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# Property Taxes from the Ground Up

Enid Slack<sup>1</sup> and Joan Youngman<sup>2</sup>

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## Abstract

This paper begins with the basic "big picture," focusing on the benefits the property tax offers as a tool for fiscal decentralization. We then look at property taxes "from the ground up" to determine what is needed to make the tax succeed today – the right tax base, workable valuation methods, the right tax rate, appropriate tax relief, and adequate responses to real-life challenges. We end with a discussion of how a well-functioning property tax can also serve other purposes besides supplying revenue for local governments – as a value-capture instrument, as a form of wealth taxation, and as a way to reduce pressure on land transfer taxes.

**Keywords:** decentralization, property taxation, local governments

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## **Introduction**

In 2016, the OECD released a report on Fiscal Federalism, subtitled “Making Decentralisation Work.” The introduction to its chapter on the property tax noted, “[R]ecently, policy makers have again become enthusiastic about this oldest of taxes and immovable property taxation has returned to the fore” (OECD 2016, p. 63). This renewed interest reflects the core strengths of property tax as an independent source of local government revenue – beginning with its very nature, immobility. While few jurisdictions are large enough to avoid tax competition for mobile revenue sources, a fixed tax base has special benefits for subnational governments. Of course, these core strengths are accompanied by significant complexities that challenge policy makers in *Making the Property Tax Work* (Bahl et al. 2008) – where Jorge has made great contributions, as he has to all aspects of the property tax and specifically its potential role in decentralization.

Jorge has always brought his unique creative focus to these issues. In reviewing the property tax as a tool for decentralization, we hope to honor Jorge’s interest in *Challenging the Conventional Wisdom* (Bahl et al. 2010) (another major topic for Jorge) by suggesting where these issues might be appropriate for a new perspective. We do this by posing several queries throughout the paper.

We begin with the basic “big picture,” focusing on the benefits the property tax offers as a tool for fiscal decentralization. We then look at property taxes “from the ground up” to determine what is needed to make the tax succeed today – the right tax base, workable valuation methods, the right tax rate, appropriate tax relief, and adequate responses to real-life challenges. We end with a discussion of how a well-functioning property tax can also serve other purposes besides supplying revenue for local governments -- as a value-capture instrument, as a form of wealth taxation, and as a way to reduce pressure on land transfer taxes.

### **1. Basic Overview**

It has been well established in the literature by Jorge and others that, for fiscal decentralization to be truly effective, local governments need an independent revenue source that is responsive to local needs and preferences (Bahl and Martinez-Vazquez 2022). Although there are grounds for intergovernmental transfers -- where the activities of local government result in externalities, for example -- local governments will be more efficient if they are responsible for raising their own revenues to pay for local public services rather than receiving transfers from national or state governments.

The property tax is an appropriate and important source of revenue for local governments because it meets many of the characteristics of a good local tax (Bird and Slack 2004; Youngman 2016; Bahl and Martinez-Vazquez 2022). Property taxes are visible, and therefore, more likely to make local governments accountable for the services they deliver.

However, it is important to recognize that, as in many other areas, there exist lively technical disputes about various aspects of the tax among experts. In the view of many, the property tax

can meet the benefit principle of taxation, with many of the services typically funded at the local level—such as roads and sidewalks, parks, and transit—reflected to a great extent in property values (Martinez-Vazquez 2015). An alternate view expertly presented by Professors Fox and Zodrow in this volume considers the property tax to be a distortionary tax on capital (Zodrow 2023). A distortionary tax would undermine the efficiency benefits associated with the tax, and affect the allocation of resources in the larger economy. Ironically, the capital-tax view also finds the tax to be progressive.

Similarly, consideration of the immovable nature of the property tax, which reduces opportunities for concealment and evasion, must distinguish land from buildings. Land is inherently immovable, but buildings may occasionally be physically moved, and more often removed by lack of maintenance or outright demolition. The property tax often extends to movable property that is subject to registration, such as automobiles and boats. In the past, machinery and equipment was often included in the tax base, but in the United States in recent years there has been widespread exemption for business personal property.

The property tax does not fluctuate with the larger economy as rapidly as sales or income taxes, which has drawbacks and benefits. This can mean that collections rise more slowly than other taxes in a time of economic growth, but it also helps to balance revenue in downturns. The property tax can be the most stable local revenue source (Anderson and Shimul 2018), which is especially important for local governments in recessions and economic downturns, because at those times higher levels of government are most likely to curtail local aid. This has led scholars to conclude that reliance on the property tax “is likely to – and should—continue in at least some form for the immediate future” (Alm, Buschman, and Sjoquist 2011, p. 320).

