each parcel to allow for the tracking of all parcels and linking of assessment, billing, and property transfer records. A good property identification system also requires that information on properties within the jurisdiction is updated and made consistent.

Fair and productive property taxes require a good initial assessment as well as periodic revaluation to reflect changes in value. Indexing (e.g. by the rate of inflation) is not as good as reassessment because property values change at different rates in different neighbourhoods and for different property characteristics. Nonetheless, where financial resources are insufficient to do regular reassessments, indexing (over a three to five year period) that reflects relative price changes among locations and property markets may both ameliorate taxpayers' discomfort with large assessment changes and improve information about market trends for assessment administrators.

Many countries have no provision for regular revaluations of the tax base or have postponed revaluations. As a result, assessed values bear little relationship to market value or annual rental value. Austria, for example, applies cadastral values from 1973 and the United Kingdom from 1991 for residential properties. Belgium uses values from 1975 and Germany from 1964 although both index the values with inflation or a corrective factor. Regular updates occur, however, in the Netherlands (annually), Denmark (biannually) and Sweden every third year (Johannesson-Linden and Gayer 2012).

No matter how well designed and implemented it may be, any property tax system may make mistakes. An essential component of a good system is thus an error-correction mechanism, and one critical element of such a mechanism is to allow taxpayers to appeal their assessment if they think it is wrong. An appeal system is both desirable and necessary: in reality, however, its outcome may sometimes be to reduce equity, simply because appeals are invariably most utilized by better-off taxpayers who both have more to gain and can better afford to pursue legal redress.

Administration of the property tax can be sufficiently costly to be an obstacle to reform (Brys 2011).[43] Property assessment can be particularly expensive. 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. Revaluation is one of the most difficult aspects of property tax reform in terms of resources and administration (McCluskey and Franzsen 2013). The costs associated with regular reassessments include computer software and support, training and availability of in house staff, and training and availability of local contract appraisers (Dornfest 2010). To administer a property tax at the same level of fairness as most other major taxes can be costly (Bird and Slack 2007).[44]

In a number of developing countries, property tax reforms have failed at least in part because the cost associated with administrative improvements was too high relative to the potential yield from the improved property tax (Bahl and Wallace 2008). On the other hand, once a property tax is established, a

[43] For more details on the elements of property tax administration, see Bird and Slack (2004a), Mikesell (2013) and Kelly (2013a).

[44] The administrative costs could be added to the tax bill. In some Canadian provinces, for example, the assessment function is performed by a corporation that represents municipalities in the province. The cost of the assessment function is passed on to municipalities who add this cost onto property tax bills.

survey of industrialized countries found that administrative costs, although somewhat higher than for most major taxes, were on average only1.35 per cent of taxes, ranging from a minimum of 0.13 per cent to a maximum of 3.69 per cent (International Property Tax Institute 2007).

4. Obstacles to Property Tax Reform

Although the property tax is a good tax for local governments for the reasons noted earlier, there are some inherent problems with the tax that make the political economy of reform very difficult. The case studies of reform in Section 2 highlight many of the problems discussed here.

The property tax is a visible tax

Much of the popular resistance to the property tax appears to be based on its visibility. Unlike the income tax, the property tax is not withheld at source. Unlike the sales tax, it is not paid in small amounts with each daily purchase. Instead, the property tax generally has to be paid directly by taxpayers in periodic lump sum payments (except in cases where the mortgage institution includes property taxes in monthly mortgage payments). Property tax liabilities are usually sufficiently large that taxpayers have to save in advance or increase their debt to pay the taxes. The result is that the payment of property taxes is more salient than other taxes (Cabral and Hoxby 2012). Moreover, the property tax finances services which are also very visible, such as roads, garbage collection, and neighbourhood parks. Studies show that residents are more willing to pay for local services when they rate their government and service provision highly (Simonsen and Robbins, 2003). If services are not considered adequate, however, they are more likely to complain about their property taxes.

The salience of the property tax has been shown to be one factor explaining the unpopularity of the tax and the prevalence of property tax revolts in the United States, a country in which property taxes are usually considerably higher than in most OECD countries.[45] Visibility is clearly desirable from a decision-making perspective because it makes taxpayers aware of the costs of local public services. Indeed, voters facing a non-benevolent government may want to keep their taxes more salient even though – or simply because -- they hate salient taxes (Cabral and Hoxby 2012). Public awareness of taxes enhances accountability, which is a good thing from both an economic (hard budget constraint) and political (democratic) perspective. However, visibility makes property taxes more difficult to sell politically and more difficult to increase or reform than other taxes. Perhaps for this reason, Ireland chose to reduce the salience of the property tax by allowing taxpayers the option of having the tax withheld from employment or pension income.

Property taxes can create liquidity problems for some taxpayers

An important aspect of the property tax is that it does not reflect a real cash flow but rather an imputed one that may not necessarily reflect the owner's current situation (Johannesson-Linden and Gayer 2012). The imperfect association between homeowner incomes and property tax liabilities may create problems for some taxpayers such as seniors with little income. It is thus not surprising that the most vocal opponents to property taxes and tax increases are often seniors, many of whom may be asset rich but cash poor.[46] In part, they may simply have more time to voice their opposition. Whatever the reason, older homeowners are a strong political force in opposing the tax and are often rewarded by receiving special tax treatment.

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[45] Cabral and Hoxby (2012) identify variation in the salience of the property tax across time and jurisdiction by using conditionally random variation in tax escrow (a method of paying property taxes that is less visible because it is included in the mortgage payment and not paid separately).

[46] Since seniors are more likely to own their home than others, they are less adversely affected by the fact that the property tax is imposed on the gross value rather than the net (of indebtedness) value.

One way to address cash-flow problems is to provide tax relief to seniors through tax deferral schemes.[47] Property tax deferrals permit the property owner to defer some or all property taxes. The outstanding amount becomes a lien against the property and is payable when the property is transferred. It is a deferral of taxes and not a tax rebate. In some cases, an interest charge (often below the market rate of interest) applies to the deferred taxes.[48] Although the economic arguments for using tax deferral schemes are strong, such schemes are not particularly popular among taxpayers and are thus not popular politically. The take-up rate in those places that offer them is extremely low "largely owing to the strong attachment of the old to their homes and to their desire to leave them unencumbered for their heirs" (Bird and Slack, 1978). Once again the economics of property taxation– deferral solves the problem – and the politics – no it doesn't! -- diverge.

