

Executive summary

This report looks at crucial elements of reforms to growth-friendly recurrent taxes on immovable property. Tax design practices in place in OECD and partner countries are compared and analysed through the lenses of economic theory and empirical analysis. Challenges and practices related to the administration of property taxes are explored as well as their interplay with different tax designs. In addition, the main political and administrative hurdles in approving and implementing property tax reforms are discussed, and the approaches commonly employed to successfully deal with them are examined.

With regard to tax design, a widely adopted and growth friendly tax design involves the use of a value-based property tax with a wide tax base and low tax rate. Typically, member and partner countries tax both land and buildings used for multiple purposes such as residential, industrial and commercial. Wide tax bases allow governments to increase tax revenues while minimising allocative distortions. Tax rates applied by different jurisdictions to these different types of property normally differ but within limits, so taxpayers have little incentives to change the use of land or to move to other jurisdictions solely on tax purposes, minimising distortions and tax avoidance.

The design of property taxes can be set so as to achieve a myriad of policy objectives such as preservation of agricultural land, promotion of business, urban development and reduction in urban sprawl. Usually these objectives are pursued by applying different tax rates across property types/uses/taxable items and by granting tax benefits to specific types of properties. Evidence shows that although these measures can achieve the desired policy objectives, they are better viewed in the context of other policy instruments that usually have a stronger impact on land use such as zoning and transport policies.

The administration of recurrent taxes on immovable property involves the following main activities: fiscal cadastre maintenance, valuation of properties, management of an appeal system, billing, revenue collection and enforcement. A poorly managed property tax system not only shrinks tax revenues but also creates asymmetries in tax obligations that do not reflect design features, treating taxpayers unfairly. Sense of fairness is a driver of tax-revolts, which in many circumstances have undermined property tax reforms and in extreme cases have led to the discontinuation of the levy.

In that light, fiscal cadastres with a higher property coverage increase tax revenues and are crucial to the fairness of the system. They often also have important roles outside the scope of property taxation, such as in urban planning, environment protection, mortgage finances and transportation, housing, recreational and social policies. Therefore, up-front investments to develop fiscal cadastres and keep them updated and accurate are usually worthwhile. In case cadastres are managed by subnational governments (SNGs) that lack capacity, upper levels of government can step in and provide technical and/or financial support.

Property valuation usually is the costlier activity in the administration of recurrent taxes on immovable property and also tends to be the activity that causes more administrative issues. Countries examined commonly use value-based tax bases that require frequent property assessments to properly keep up with the changes in the housing market, since other means of estimating tax bases, such as self-reports and indexation, although useful, can create distortions in the long term if used alone.

Despite this need of frequent property revaluation, value-based tax bases offer unique advantages that more than compensate for these costs. More specifically, they tend to be more progressive, raise more revenues in the long term without resorting to changes in statutory tax rates, have a greater impact on the volatility of house prices, are more growth-friendly, among others. In addition, if there is sales data available, which usually is the case for small properties such as for small offices, retail and most residential properties, properties' values can be assessed by the sales comparison approach. This can be especially relevant since sales comparison can be done in an automated manner through the employment of a computer assisted mass appraisal (CAMA) system, drastically reducing the costs of property reassessments. When SNGs are responsible for these assessments, upper levels of government commonly define guidelines and oversee the process, so properties' values are consistent across jurisdictions.

The billing process is especially important to raise taxpayers' compliance. Countries carefully choose bills' content. Multiple studies have found that a significant increase in tax compliance can be achieved through the disclosure of some type of information such as the compliance rate, a clear explanation of the tax system and a list of public goods that are funded with the tax and sanctions. In addition, allowing payments in multiple instalments also tends to increase compliance as it reduces taxpayers' liquidity issues.

Even in case tax design and administration were satisfactorily planned to meet a reform's goal, a reform can be blocked politically and, thus, failing to have the desired effects. Key factors that can undermine a reform's implementation are their distributional consequences, the impact on the revenue of multiple levels of government, the unpopularity of the tax, transitional costs and timing. In order to deal with these issues, countries by and large bundle recurrent property taxation reforms with the reform of other taxes and/or reforms in fiscal federalism, phase in the reform's impact so that abrupt effects are alleviated, and they put forward reforms in moments that future taxpayers are more willing to support the reform.

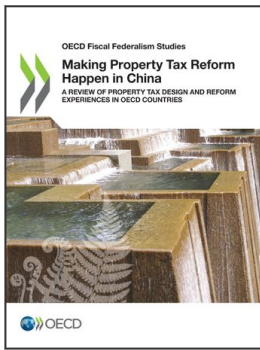
There usually are gains in discussing tax reforms taking into account the broader fiscal context. The impact of the reform of a specific tax interacts with the current state of the fiscal system and, hence, discussions of a tax in isolation can be misleading. In addition, seldom can a reform of one tax achieve different policy goals without creating fierce resistance. For instance, recurrent taxes on immovable property tend to be the most growth friendly tax and especially useful to boost subnational autonomy, nevertheless there are other more progressive taxes such as income, wealth and inheritance taxes. As a result, if one of the goals of the reform is to improve the distribution of income, bundling a reform on recurrent property taxation with reforms in income, wealth, inheritance tax or even with cash transfer programmes, can be particularly interesting to achieve multiple policy objectives. For revenue-neutral reforms, the most common case is to bundle a recurrent taxation reform with a reduction in transaction taxes, which are considered to be highly distortive, leading to an overall more growth-friendly tax system.

As recurrent property taxation has a prominent role in funding subnational governments, recurrent property tax reforms are often bundled with inter-governmental fiscal relations reforms to alleviate problems related to the distribution of revenue across and within levels of government. More specifically, reforms of these taxes may exacerbate regional inequalities since richer SNGs are more likely to succeed in the implementation of a well-functioning property tax administration structure and may also benefit more from higher property values. These problems are commonly mitigated by reforming the equalisation system to take into consideration regional differences in revenue-raising capacity and through the use of central or provincial support for introducing the tax. The support can be provided in the form of, among others, capacity development programmes and/or financial incentives that reward efforts to introduce the property tax.

So as to alleviate abrupt effects of the tax reform, countries implement tax reforms gradually. Abrupt changes in tax obligations can lead to undesired changes in resource allocation and public resistance, both of which should be minimised. A more gradual introduction of the tax, starting with low and increasing rates, tied to improvements of visible public services or to income transfer programmes might reduce the

resistance to the reform, as payments are linked to benefits received, and provide the necessary time so homeowners and investors have time to adjust to their investment portfolios. Sunset clauses can be used to cease transitional measures at specific dates without further legislative action, increasing the likelihood of the full implementation of the planned reform.

Lastly, regarding timing, economic upswings and booming housing markets tend to create windows of opportunity for putting forward property tax reforms. First, a better fiscal instance as a result of the good economic moment, makes it easier for governments to financially support the introduction of the tax and to compensate losers. Second, evidence points to a small but significant effect of these taxes on reducing housing prices. Hence, tax increases during a slowdown might destabilise the market, whereas tax increases during upswings might act counter-cyclically, stabilising prices. Proper timing can be especially important to raise awareness of the necessity of the tax and, thus, gather public support.



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