To be a good local tax, however, the property tax needs to meet some basic requirements. Ideally, the property tax base would be as broad as possible, with limited exemptions and limited use of property tax incentives to attract business. Assessments would be based on market value and updated annually. Tax limitations (such as property tax capping and assessment limits) to address increases arising from a reassessment would be avoided. Taxpayers would have the ability to appeal their assessments if they thought they were unfair. Property tax collection would be enforced, and the administration would be cost effective.

On the ground, however, the property tax often deviates from the ideal. And it deviates in different ways in different parts of the world. Although a property tax is levied in most countries, a comparison of its application in developed and developing countries highlights some major differences. Perhaps the starkest difference is in the amount of revenue collected. In OECD countries, for example, property taxes account for about 1.1 percent of GDP and range as high as 3 percent in countries such as Canada, the United Kingdom, and the United States (Slack 2022). In less developed countries, property taxes generally account for much less than 1 percent of GDP and are as low as 0.26 percent of GDP in Africa (Bahl, Li, and Youngman 2024).

The issues are also different in different countries. Not surprisingly, in less developed countries, the goal of property tax reform is often simply to increase tax revenues. Although the reasons for low tax collection vary, they mainly stem from the administration of the tax and lack of capacity with respect to cadasters, valuation, collection, and enforcement. In developed countries, issues more often concern the estimate of market value and timing of updates, differential tax rates on different types of properties, property tax incentives, and property tax relief mechanisms. One thing that is common in all countries, however, is the unpopularity of the tax. No one wants to pay property taxes and those who do pay them do not ever want to see them increased. This is the other side to the transparency and accountability of a highly visible tax.

To make the property tax work in practice and come closer to the ideal tax for local governments, there are many policy and implementation challenges to address. Indeed, some authors have argued that these challenges explain, in part, why central governments are willing to leave this “difficult” tax to local governments (Bahl and Martinez-Vazquez, 2007; Martinez-Vazquez and Sepulveda 2011). When considering the right approach to property taxes for developing and developed countries, it becomes clear that there is no “one size fits all” approach. What works depends very much on the context and history of each property tax system.

## **2. The Right Tax Base**

The right tax base is key to a successful property tax. It determines the economic impact of the tax, both in terms of its effect on the efficiency of the wider economy and the equitable distribution of the tax burden.

A property tax may reach many different types of property: real property, personal property, tangible property, intangible property, and within the realm of real property it may include land, buildings, or land and buildings together. If land and buildings are both subject to the tax, they can either be combined as one tax base or be subject to separate rates under a “graded” tax.

### *Movable and Immovable Property: Tangibles and Intangibles*

For purposes of decentralization, a tax limited to real property has many advantages for local governments, as discussed earlier. Most significantly, the fixed location of immovable property permits stable tax registers that are not possible for intangible financial instruments and difficult even for tangible moveable property.<sup>1</sup> The difficulty of taxing financial instruments has been a major reason for limiting the property tax to immovable property, with an income tax on investment earnings taking the place of a property tax. This is also one reason for the decline of wealth taxes even in countries committed to redistributive policies.<sup>2</sup>

One intriguing aspect to taxation of intangible property concerns its influence on the taxable value of land and buildings. An operating permit may be essential for productive use of a power

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<sup>1</sup> The exception for vehicles requiring local registration rarely supplies significant revenues.

<sup>2</sup> Section 7 suggests how the property tax can serve as a form of wealth tax.

plant while, conversely, a requirement for abatement of environmental damage may greatly reduce its market value. Courts have reached differing conclusions as to the impact of these elements. In the extreme case, early settlers in the western United States sometimes refused to take title to their land in the hope of avoiding taxation, but courts found their property taxable, nonetheless.

### *Land and Buildings*

The case for a special tax on land value draws on concern for both equity and efficiency. The equity perspective considers that the value of unimproved land does not represent the owner's productive effort, but rather the social development that produces demand. Efficiency is best served by a tax that minimizes the deadweight loss associated with changes in taxpayer behavior to avoid tax liability.

**Query: Can we identify an unearned increment?** Both considerations (equity and efficiency) are compelling, but each has limitations. The social claim to "unimproved land value" shares some of the complexities faced by attempts to impose special taxes on "unearned income." An owner whose family has held bare land in a state of nature for years or decades may fit this model, but an owner who has recently purchased a plot of land with the savings from many years of productive labor will certainly object to any special tax on this value.

Similarly, the characterization of speculative landholdings must be approached with care. Family farms, treated with great respect for tax purposes around the world, can combine working assets and speculative investments, when farmers rightly consider their land value to be their savings for retirement. If the term "speculation" denotes the holding of an asset in expectation of its increase in value, that may define the farmer, the homeowner, and the builder.