Is the property tax regressive?

Some of the resistance to property tax reform is based on the belief that the tax is regressive. Who pays the property tax, and is it an equitable tax? There are as many answers to these questions as there are views about the property tax. Those who view taxes on residential real property as essentially taxes on housing services tend to think that property taxes are inherently regressive, since housing usually constitutes a relatively larger share of consumption for poorer people. Those who view property taxes as essentially a tax on capital tend to think that such taxes are inherently progressive, since income from capital constitutes a relatively higher share of income for richer people. Those who view the portion of the tax that falls on land as being paid out of economic rent consider it to be inherently equitable to tax 'unearned increments' that often arise from public actions. Those who view property tax as essentially a benefit tax see no more sense in asking if the 'price' of local public services (the property tax) is regressive than in asking if the price charged for anything else is regressive: voluntary exchange (imposing property taxes as generalized user charges for services) does not, in their view, raise any question of incidence.

Although hardly conclusive, the empirical evidence on capitalization on the one hand and 'tax exporting' on the other, at least in the United States and Canada, suggests that there may be something in all of these views.[49] Since almost all quantitative studies purporting to show property tax regressivity reflect the assumption used in allocating property tax revenues across income classes, in the end beliefs concerning the equity or inequity of the property tax depend less on the (unclear) evidence than on what one thinks of the property tax in the first place.

Property taxes may be levied at a flat or graduated rate. In many countries, some graduation is introduced by exempting low-value properties. While there is little case for rate progressivity (Bird and Slack 2004), the progressivity of the tax can be enhanced by measures designed to reduce or eliminate the tax liability on low-income taxpayers (IMF 2013b). For example, the tax could apply only to property values above a certain threshold, such as the homestead exemptions provided in parts of Canada and the United States. Homestead exemptions lower the assessed value of owner-occupied principal residences and can be set at a dollar amount or as a percentage of assessed value. Other design changes such as circuit breakers or property tax credits target assistance to low-income and elderly residents whose taxes exceed a certain percentage of their income (Haveman and Sexton 2008).

47 Another way to address asset-rich and low-income households is to waive or reduce the property tax liability that exceeds a certain percentage of income (Johannesson-Linden and Gayer 2012). The threshold could be based on income only or combined with age or family requirements. For a detailed discussion of this approach, see Bird and Slack (1978).

48 It is not recommended that tax deferrals be expanded to include the non-elderly because the loans would be outstanding for a much longer period of time and it would be necessary to determine eligibility to receive a referral to ensure a reasonable number of beneficiaries. Deferral schemes may be funded by central governments if they wish to compensate local governments for revenues forgone.

49 This literature is reviewed in most textbooks e.g. Bird and Slack (1993).

The property tax is inelastic ... a good or bad thing?

Property tax revenues are relatively inelastic because unless the base or rate is changed revenues do not change. Unlike income or sales taxes, property taxes do not automatically increase with growth. Even if the potential tax base does increase with growth, as with a market-value based tax, property values generally respond more slowly to changes in economic activity than do incomes or sales. This inelasticity is exacerbated because few of the countries that use market value assessment update property values for taxation purposes on an annual basis. In those countries where property taxes are based on the area of the property, the tax responds even more slowly to annual changes in income. In order to maintain property tax revenues in real terms (let alone increase them), it is thus usually necessary to increase the rate of the tax. One result of inelasticity is more accountability because local authorities must increase tax rates and persuade taxpayers that they are justified in doing so.[50] But this good feature is seldom considered desirable by those held accountable.

As times change, perspectives may change. When the economic tide is rising, local governments deplore the inelasticity of the property tax both because it means their revenues do not expand automatically with growth and because they have to face the voters with higher rates simply in order to maintain revenues in real terms. On the other hand, the stability of property tax revenues may be considered a good feature by local governments in times of recession since it provides them with a more stable fiscal base for financing local services than they would otherwise have. At the same time, however, local taxpayers may again be very unhappy because their property taxes do not go down as quickly as their incomes and probably not as quickly as the value of their properties. In the last few years, for example, although property prices have fallen sharply in some OECD countries, property taxes did not fall as quickly and to the same extent.

Property taxes can be volatile for individual taxpayers

Volatility can be a problem for taxpayers when values rise quickly since they are unlikely to do so uniformly (Haveman and Sexton 2008). Even if total local tax revenues remain constant there may be large swings in the distribution of the property tax burden when property values increase rapidly. Shifts in taxes on certain properties (those increasing – or decreasing -- more rapidly than the average for the municipality) are a particular problem when the market impact is not uniform across a jurisdiction (Dornfest 2005). Depending in part on the political importance of the groups affected, the result may be a "property tax revolt." Most such tax revolts have occurred in market value systems in which rapidly rising housing prices led to dramatic increases in property taxes.[51]

Annual reassessments would help to reduce the magnitude of such shifts in taxes. However, a more common reaction has been to delay, sometimes for decades, revaluations (McCluskey and Franzsen 2013). As assessment inequities become more and more entrenched over time, politicians find it more and more difficult to update values and good assessment practices are less and less likely to be followed (Bahl, Martinez-Vazquez, and Youngman 2010).

The property tax is a presumptive tax

One reason taxpayers dislike the property tax may be because they do not agree with or indeed understand the base of the tax. Most taxes are based on flows – income or sales. Although the tax base

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50 Even where assessed values increase, provincial/state legislation in many North American jurisdictions requires municipalities to lower their tax rates so that there is no tax increase arising from an increase in property values. In Ontario, Canada, municipalities can maintain their tax rates in the face of an assessment increase but they have to report it to taxpayers as a tax increase. In some jurisdictions, this measure is known as revenue neutrality; in others as truth in taxation.