Taiwan is the country most closely associated with taxation of unearned increments, and its constitutional provisions reflect the influence of Sun Yat-sen and Henry George. Its split-rate property tax was designed to raise significant revenue and promote land reform. The challenges to this approach can be seen in current evaluations that conclude, "In practice, many of those innovations do not seem to meet their original promise" (Lin and Wu 2022). The land value increment tax was intended to reach unearned increments, but the ease with which this could be avoided led to a new capital gains tax in 2016. Because the land value increment tax is a constitutional measure and correspondingly difficult to alter, it is deducted in the calculation of the new capital gains tax.

**Query: Is a land tax neutral or does it provide an incentive for development?** As the example of Taiwan shows, land taxes are often considered an instrument to encourage the productive use of land, and specifically the more intensive use of high-value land. This is a particularly interesting issue, and perhaps one in which behavioral economics may offer insights.

Use of a land tax to encourage development assumes that a landowner who has not made the most productive use of property will be motivated to increase its yield when faced with the need

to pay an annual tax on its value. For example, Estonia instituted its land value tax when restitution after the fall of communism restored properties to their pre-1939 owners (Tiits 2008). These owners or their heirs might be living far from those properties, or even in other countries, and the tax was intended to encourage the use or sale of the land.

Many economists would challenge the assumption that imposition of a land-value tax could lead to a change in the use of the land, because whatever was the most profitable use of the land before the tax will remain its most profitable use after that the tax is imposed. The neutrality of a land tax is considered one of its most important features. If an owner cannot take any action to change the value of unimproved land, the economy will not struggle under the “deadweight” welfare loss caused by legal tax avoidance – the most dramatic example being the window tax imposed for more than a century in Britain, and into the twentieth century in the Netherlands (Oates and Schwab 2015). The damage to public health and aesthetics caused by bricked-up or boarded-over “blind” windows can be seen in historic structures today.

Given that the neutrality of the tax is an important benefit, this neutrality should also mean that taxpayers cannot take action to avoid the tax, even if that action (such as productive use of the land) is in society’s interest. “[A]s long as land is properly assessed for tax purposes according to its ‘highest and best use,’ land value taxation is neutral in a temporal setting—that is, the time at which it is most profitable to develop a parcel of vacant land does not depend on whether it is subject to a tax on land value” (Oates and Schwab 2009, p. 60).

It is possible that many owners fall short of complete economic rationality and do in fact respond to the signal of a tax bill by altering the land use to produce a cash flow with which to pay the tax. This could also be a rational response to lack of access to mortgage markets or other means of converting some portion of an illiquid investment to cash. But the benefit of a truly neutral land tax extends beyond these special cases. Wallace Oates and Robert Schwab, who argued convincingly against the ability of a land tax to encourage development, nonetheless found that Pittsburgh’s land value tax played an important role in the city’s economic resurgence. “The contribution of land-value taxation is to be understood not in terms of any direct stimulus to development, for there is likely to be little or none if the tax is basically neutral. Rather, land-value taxation provides city officials with a tax instrument that generates revenues but has no damaging side effects on the urban economy. In this way, it allows the city to avoid reliance on other taxes that can undermine urban development” (Oates and Schwab 1997, pp. 18-19).

**Query: Can land value be calculated for an improved parcel?** As a decentralization tool, a pure land tax can offer benefits and challenges. Land value can be difficult to gauge in markets where nearly all transactions combine land and structures. But land values have one important advantage: the value of each parcel of land should stand in an explicable relationship to the value of its neighboring parcels. There is no necessary equivalent relationship between neighboring buildings. As a result, a land value map can be created and presented for public comment to elicit new information on specific characteristics of the land. This was the approach taken in Estonia,

when the land tax was introduced before formal land markets had matured. At the other end of the technological spectrum, there is continual interest in new statistical methods for separating land and improvement values. In 2022 the *Journal of Housing Economics* brought together practitioners and academics for a special issue on land valuation.

An additional consideration relevant to some decentralization efforts concerns political perceptions when adjoining land uses reflect economic inequality. The image of a laborer or subsistence farmer with a plot of land next to an expensive structure owned by a politically well-connected investor can undermine popular support for the tax. This is also an argument for a substantial basic deduction or homestead exemption to remove low-value properties from the tax rolls. As discussed later, this can also help address the perennial challenge of accurately valuing properties with unusually high or low market values.

### *Market Value as a Tax Base*

A tax based on market value has two crucial advantages. It reflects one measure of wealth – wealth of one particular type, but a very important type and one often benefiting from special tax advantages. It also has a natural buoyancy, where alternate measures such as land area or original acquisition cost can diminish in revenue impact over time.

There has been new attention to the role of real property, and particularly residential property, as a factor in economic inequality. Some commentators suggested that Thomas Piketty’s 2014 volume could have been titled *Housing in the Twenty-First Century* (DeVore 2015). In 2015 Professor Anthony Atkinson of the London School of Economics set out fifteen specific proposals to reduce economic inequality. Proposal 11 states, “There should be a proportional, or progressive, property tax based on up-to-date property assessments” (Atkinson 2015, p. 198).

Of course, a market-value tax requires an active market with accurate transaction data, together with a sufficient number of trained valuers available for government service. Any of these elements may be lacking in economies seeking greater decentralization.

One critical issue in valuation is the *use* being valued. For taxation and planning purposes, there is often a great difference between current use and “highest and best use,” the latter being the most profitable use that is legal, financially feasible, and adequately supported. The analysis above which found that a land tax would be neutral as to land use is based upon the assumption that the tax is calculated on highest and best use.

A tax calculated on current use would not be neutral as to the timing of development. If a low-density use yielding little income were replaced by a higher and more profitable use, the tax would change correspondingly. In fact, there is a natural incentive for assessors to value property in its current use. Increasing the tax to reflect a different use can be seen as hypothetical and unrealistic, and economic pressure for more dense development can be politically unpopular – however much it may be the planning goal.

The Colorado Supreme Court succinctly explained the importance of considering potential future use in valuation: “[R]easonable future use is considered because it is relevant to the property’s present market value.... [A] tract of undeveloped land with potential for development has a higher present fair market value than the same size tract of undeveloped land with no such potential, i.e., even in its undeveloped state, a willing buyer and a willing seller would agree on a higher price for it” (Colorado Supreme Court 1988, at 152). The Colorado legislature responded to political pressure by requiring valuation for property tax purposes to reflect current use rather than highest and best use.

A recent pilot program in Vancouver, British Columbia demonstrates the political difficulty of valuation at highest and best use. The Development Potential Relief Program (DPRP) taxes a parcel’s “development potential,” defined as the difference between value at highest and best use and at current use, at only half the normal tax rate. As discussed above, this eliminates the neutrality, and the associated economic efficiency, of the tax on land. Widespread taxation at current use, whether by legislation or assessment practice, undermines the economic argument discussed above concerning the impact of the tax on the timing of development.

**Query: Is a value base opposed to an area base?** Where the administrative infrastructure for accurate valuation is lacking, an area base is often the first alternative. However, an area base need not be a complete alternative to a market-value system. Nearly all area taxes utilize some locational factors as well as size and quality adjustments, just as all market value measures are to some extent the best estimate based on available information. From this perspective, the area base and the market value base can be considered on a continuum, with increasing attention to value elements moving the measure from the area base and toward market value. This was in fact the case in the Netherlands, where the initial local option for an area base or a market value base gradually changed to a single market value base as more location and quality factors gradually brought the two alternatives together (Kruimel 1999).

The “points” system has been succinctly described by Fish (2018, p. 14) as assigning to taxable properties points reflecting the surface area of a structure, with additional points awarded or deducted for positive or negative features such as location, construction type, materials, quality of finish, and access to services. The African Tax Administration Forum discussed a simplified points-based assessment system in Freetown, Sierra Leone that enabled the city to more than double its taxpayer registry and implement a “relatively simplified, automated, fair and progressive property tax” (Kamara 2021).

### **3. Workable Valuation Methods**

Accurate and continually updated valuation of all properties in a tax jurisdiction requires computerized assessment. “CAMA,” or computer-assisted mass appraisal, is a term that could apply to any use of computers, even for filing and record-keeping. In this sense, an area-based tax or a tax based on a point system could utilize CAMA. In a value-based system, the crucial element for tax administration is the use of automated valuation models (AVMs). The

International Association of Assessing Officers defines an AVM as “a market appraisal produced through mathematical modeling” (IAAO 2018, p. 4).

The valuation system in Latvia provides an example of gradual expansion of the tax base and use of mathematical models in assessment (Barvika 2020). The valuation of buildings began in 2002, with simplified models appropriate for a tax that only reached commercial and industrial structures. Residential buildings became subject to tax in 2010, requiring more complicated models accounting for various amenities and improvements. In 2012, three different models were developed for individual dwellings, mixed-use commercial and residential buildings, and non-residential structures. Since 2012 an increasing number of factors have been accounted for in continually updated and expanded valuation models.

As models become more sophisticated, with potential use of artificial intelligence and machine learning, the “black box” problem of explainability becomes increasingly important (Bidanset 2019; IPTI 2019). Even CAMA models based on linear regression techniques are no exception, and assessment officials frequently use computer models to produce assessments but are prepared to defend the values in court by reference to comparable sales data. In New Jersey, the respected specialized Tax Court has expressed concerns about the reliability and explainability of software systems that produce values at issue in judicial appeals (Muse 2018). The Wisconsin Supreme Court upheld the use of computerized mass appraisal against a legal challenge in 2018, but two dissenting justices argued that “the law requires assessments to closely match the amount a buyer would pay for a subject property and a mass appraisal method is not reflective of full value through private sale” (Forward 2018).