51 In response to taxpayer resistance to such tax increases, some jurisdictions, notably in the US, have implemented tax limitations, as discussed further in Section 4 below.

may sometimes be the source of argument between the taxpayer and the tax authority, there is, in principle, a measurable economic activity on the basis of which the tax is levied. Property taxes, on the other hand, are usually based on asset values. Unless the asset subject to tax is sold in an arm's length transaction by a willing buyer to an unrelated willing seller on the precise valuation date specified in the law, someone has to determine the value that serves as the basis on which to assess the tax: the property tax is thus inherently a presumptive tax.

Property tax valuations are thus always arguable (Bird, Slack and Tassonyi 2012), and such arguments are more likely the less people trust government. If there is a 'self-assessment' system owners are likely to undervalue their property. If there is an 'official' (cadastral) assessment system, owners are likely to think that their property is overvalued, at least relative to their neighbour's property. In the end, someone has to determine the tax base for the property tax in a way that is not true for any other significant tax. It is not surprising that the results of this administrative process, no matter how technically solid, are often perceived to be unfair and arbitrary. Taxpayers' perceptions of the fairness of the tax (and how it is implemented) impact the extent to which local governments can raise or reform the tax. If the rate is very low, such problems may not be worth bothering about; but when the rate is raised substantially, people are likely to become much more resistant.

5. Strategies for Property Tax Reform

The reasons for undertaking property tax reform vary over time and across countries.[52] Good reasons for reform include increasing local revenues (and perhaps reducing transfers to local governments), improving local fiscal performance, removing inequities in the tax system so that there is similar treatment of similar properties, reducing administrative and compliance costs by simplifying the tax system, and improving efficiency by reducing the impact of taxes on households and business decisions.

The economic approach to property tax reform emphasizes efficiency. In reality, however "tax policy is the product of political decision making, with economic analysis playing only a minor supporting role" (Holcombe 1998). As a rule, politicians are less concerned with economic efficiency than with equity and public acceptability – concerns that often lead to such structural elements as exemptions, procedural elements such as less frequent assessments, and an array of supposedly transitional limits and constraints on the tax (Giertz 2006).

As noted in Section 1, the disconnect between the (desired) economics of property tax reform and the (necessary) politics of accomplishing such reform is particularly sharp, in part because of the special characteristics of the property tax discussed in Section 3. Like all tax reforms, of course, reforms in property taxes require close attention not only to the substance of the reform but to the process by which taxpayers are induced to accept reform as necessary and even desirable.

The Process of Property Tax Reform: Consultation, Education, and Communication

A well-designed reform is more likely to succeed; but it is not necessarily more likely to be accepted. Tax reform is always as much or more a political exercise as it is a technical one. Someone always loses from tax reform and losers are vocal in their opposition. Nonetheless, reform requires not only sufficient and sustained political will and support to ensure that it is implemented but sufficient political acceptance to ensure that it is sustainable and sustained.

[52] See Bird and Slack (2004a) for a review of property taxes in 25 countries including reform efforts in six of those countries.

For such support to be generated, taxpayers (and local governments) must also accept the reform. Both are more likely to buy into reform if they have been consulted and feel that their issues have been properly heard. Consultation raises awareness of the reform and stakeholders who have participated in the consultation process are less likely to oppose it. Of course, consultation also runs the risk of consolidating opposition to reform: it is not always easy to lead people to the light, especially if they have little trust in their leaders.

As discussed earlier, it is not surprising that property taxes – and especially increases in property taxes – may be perceived to be unfair and arbitrary. Taxpayers' perceptions of how fair the property tax is and how fairly it is implemented affect the extent to which local governments can raise the tax. There is some – though hardly overwhelming -- evidence that people treat local taxes as essentially prices for local services, an outcome which is on the whole to be welcomed. However, for people to respond appropriately to tax prices, they must be aware of those prices. Strengthening the 'Wicksellian link' between local taxes and local expenditures may increase both awareness and support (Bird and Slack 2013).

More and better 'taxpayer education' has often been put forward as a way to increase public understanding and acceptance of rising property tax bills. However, the inherent arbitrariness of even the best assessment procedures when combined with the complex institutional process that lies behind the 'local tax demand' almost guarantees that many taxpayers will not understand -- or trust -- the basis on which property values are assessed or how the tax bills they receive are related to those assessments. A proper communications strategy engaging businesses, unions, special interest groups, academics, and the broader public may help to overcome some of the obstacles to property tax reform (Brys 2011). But communication has to be in a form that taxpayers understand. All too often, there is a striking divergence between the popular (and media) 'frames' for property tax policy and those of the experts, who "speak an obscure and unrecognizable language to each other" and "have forgotten how to communicate and 'frame' the property and land tax issue sensibly" (Pagano and Jacob 2008, pp. 30-31).

One way to overcome both the apparent distrust of what politicians say and the incomprehensibility of what experts say may be to create a credible independent panel outside of the direct influence of the politicians or administration consisting of both those who know the subject (experts) and people who know how to communicate with non-experts to help develop and interpret the reform package to the public (Blöchliger and Vammalle 2012). The public may still not understand exactly what is being proposed, let alone what it might mean for them personally, but they may, perhaps, be more willing to heed the words of respected outsiders than of governments directly implicated in the reform process.

Whatever the approach used, it is essential to ensure that there is not only discussion at the national level of the necessity and desirable characteristics of property tax reform but also considerable discussion at the local level. People do not relate easily to questions about national or even local tax policy. They can relate more to 'how much' more or less changes may mean for them, so to launch and carry through any significant property tax reform, efforts must be made through detailed local discussions to persuade them that the expected changes are fair and reasonable. No 'coalition of the willing' is ever likely to support the proposed property tax reform, but it can be possible, through a combination of substantial consultative discussions – discussions in which the concerns of citizens are taken seriously and responded to appropriately – and careful reform design, along the lines next discussed, to create a sufficiently large group that, even if grudgingly, may accept that some such changes may make sense to make it possible to implement such a reform.