In many decentralization contexts, the benefits of technological advances of this type will depend on administrative capacity. A 2017 study concluded that “the absence of reliable data on property transfers leaves computerized mass appraisal out of the reach of almost all African governments. The City of Cape Town is all but unique in Africa in its use of computer-assisted mass appraisal (CAMA)” (McCluskey, Franzen, and Bahl 2017, p. 561). The Latvian example shows the advantage of central assessment in a compact state, and the possibility of progressing from an initially simpler model to more complex approaches that utilize greater amount of data.

### *Measuring Assessment Equity*

In recent years many “big data” studies have brought new attention to the problem of assessment equity in the United States. This is a positive development, but the results of statistical analysis of thousands of jurisdictions over many years must be approached with caution. The *New York Times* Editorial Board used the results of an unpublished study to conclude that from 2007 to 2016, in an average year 90 percent of counties “failed to meet a basic industry standard for accuracy and equity” (New York Times 2021). Yet these commercial data sets often have numerous errors and omissions that are impossible to correct for millions of observations. The data is presented by county, where in Massachusetts, for example, taxation is by city or town,

and Suffolk County has five taxing jurisdictions with different tax provisions and reporting protocols.

In comparing the results of this particular study with specific data for Boston, the regressive nature of the tax found by the study resulted from its not taking account of the extremely generous homestead allowance in the city. Although the study stated that such provisions were accounted for, in the case of Boston they were omitted. The homestead allowance in Boston is above \$300,000, which turns a somewhat regressive tax into a strongly progressive one. Other errors, inevitable in a data set this large, included a mismatch of the years of valuation with the years of taxation (Rakow 2022).

None of this means that assessments are not often regressive, or that better approaches are not needed. New attention to assessment equity is a beneficial development. However, new opportunities to analyze huge data sets should be approached with caution and respect for the many individual features that might not be captured by them.

**Query: Is Banding Easier?** “Banding,” introduced by the Council Tax in Britain, allows the assessing agency to avoid exact point estimates of market value, instead assigning taxable properties to a given range of value. This can avoid controversies over small amounts of value, but it may be questioned whether such controversies are numerous. Some tax systems, such as that in New Jersey, will not accept appeals when the dispute concerns assessments that fall within a “common level range” promulgated by the state each year (New Jersey Statutes Annotated. 54:51A-6). This could be considered a form of banding. If bands are very wide, they could raise issues of horizontal equity; if bands are very narrow, there may be no efficiency gains. A sharp gradation in tax amounts between bands can re-introduce the problem of fine gradations that banding was designed to resolve, if a slight change in value can result in a much greater tax in a higher band. With attention to this “notch” problem, banding could be an effective estimating approach along the continuum from an area base to a market-value base.

Unfortunately, the experience in Britain demonstrates the inequities that follow when banding is simply a method of avoiding accuracy in valuation. There are only eight bands of value, and the highest band is much too low, covering all properties above £320,000. This regressivity is made far worse by the lack of any revaluation in the more than thirty years that the bands have been in effect, since April 1, 1991.<sup>3</sup>

#### *The Importance of Regular Revaluation*

Britain joins jurisdictions from Germany to India to New York State that have preferred to keep outdated values on the tax rolls rather than face the disruption of long-delayed revaluations. Whenever properties are revalued, there will be winners (those whose property values have increased less than the average and thus pay lower taxes) and losers (those whose property

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<sup>3</sup> After much analysis and consultation, Wales did revalue the council tax in 2005 with the idea of making it more equitable and easier to understand (Sheffrin 2013).

values have increased more than the average and pay higher taxes), and the losers will be more vocal than the winners.

More than ten years ago the Mirrlees Report noted, “As council tax valuations have passed the milestone of being 20 years out of date, the absurdity of the status quo becomes ever more apparent. Any property tax requires regular revaluations, and this process should begin as soon as possible” (Mirrlees 2011, p. 383). Failure to revalue undertaxes properties appreciating at the fastest rate, often in the most affluent areas, at the expense of properties that are stagnant or even declining in value. Infrequent reassessments are also a major cause of tax revolts (Youngman 2023). Nassau County, on Long Island in New York State, undertook a revaluation after decades of delay only when the federal Justice Department found the assessments to discriminate against minority homeowners (Mcquiston 1999).

In the case of Germany, the Federal Constitutional Court in 2018 declared that the way in which properties were valued for property tax purposes violated the constitutional principle of equal treatment. Properties in the states in the former West Germany had not been revalued since 1964, and in the former East Germany since 1935. These different bases in different parts of the country meant that similar properties often pay dramatically different taxes. The court set a deadline of December 31, 2019 for a new approach to taxing real property. New provisions came into force on January 1, 2020 and will apply from January 1, 2025.