The Substance of Property Tax Reform: Design for Success

Table 1 summarizes six major problems that have arisen in property tax reform exercises around the world, five of which may make reform less attractive to taxpayers and one (inelasticity) that may make it less attractive to local governments. The simplest issue to deal with, and one that any worthwhile reform usually remedies to at least some extent, is to turn the property tax into a somewhat more elastic source of revenue for local governments by ensuring that the tax base captures a fair share of economic growth for the local public sector, for example, by more frequent reassessments, perhaps supplemented by some indexing, and cushioned to some extent by phasing in increases in base over several periods. The remaining issues listed in Table 1, all of which have been discussed to some extent earlier in this paper, are harder to deal with. The table identifies a number of approaches that could be used and, in some cases, have in fact been used to overcome these obstacles to reform. From the perspective of improving property taxation, as Table 1 indicates, some of these approaches are considerably more promising than others.

For example, the salience of the property tax makes it difficult to reform the tax. The best approach to dealing with this problem in terms of transparency and accountability, in addition to approaching the whole process of reform along the lines sketched earlier, is by bundling tax reform with improvements in service delivery since people are happier to pay taxes when they see what they are getting for them. It is probably more feasible to take this approach when tax changes are phased in over several years along with improved services than if abrupt changes are made on the tax side alone. Another possible approach, as illustrated recently in Ireland may be to, in effect, hide some of the impact of the tax by providing withholding mechanisms since people seem to be more willing to pay taxes when they do so incrementally rather than in a lump sum. Doing so reduces transparency but may be necessary to make property tax reform politically palatable. However, some common approaches to 'cushioning' the salience of property tax reform are problematical.

While politically attractive because they take the form of offering immediate relief to some groups, measures such as limiting (capping) increases in the tax rate or (through assessment limits) in the tax base may not only reduce the impact of the reform but also, by perpetuating some of the inequities reforms are intended to reduce, make it even more difficult to reform the tax in the future. Paradoxically, because such measures reduce the elasticity of property tax revenues, they likely increase the pressure for such future reforms. Solutions that end up increasing the size of the underlying problem are not real solutions.

Similarly, liquidity constraints are often cited as an obstacle to property tax reform. Every taxing jurisdiction contains some elderly person on a fixed income who bought a house 50 years ago which is now worth 20 times what she paid for it with the result that she cannot afford to pay increased property taxes. Deferring tax increases until the property is passed to someone else (preferably, though seldom in practice, with interest being charged on deferred payments) is technically the best way to address the cash-flow problem. However, the evidence is that such programs are not very popular.[53] Politicians do not want to look as though they are throwing the elderly out of their homes or even putting a lien on their property to pay the taxes. Property tax reform may be delayed year after year on the grounds that it would be unfair to someone while the unfairness of the unreformed system, which is not so easy to headline in the media, is ignored. Phasing-in changes gradually and providing alternative payment systems may again be of some help in overcoming this problem, as may property tax relief schemes like those next discussed.

[53] Some evidence even suggests that when extended to all income groups, deferrals for seniors are seldom used by low-income persons and sometimes used mostly by better-off people who invest the savings elsewhere.

Table 1: Strategies for Property Tax Reform

Issues and Problems	Promising Approaches	Problematic Approaches
Salience: property tax is more visible than other taxes	Couple tax reform with improvements in local services Phase-in Withhold tax at source and other payment options	Assessment limits Property tax capping
Liquidity constraints: imperfect association between taxpayers' incomes and property taxes, especially for seniors	Tax deferrals for seniors More payment options Phase–in	Assessment limits Property tax capping
Perceived regressivity: taxes higher as a percent of income for low-income taxpayers	Property tax credits Tax deferrals Bundle with other tax reforms Package with expenditure changes Low-income housing exemptions	Banding Classified tax rates Progressive tax rates Assessment limits Property tax capping
Volatility: potentially large swings in taxes for some taxpayers	Annual reassessment Index base Taxpayer education Communication in understandable form Phase-in	Assessment limits Property tax capping
Presumptive tax: tax base is inherently arbitrary	Taxpayer education Consultation Accessible appeal process Phase-in	Self-assessment Classified property tax rates Assessment limits Property tax capping
Inelasticity (a problem for local governments, not for taxpayers): taxes do not increase with growth	Annual reassessments Index base Phase-in	

Another common objection to property tax reform is that it is regressive. Strong statements about the progressivity or regressivity of particular changes in property taxes are often made in the course of reform discussions, but as noted earlier there is little or no firm evidence about the incidence of most reform proposals, let alone their implications for the progressivity of the fiscal system or inequality. This is not surprising because it is inherently conceptually and empirically surprisingly difficult to analyse the effects on the distribution of personal income of a (largely capitalized) tax on a particular form of gross wealth. Almost invariably, quantitative estimates of such effects do little more than illustrate the assumptions made. Nonetheless, experience in a number of countries suggests that many people think that more progressive rates mean more progressive outcomes. Measures such as banding and classified tax rates are also often justified in part on progressivity grounds. Undoubtedly, at least in countries, like many in the OECD where income taxes reach much of the populace, the best way to deal with the progressivity issue – or perhaps better, the perceived regressivity issue – with respect to property taxes is to provide any degree of desired relief through some form of income-related credit against income tax (Bird and Slack 1978). Tax deferrals, like those mentioned above with respect to liquidity, may also have a role to play as may a simple exemption of very low-valued residential properties in some countries.

Annual reassessments would go a long way to addressing inelasticity and volatility in the property tax. Yet, annual reassessments are a rare occurrence around the world. The reasons vary – in some cases, the resources to update assessment on an annual basis are simply unavailable; in others, the political fallout from reminding taxpayers how much their property values have increased each and every year may be too painful. When annual assessment is too costly or difficult, indexing between assessment years may be one way to phase in changes, while phasing in above-average increases may be another. Of course, any time some taxpayers are allowed to pay less than the (unmodified) tax system requires someone else has to pay more in one way or another: there is never a free lunch in tax reform. However, transitory phase-ins, like interim indexing, may make it a bit easier for people to swallow the reform medicine in the first place.