The Netherlands went from a four-year reassessment cycle to annual revaluations, and reduced costs in the process (Bervoets et al. 2024, p. 11).

**Query: Is anything more ridiculous than “parcel taxes?”** If banding is a move away from assessment equity, parcel taxes are an even more dramatic step in that direction. Parcel taxes were introduced in California specifically to avoid the property tax limitations of Proposition 13, which basically substituted acquisition cost for market value as the tax base, with no more than a 2 percent annual inflation adjustment. With this property tax written into the state constitution, residents wishing to raise more revenue, generally for local schools, had to utilize a levy that was not a property tax, and the parcel tax was the result (Sonstelie 2015). Parcel taxes are more prevalent in northern California, with the ironic result that the geographic center of many technological advances utilizes a revenue source reminiscent of the “hut tax” described by Ursula Hicks in *Development from Below* (1961).

**Query: Is uniformity of practice needed?** South Africa has experienced a particularly interesting evolution of its property tax base in the post-apartheid era. In considering the property tax as a potential element of decentralization, the problems encountered by the ANC’s desire for nationwide uniformity show some of the drawbacks of centralization.

The original choice afforded to localities allowed them to utilize a pure land tax, called “site rating, a combined land and building tax, called “flat rating,” or a tax with separate rates for land and for buildings, called “composite rating.”

The change in government initiated a lively debate over the best path forward for property taxes throughout the country. For example, in 1992 Professors Riël Franzsen and Ch Heyns of the University of Pretoria edited a volume of essays on *A Land Tax for the New South Africa?* and Professor Franzsen followed this in 1994 with *Regional and Local Taxation in a Future South Africa*. Subsequent developments have potential implications for decentralization initiatives in countries which, like South Africa, contain local and regional governments of vastly different land arrangements, administrative capacities, and resources.

In 2004, the provincial laws permitting the choice among site rating, flat rating, and composite rating were repealed and replaced by a single national law calling for a uniform system of flat rating for the entire country. While this is appropriate for jurisdictions such as Cape Town, a global leader in technologically advanced valuation and assessment, many local municipalities have no valuation experts on staff. They have had to outsource these functions to the private sector, often without the necessary experience in choosing and evaluating consultants.

Experience with the new uniformity of practice has raised important questions as to the feasibility of a locally administered uniform market-value tax base. In 2017 Professor Franzsen wrote, “Especially in rural local municipalities with predominantly communal land, it is questionable whether this one-size-fits-all tax base is appropriate.” (Franzsen 2017, p. 394). By 2022 his views were even more definitive: “A value-based rating system is indeed not an appropriate system for all South Africa’s local municipalities. . . the principles of ‘certainty, uniformity and simplicity’ cannot or should not be understood to imply a single, uniform rating system across all metropolitan and local municipalities.” (Franzsen 2022, p. 11).

If an assessment system can be considered as a continuum from a pure area base to a pure market value base, neither of which is likely to be encountered in this pure form in actual practice, the South African experience can suggest that in a decentralization context, different points along this continuum may be appropriate for different jurisdictions. The Netherlands experience demonstrates that gradual transition toward a market value base could be a feasible goal as different areas and regions gain administrative capability.

### *Assignment of Functions*

In the context of fiscal decentralization, there is the question of who should be responsible for running the property tax system – the local government, or the national or state government. The choice comes down to the capacity to administer the tax versus the incentive to collect revenues. Local administrations have local knowledge about properties such as location, ownership, renovations, and additions. They also have an incentive to collect the taxes if the revenues stay with them. In some cases, however, local authorities simply do not have the capacity to administer the tax. Many administrative functions are performed manually rather than being computerized. Other problems include a revenue base that excludes some taxable properties, low collection rates, and lack of enforcement mechanisms. Even countries with a relatively good property tax administration often have problems updating values on a regular basis.

Arguments in favor of centralized property tax administration revolve around the national (or state) government having greater resources and technical capacity. Central tax agencies hold a fair bit of data on taxpayers that could assist in implementing property taxation and their greater political strength may allow them to enforce payment more easily. Even central administrations may fall short, however, if they do not share the property tax revenues. They have little incentive to respond to requests from local governments for up-to-date and accurate tax base information.

With “Proposition 13” in California, property tax collections have essentially become state revenue, while the administrative costs of the tax have remained at the local level. The result is that local assessors have no incentive to follow all value changes resulting from property improvements. This division of responsibilities was a primary reason for assessors’ opposition to a failed 2020 initiative to value business property at market levels. In this way, California offers another lesson for decentralization: assigning the costs and benefits of a tax to separate levels of government can undermine incentives for effective policy.