All these arguments also apply to what is perhaps the most striking difference between property taxes and other taxes, namely, the essentially presumptive nature of the tax base. While the consultation and other processes discussed earlier are helpful with respect to any tax reform, they are especially important with respect to an administratively-determined tax like the property tax. Self-assessment is sometimes used to avoid the pain but it works in terms of achieving the objectives of property tax reform only if it is supported by an increasingly strong administrative system which ensures that the estimates are at least roughly in line with those that a proper assessment system would produce. As a rule, at some point such a system should likely replace any interim reliance on self-assessment based valuations.

Transitioning to Success

In all likelihood, no matter how well a reform is ‘marketed,’ the economically ideal current value assessment system with a uniform rate is unlikely to emerge from the process in a pristine state. 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, the costs and benefits of any reform are likely to be unevenly distributed (Blöchliger and Vammalle 2012). There are always winners and losers from tax reform: those who were relatively over-taxed before the reform was implemented will pay less in taxes; those who were relatively under-taxed before the reform will pay more. As behavioural economics implies, 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. Losers tend to have “well-identified stakes and interests which they tend to defend vigorously” (Blöchliger and Vammalle 2012, p. 13). Moreover, people may suspect that any change in tax policy is probably a way for 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.[54] The public perception is that in general 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.

Such problems are not unique to property taxes but they are particularly significant because of the visibility of the tax (Slack 2013). With a visible tax such as the property tax, increasing the tax on some taxpayers (particularly on politically influential residential homeowners) is never easy. 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, owners of office towers or hotels, or seniors) in opposition to reform. Winners, on the other hand, are often not even aware of the potential gains from reform (Blöchliger and Vammalle 2012). The fact that the costs of reform tend to be apparent immediately but most of the benefits emerge only later does not help.

[54] In this context, the timing of the reform may also be important: it is easier to implement a reform when you have budgetary surpluses to compensate the losers from reform (Brys 2011) or when incomes are rising so rapidly that tax increases are hardly noticed. In some cases, however, like those of Greece and Italy discussed in Section 2, neither condition holds so property tax reform starts with two important strikes against it.

Since property tax reform is expected to result in major tax shifts within or among property classes, some form of phase-in mechanism is almost invariably politically necessary to cushion the impact, at least in the short run (Blöchliger and Vammalle 2012). Failure to allow adequately for transitional problems and to cushion burden shifts adequately can be a fatal defect. However, there is an obvious conflict between moving to a fairer system as quickly as possible and lessening the impact on those whose taxes would increase. Existing inequities should not be perpetuated; on the other hand, it is not wise to create undue hardship by moving too fast. Phase-ins are more needed the longer the reform is delayed since shifts are likely to occur and the reactions from those adversely affected are likely to be strong. Phase-in schemes can dampen the tax shifts but they also reduce the fairness that the reform was trying to bring about. [55]

Much evidence across North America shows that assessment limits often look like a quick, attractive 'fix' to the political problems that may arise when there is volatility in market value assessment (Haveman and Sexton 2008). However, assessment limits complicate the administration of the property tax and create confusion among taxpayers because taxes are no longer calculated simply as a tax rate multiplied by the tax base. Moreover, since there is no incentive to review one's assessment volatility arising from assessment errors is unlikely ever to be corrected. Assessment limitations that persist until the time of sale (as in the California case) may distort economic decision-making severely: for example, homeowners have a reduced incentive to move e.g. for a better job because even if they moved to a house of equal value their property taxes would rise.[56] Assessment limits generally help those who are being made wealthier by the market at the expense of those whose property values have not changed.[57] Capping may not only help most those who need it least but even result in increased taxes for some whom it is designed to help. Such measures do not really deal with the perceived problems they are intended to solve and may in some cases actually make them even worse.

The classic example of capping assessments and property taxes was Proposition 13, passed in California in 1978. Under Proposition 13, property tax rates cannot exceed 1 per cent of the property's market value and valuations cannot grow by more than 2 per cent per year unless the property is sold (this provision is known as time-of-sale reassessment). Tax freezes have also been applied in Sweden and Denmark during the latest house price boom (Johannesson-Linden and Gayer 2012). Denmark froze the tax burden on residential properties in 2002. In Sweden, the tax base was frozen in 1997; although it was updated in 2001 the increased tax base was compensated by a decrease in the tax rate. In 2008 Sweden gave up on the property tax, replacing it by a lump sum tax on each residential property (Johannesson-Linden and Gayer 2012).

Tax caps and assessment limits privilege stability as the most important feature of a good local tax over equity, efficiency, administration, and even taxpayer understanding. A better way to address hardships that arise from market value assessment is through such generalized property tax relief measures as property tax credits and deferrals (such as the deferrals recently introduced in Ireland). Another approach sometimes mentioned is to attempt to deal more adequately with liquidity problems arising from property tax increases by creating more payment options for taxpayers such as more frequent

55 As the Ontario, Canada case in Section 2 shows, one consequence of paying inadequate attention to such problems in designing a reform may be successive pieces of legislation to cap residential tax increases and claw back non-residential tax decreases. The end result in this case was largely to re-introduce the inequities in the property tax system that necessitated the reform in the first place.

56 However, it should be noted that one study of the assessment freeze in Muscogee County, Georgia, did not find statistically significant evidence of taxpayers being discouraged from moving (Sjoquist and Pandey 2001).

57 Slack (2010) explored these issues in Ontario by simulating the impact on taxpayers if assessment capping had been introduced in 1980. Specifically, she estimated the impact of a 5 percent cap, a 10 percent cap, and a cap based on the rate of inflation (all of which are imposed until the time of sale) on assessed values for residential properties across the province. The results, which are generally consistent with those found in the US literature, suggest that the change in assessed value arising from capping favors property owners with high incomes and high property values at the expense of owners with lower property values and lower incomes; seniors at the expense of young homeowners; owners of waterfront and recreational properties at the expense of owners of single-family homes; and properties sold a long time ago at the expense of properties that sold more recently.

payments, the use of bank and credit cards, and perhaps even withholding from salary payments at source (as is currently being done in Ireland).