Although there is international debate on this question, there is little if any evidence on the relative merits of central versus local administration of the property tax. Does the technical capacity of the national government outweigh the incentive of local governments to collect revenues? In Tanzania, property tax administration has gone back and forth between the central and local governments but the impact on revenue collection is unclear (Fjeldstad et al. 2019).

#### **4. The Right Tax Rate**

For fiscal decentralization to work, local governments need to have some autonomy over the property tax. There may be grounds for central or state governments to determine the tax base and perhaps even administer the tax because they have greater capacity and are more able to achieve economies of scale. Central or state governments may also be able to ensure fairness across jurisdictions. There is general agreement, however, that tax rates should be set locally (Bahl and Martinez-Vazquez 2022). Local determination of tax rates is particularly important in countries where a senior level of government determines the tax base.

**Query: Should local governments set tax rates?** Efficient fiscal decisions at the local level require local governments to weigh the marginal benefits of services against the marginal costs of providing them. When local governments do not pay for services with their own revenues, the link between expenditures and revenues is broken and the choice of services will not reflect an accurate picture of their cost (Slack and Bird 2014).<sup>4</sup> When tax rates are set locally, there is local accountability that is likely to result in better local services (Bahl and Martinez-Vazquez 2022).

To avoid distortions, however, the central or state government will need to place limits on local tax rate setting. A minimum tax rate would encourage local governments to levy at least a minimum level of taxation and would avoid distorting tax competition where richer local

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<sup>4</sup> This argument assumes that any externalities of local taxing and spending decisions have been appropriately offset by intergovernmental transfers.

governments lower tax rates to attract business. Because richer governments have larger tax bases, they can provide comparable services at lower rates than poorer competing local governments. A maximum tax rate may be needed to prevent tax exporting, which can occur when local governments levy higher tax rates on industries on the assumption that the burden of the tax will be borne by non-residents (Kelly et al. 2020). Tax exporting results in inefficient decision-making about taxes and expenditures because it severs the connection between payers and beneficiaries. Although some political leaders may prefer delivering services to their residents without placing the burden of payment on them, the result may be increased demand for services from those who do not have to pay for them.

The property tax rate structure is generally defined under national legislation in unitary countries and state/provincial legislation in federal countries. The extent of local discretion over tax rates varies around the world. According to Kelly et al. (2020), several Latin American countries permit local governments to set their own tax rates subject to maximum and minimum levels. In many parts of Africa, the national government sets the property tax rate, but local governments set property tax rates in South Africa, Kenya, Namibia, Swaziland, and Zambia (McCluskey, Franzen, and Bahl 2017). In Canada and the United States, municipalities are permitted to set their own tax rates, but these can be subject to caps set by state governments or through citizen referenda in the case of U.S. jurisdictions.

### *Tax Classification*

The worldwide impulse to tax business property more heavily than residences has many elements, chief among them recognition of the political importance of local voters. Within the residential class of properties, a principled intent to reduce the tax burden on those with less ability to pay is undermined when rental property is not provided with the same tax-favored status as owner-occupied residences. Renters are generally less affluent than owners, but often are prey to the illusion that property taxes paid by their landlords do not affect them. And tax benefits for the very highest- value residences often dwarf any preferences for modest homes, as is the case in New York City, a jurisdiction that prides itself on its progressive policies.

**Query: Should Businesses Pay More?** The corollary of residential preferences is a relatively higher burden on business property, also supported by many progressive commentators. ITEP, the Institute on Taxation and Economic Policy, writes, “State corporate taxes fall primarily on corporate shareholders, a group that is wealthier than average, disproportionately white, and geographically dispersed. Because of this, robust taxation of corporate profits is an effective means both for lowering inequality and for ‘exporting’ some state tax liability to nonresident taxpayers” (ITEP 2024, p. 31). This benefit of exporting the tax to “geographically dispersed” nonresidents is similar to the aim of insulating voters from the full cost of public services. The OECD took a different position: “The more property owners are able to forward-shift the property tax to tenant, consumers or workers, the more it tends to become regressive” (OECD 2016, p. 72).

A second problem has become evident in the U.S. in particular: heavier taxes on business property not only distort the choice between physical and intangible investments, but also encourage mobile businesses to demand special incentives and preferences to locate in a specific jurisdiction. In extreme cases this has led individual businesses to move back and forth across a state border multiple times. Preferences for mobile businesses thus burden the established corporate citizens who have long provided jobs and tax revenue and ignores one of the important benefits of an immovable tax base – its relative insulation from tax competition pressure.<sup>5</sup>