From a political perspective, property tax relief measures of different types have served, in many cases, to make the tax more palatable to the electorate (Oates 2001). At the same time, however, many of these schemes have impaired the effectiveness and efficiency of the system of local government finance. Limitations on property taxes in the US have undermined the role of the property tax in encouraging efficient budgetary decisions and resulted in a decline in local property taxes and an increase in intergovernmental transfers (Oates 2001). Another problem with property tax relief measures is the danger that transitional or remedial measures take on a life of their own and extend beyond the time required for the transition: "once a freeze is imposed, the process of thawing may be too painful to bear" (Youngman 1999, p. 1395).[58]

The basic message is clear: transitional measures have usually proved to be politically necessary when changing property taxes to ameliorate the large shifts in tax burdens that may result. Almost never, however, has sufficient attention been paid to designing and implementing such measures in ways that ensure they will not only be transitory but also not undermine the achievement of the goals of the initial reform.

6. Conclusion

The property tax is not really a simple tax that is easily employed by even the smallest local government. It is a surprisingly complex levy in part because it interacts in so many ways with so many different components of the local and intergovernmental finance systems, in part because its incidence is, to some extent, not understood clearly – although many seem to think the contrary -- and in part because a property tax in the conventionally preferred shape of one imposed at a uniform rate on a current market value base is surprisingly difficult to administer fairly and acceptably. The result of the interplay of these different factors in most countries has been the long-term persistence of many economically undesirable characteristics in the design and administration of property taxes and frequent failures in attempts to reform such taxes, especially when one important aim of such reform is to increase substantially their revenue yield.

Nonetheless, as Kelly (2013b) has recently asserted with respect to developing countries, in most countries there is considerable potential for significantly increasing property taxes and making them better taxes in the course of such reform. To do so, it seems generally essential to link property tax reform to broader reforms in public sector management aimed at improving both public services and governance. One implication of this argument is that it is easier to reform property taxes – a major local tax in many countries – if people can realistically expect to see some improvement in local governance and local service provision as a result (Bird and Slack 2013). The future of local property taxation in any country seems highly dependent on the role that local governments are expected (and able) to play. For example, a local property tax reform accompanied by changes in the transfer system to support and encourage local accountability to local residents for the taxes they pay and the services they receive, as well as perhaps some realignment of functions and finances between levels of government, may be a more promising path to reform than a 'stand-alone' reform effort. On the other hand, a simple attempt to increase property taxes with nothing else changing – pushed, for example, by a central government trying

[58] The current situation with the capping and clawbacks of commercial and industrial properties in Ontario provides an example. It will obviously be politically difficult to return to a straight market value assessment, even if it is a fairer system, after capping assessment-related tax increases for a period of time.

to reduce its budget deficit by off-loading more fiscal responsibility on local governments -- is unlikely to be received with much enthusiasm either by local decision-makers or people in general.[59]

Whether bundled or not, as discussed earlier, property tax reforms could clearly be designed and implemented much more sensibly than appears to have been the case. To do so, however, countries need to recognize clearly both the nature of the task facing would-be reformers and also the complexity of the task they face in attempting to change what is usually a well-established, if seldom very logical, institutional structure inextricably related to very long-lived assets and often deep-rooted social beliefs and norms. Considerably more careful pre-planning than is evident in some reforms seems needed if success is to be achieved. Moreover, since property tax reform is not a one-time effort, close attention needs to be paid to smoothing the rough patches that will inevitably be encountered on the road to successful property tax reform. The road to successful reform may be longer and harder than many seem to think. But the goal can be reached, and most countries can and should do a better job with the property tax than they have to date.

[59] Property tax reform might perhaps also be made more palatable by 'bundling' it with other reforms such as changes in other property-related taxes (e.g. transfers or other levies imposed on local residents and businesses) or perhaps changes in personal transfer systems (such as income tax credits) to offset effects on low-income seniors or other specific taxpayers, although these avenues are not explored further here.

Appendix
THE ROLE OF THE PROPERTY TAX IN OECD COUNTRIES

Although the economic justifications for property taxes at the local level are strong, especially for residential properties, and the property tax is widely used in OECD countries, it is important in only a few countries. Table 1 shows property taxes relative to GDP for selected years from 1965 to 2010. The property tax refers only to recurrent taxes on real property (residential and non-residential) and not to other property-related taxes such as land transfer taxes, stamp duties, charges on developers, and other non-recurrent taxes on property. Property taxes in 2010 yielded 3 per cent or more of GDP only in the United Kingdom, Canada, and the United States and more than 2 per cent only in four other countries (France, Israel, Japan, and New Zealand). In 22 OECD countries, property taxes yielded less than1 per cent of GDP.

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

	1965	1975	1985	1995	2005	2010
Australia	1.4	1.3	1.3	1.3	1.4	1.4
Austria	0.5	0.3	0.3	0.3	0.3	0.2
Belgium	0.0	0.2	0.3	0.4	0.4	1.2
Canada	3.1	2.7	2.6	3.2	2.7	3.1
Chile				0.6	0.6	0.5
Czech Republic				0.2	0.2	0.2
Denmark	1.5	1.5	0.9	1.0	1.1	1.4
Estonia				0.3	0.3	0.4
Finland	0.0	0.0	0.1	0.5	0.5	0.7
France	0.7	1.1	1.5	1.9	2.1	2.5
Germany	0.5	0.4	0.4	0.4	0.5	0.5
Greece	0.0	0.1	0.1	0.2	0.1	0.1
Hungary				0.1	0.3	0.3
Iceland		0.9	0.9	1.3	1.4	1.9
Ireland	3.9	2.2	0.9	0.8	0.7	0.9
Israel				2.3	2.5	2.3
Italy	0.4	0.0	0.0	0.8	0.8	0.6
Japan	0.9	1.21	1.6	2.1	2.0	2.1
Korea		0.4	0.5	0.7	0.6	0.8
Luxembourg	0.4	0.2	0.2	0.1	0.1	0.1
Mexico			0.1	0.2	0.2	0.2
Netherlands	0.3	0.3	0.8	0.8	0.8	0.7
New Zealand	2.1	2.0	2.0	1.7	1.8	2.1
Norway	0.2	0.2	0.2	0.3	0.2	0.3
Poland				1.0	1.3	1.2
Portugal	0.0	0.0	0.0	0.4	0.6	0.6
Slovak Republic				0.6	0.5	0.4
Slovenia				0.4	0.4	0.5
Spain	0.1	0.1	0.6	0.6	0.7	0.9
Sweden	0.0	0.0	0.4	0.8	0.9	0.8
Switzerland	0.1	0.2	0.1	0.1	0.2	0.1
Turkey				0.0	0.2	0.3
United Kingdom	3.4	3.8	3.8	3.0	3.3	3.4
United States	3.4	3.2	2.5	2.8	2.9	3.0

Source: OECD (2012) Revenue Statistics, 1965-2011.

In most countries, property taxes relative to GDP have remained stable for decades. Although over the 1965-2010 period the property tax ratio increased in 11 of the 23 countries for which data are available, it did so as a rule only very slightly apart from France (up from 0.7 per cent in 1965 to 2.5 per cent in 2010) and Japan (up from 0.9 per cent to 2.1 per cent). In contrast, in Ireland, property taxes accounted for almost 4 percent of GDP in 1965 but fell to less than 1 per cent when the residential property tax was abolished in 1978. Over the shorter 1995-2010 period, although the property tax ratio rose slightly in 19 out of 34 OECD countries, the only significant increases were in Belgium (up from 0.4 per cent of GDP to 1.2 percent), followed by Spain, Iceland, and France.

Reliance on the property tax as a source of local government revenue does not depend on whether the country is federal or unitary. For example, property taxes are 0.1 per cent of GDP in Switzerland and over 3 per cent in Canada, both federal countries. More important determinants of the significance of property taxes appear to be the expenditure responsibilities assigned to local governments and the other revenues available to fund them.

Table A.2 shows local expenditures as percentage of GDP and provides a breakdown of local expenditures by category of expenditure in selected OECD countries in 2010. Where local government expenditures account for a fairly high proportion of GDP (for example, in the Nordic countries), property taxes are a small share of GDP (Table 1). In most countries local governments are generally responsible for public order and safety (fire and police protection), local transit and roads (included under economic affairs in Table A.2), environmental protection (including waste and wastewater), housing and community services (including water supply and street lighting), recreation and culture. In some countries they are also responsible for education, health and social protection. There is considerable variation, however, in the extent to which local governments in different countries are responsible for these services. For example, local expenditures on health, education and social protection account for an astounding 88.3 percent of total local expenditures in Denmark, 75.0 per cent in Sweden, 72.9 per cent in Finland and 66.2 per cent in Norway.

Table A.2: Distribution of Local Government Expenditures, Selected OECD Countries, 2010

	Local expenditures as % of GDP	General Public Services	Public Order, Safety, Defence	Economic Affairs	Environment Protection	Housing and Community Amenities	Health	Recreation, Culture and Religion	Education	Social Protection
Austria	8.2	59.0	1.9	11.9	3.9	2.9	19.2	6.6	17.5	19.5
Belgium	7.0	18.8	13.2	10.7	5.0	2.2	0.5	9.1	19.4	21.1
Czech Republic	11.9	12.4	2.0	22.8	8.0	4.3	2.0	8.3	29.1	11.0
Denmark	37.3	4.0	0.3	4.1	0.6	0.4	22.4	2.3	10.7	55.2
Estonia	10.3	8.2	0.3	10.5	3.0	5.1	16.2	9.2	39.4	8.1
Finland	22.6	14.4	1.2	6.1	0.4	0.9	29.4	3.9	18.7	24.8
France	11.8	17.0	3.1	13.3	8.4	14.7	0.7	9.8	15.3	17.7
Germany	7.9	18.0	3.2	13.9	5.1	4.3	1.8	6.6	14.5	32.7
Greece	2.8	45.3	0.8	15.9	16.5	4.1	0.0	3.8	1.5	12.1
Hungary	12.7	17.4	1.7	10.1	3.5	4.4	14.9	6.1	29.3	12.6
Iceland	13.4	11.7	1.0	7.2	2.2	2.3	0.7	18.6	36.4	19.8
Ireland	6.5	3.3	2.8	25.0	12.7	15.4	0.0	5.2	22.7	12.9
Israel	6.1	16.9	2.8	6.4	8.5	2.8	0.4	11.8	32.9	17.4
Italy	15.9	13.7	1.5	14.0	4.9	3.8	46.6	2.8	7.6	5.2
Korea	13.0	17.1	2.1	18.9	4.7	7.3	4.1	4.2	29.3	12.2
Luxembourg	5.3	25.1	1.7	16.1	12.9	7.8	0.3	13.0	17.0	6.2
Netherlands	17.2	7.9	6.8	18.1	9.5	3.5	1.6	9.0	28.3	15.2
Norway	15.2	9.8	1.1	9.2	3.8	4.3	13.4	5.6	26.0	26.8
Poland	15.1	9.5	2.0	18.5	4.1	5.3	14.6	7.4	26.2	12.4
Portugal	7.2	29.6	0.9	24.2	7.2	7.5	4.9	8.9	10.5	6.3
Slovak Republic	7.3	15.5	1.3	14.3	6.6	9.4	0.3	6.9	38.8	6.8
Slovenia	10.3	9.8	1.5	12.8	4.1	4.6	10.3	11.9	35.1	9.8
Spain	7.3	31.6	7.1	20.0	9.5	5.2	1.4	13.0	3.6	8.6
Sweden	25.1	11.1	0.9	6.1	0.8	2.6	27.3	3.6	21.2	26.5
Switzerland	7.5	17.0	6.1	14.6	6.3	2.1	3.4	6.9	25.6	18.0
United Kingdom	14.0	5.7	9.7	8.7	4.1	5.4	0.0	3.7	32.8	29.9

Note: Police and fire protection services are included in public order and safety; transportation is included in economic affairs; waste and waste water management are included in environmental protection; housing, water supply, and street lighting are included in housing and community services includes; public health and hospitals are included in health.

Source: OECD (2011) “General Government Accounts: Government expenditure by function,” *OECD National Accounts Statistics* (database)

As Table A.3 shows, although local governments in all 34 OECD countries levy property taxes, such taxes account for more than 10 per cent of local taxes in only 27 countries, and are the most important local tax source in only 12 countries.[60] On the other hand, the property tax accounts for over 90 per cent of local taxes in Canada, Israel, and New Zealand and is the only local tax levied in Australia, Ireland, and the United Kingdom. Income taxes are the largest source of local tax revenues in 14 countries and in 12 such countries account for over half of local taxes. In these countries, in which local governments usually have significant responsibility for redistributive services such as social assistance and social housing, dependence on the property tax is relatively low. The property tax, it seems, is generally used to pay more for "property-related" services than for "people-related" services. Finally, taxes on goods and services are the most important local tax in six countries, accounting for almost 50 per cent or more local revenues in six countries (not the same six) – 80 per cent in Hungary – and over 10 per cent of local taxes in 16 countries. Table A.3 also shows that where the property tax represents a significant percentage of total taxes, local taxes overall generally account for a relatively small percentage of local expenditures (e.g. Ireland and the United Kingdom), with most expenditures financed from such sources as grants and user fees.

Table A.3: Distribution of Local Taxes, OECD Countries, 2010 (%)

	Income*	Goods and services	Property	Other**	Local taxes as % of local expenditures
Australia	0.0	0.0	100.0	0.0	n.a.
Austria	61.4	9.9	15.4	13.3	59.0
Belgium	36.7	9.9	53.2	0.3	31.9
Canada	0.0	2.0	91.2	6.8	n.a.
Chile	0.0	59.7	40.3	0.0	n.a.
Czech Republic	0.0	48.5	51.5	0.0	39.7
Denmark	89.0	0.1	10.8	0.1	34.1
Estonia	89.6	2.6	7.8	0.0	45.5
Finland	93.6	0.0	6.3	0.1	45.7
France	8.4	25.3	53.8	12.5	39.0
Germany	78.1	6.0	15.8	0.1	36.0
Greece	0.0	21.4	24.0	54.7	11.9
Hungary	0.2	80.0	14.2	5.6	19.3
Iceland	77.4	2.0	20.6	0.0	67.1
Ireland	0.0	0.0	100.0	0.0	13.5
Israel	0.0	4.8	95.2	0.0	39.9
Italy	25.0	32.9	9.4	32.7	41.4
Japan	48.6	19.4	29.8	2.2	n.a.
Korea	16.8	26.7	16.3	40.1	n.a.
Luxembourg	92.2	1.4	4.4	2.0	31.1
Mexico	0.3	1.7	59.3	38.7	n.a.
Netherlands	0.0	50.0	47.6	2.3	8.6
New Zealand	0.0	8.7	91.3	0.0	n.a.
Norway	88.5	1.4	4.8	5.3	38.3
Poland	58.2	8.3	29.1	4.4	26.8
Portugal	34.6	26.4	33.9	5.2	24.6
Slovak Republic	0.0	49.2	50.8	0.0	11.4
Slovenia	78.5	6.5	11.9	3.2	40.3
Spain	20.6	39.2	29.6	10.6	41.9
Sweden	97.4	0.0	2.6	0.0	64.1
Switzerland	84.3	1.3	1.4	13.1	58.5
Turkey	24.5	49.8	11.1	14.5	n.a.
United Kingdom	0.0	0.0	100.0	0.0	12.6
United States	5.2	21.4	73.4	0.1	n.a.

* Includes income and payroll taxes
** Includes social security contributions, other property-related taxes, and other taxes.
Source: OECD (2012) *Revenue Statistics, 1965-2011*; OECD (2011) "General Government Accounts: Government expenditure by function," *OECD National Accounts Statistics* (database);

[60] It should be recalled that "local" taxes, as defined in OECD data, may in some countries include substantial revenues from taxes that are largely or entirely controlled by the central (or regional) government. Inter-country comparisons must be made with care, as discussed, for example, in Blöchinger and Rabeona (2013)

Table A.4 shows the extent to which the property tax is shared between levels of government. In most federal countries (the exceptions being Germany and Spain), at least some state or regional governments levy property taxes. In Australia, for example, the state governments levy almost 40 per cent of total property tax revenues. In most unitary countries, the central government does not levy a property tax but there are exceptions. In the United Kingdom, for example, local governments levy residential property taxes (the council tax) but the central government levies the non-residential property tax (non-domestic rates) on a uniform basis across the country. Central governments in Korea, Norway, and Sweden also levy a significant portion of property taxes although property taxes overall are not very large in those countries.

Table A.4: Distribution of Local Taxes by Level of Government,
OECD Countries, 2010
(%)

	Central	State/ Regional	Local
Australia*	0.0	37.4	62.6
Austria*	4.8	5.9	89.3
Belgium*	0.8	3.3	96.0
Canada*	0.0	7.8	92.2
Chile	1.6	..	98.4
Czech Republic	0.1	..	99.9
Denmark	0.0	..	100.0
Estonia	0.0	..	100.0
Finland	0.0	..	100.0
France	0.1	..	99.9
Germany*	0.0	0.0	100.0
Greece	0.0	..	100.0
Hungary	0.0	..	100.0
Iceland	0.5	..	99.5
Ireland	0.0	..	100.0
Israel	0.3	..	99.7
Italy	0.0	..	100.0
Japan	0.0	..	100.0
Korea	13.3	..	86.7
Luxembourg	0.0	..	100.0
Mexico*	0.0	33.1	66.9
Netherlands	0.0	..	100.0
New Zealand	0.0	..	100.0
Norway	16.2	..	83.8
Poland	0.0	..	100.0
Portugal	0.0	..	100.0
Slovak Republic	0.0	..	100.0
Slovenia	0.0	..	100.0
Spain*	0.0	0.0	100.0
Sweden	46.6	..	53.4
Switzerland*	0.0	29.5	70.5
Turkey	0.0	..	100.0
United Kingdom	48.0	..	52.0
United States*	0.0	3.3	96.7

* Federal countries
Source: OECD (2012) Revenue Statistics, 1965-2011

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