Although there may be a case to differentiate taxes on the basis of different benefits received from local services for different property types or because capital mobility differs for different property types (Kitchen et al., 2019), the application of differential rates in many countries rarely reflects these considerations. Rather, in most countries around the world, non-residential properties are taxed at a higher rate than residential properties even though the economic rationale for differentials would point to the opposite (Bird and Slack, 2004). Based on the benefits-received principle, non-residential properties tend to use fewer local public services than residential properties. Large business properties, in particular, may take care of their own security and business improvement districts may supplement local services. Based on efficiency considerations, non-residential capital tends to be more mobile than residential capital. For both equity and efficiency reasons, there is not a strong argument for taxing non-residential properties more than residential properties (Kitchen et al. 2019). The reason that governments do charge non-residential properties more is simply that residential property owners vote.<sup>6</sup>

The over-taxation of business properties presents a particular problem in the current context of a spike in commercial office vacancies in many North American cities because of high interest rates, increased use of digital technology, and the rise in the work-from-home phenomenon. Some authors have written about an urban “doom loop” where businesses leave downtown offices, commercial property values fall, tax revenues fall, service levels decline, more businesses leave, and the downward spiral continues (Van Nieuwerburgh 2022). Others have estimated the impact of working from home on municipal finances in U.S. cities and suggest that the demand for commercial real estate space might fall by as much as 25 percent, resulting in a decline in property values and property taxes (Chernick et al. 2021).<sup>7</sup> Cities that overtax business properties are particularly vulnerable to the doom loop as are cities that have a high proportion of office properties.

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<sup>5</sup> For more analysis of the impact of property tax incentives for businesses, see Kenyon, Langley and Paquin (2012).

<sup>6</sup> Similarly, higher taxes on second homes, which may impose few costs on the locality and usually none on the local school system, reflect a sense that multiple homes indicate a higher ability to pay – and that their owners generally do not vote in the taxing jurisdiction.

<sup>7</sup> New York City, however, reports that although office values and property taxes fell during the pandemic, values are climbing again (Office of the New York State Comptroller 2024).

If commercial property values fall relative to residential values, there will be increasing pressure on residential properties to pay for local services unless commercial tax rates are increased. Since politicians do not like to increase residential property taxes, however, falling commercial property values could well result in higher commercial property tax rates even though they are already higher than residential rates. In Boston, for example, declining commercial property values have led the mayor to seek higher commercial tax rates. An alternative to raising commercial or residential tax rates is to cut public services. A declining commercial tax base leads to difficult choices!

**Query: Should the Elderly Pay Less?** The impact of property taxes on the elderly is an issue whose political importance is out of all proportion to its economic importance. As the OECD says succinctly, “Although many people own large houses but have small incomes after retirement, there is no automatic relationship between age and poverty” (OECD 2016, p. 70). Property taxes, like all costs of homeownership, may be one factor encouraging older taxpayers to downsize, but it is not easy to reach equitable conclusions from these facts alone. A 2021 study that found that in the United States rising property taxes made low-income seniors more likely to become renters or to downsize. This was interpreted in 2024 as “some home owning senior citizens in the past were, over time, *forced* to move out of their home due to rising property taxes” (Bervoets et al. 2024, p. 18, citing Kim and Dawkins 2021) (emphasis added).

This example highlights the important “rhetorical” role for tax deferral programs. It is impossible to judge whether downsizing in any particular case increases or decreases welfare, and whether it is the result of progressive or regressive tax policy. However, the availability of a deferral option makes it clear that no senior citizen need move because of property taxes. The existence of tax deferral schemes defuses a major and very powerful antitax argument.

Tax deferrals generally make the outstanding balance a lien against the property, payable when the property is transferred. In some cases, an interest charge (often below the market rate of interest) applies to the deferred taxes. Interestingly, the take-up rate on deferrals is often very low, especially among low-income taxpayers, because the elderly do not want to leave an encumbered property to their heirs. Low uptake means that the argument that property taxes are forcing people out of their homes is unlikely to be true (Youngman 2023). Reluctance to take on debt that would encumber property that the owners hope to leave to their heirs is natural, but that permits a policy discussion balancing these interests and local fiscal needs. By contrast, the possibility of a senior citizen being evicted for nonpayment of property taxes is completely unacceptable politically and serves to magnify antitax sentiment.

### *Progressivity*

Although the case for progressive property tax rates, particularly at the local level is weak, governments often favor taxing higher valued properties more heavily. Progressive property taxes, often referred to as “mansion taxes,” are levied in many countries in Latin America, as

well as in some North American jurisdictions. South Korea also applies a progressive property tax rate (Kelly et al, 2020), as does Taiwan (Lin and Wu 2022).

**Query: Should higher-valued properties be taxed at higher rates?** Experts generally agree that progressive property tax rates should be avoided (see, for example, Kelly et al., 2020; Kitchen et al., 2019). Proponents of progressive property tax rates argue that they serve as a partial wealth tax. If income redistribution is attempted at too local a level, however, one jurisdiction might implement progressive taxes while another might not. Because taxpayers can move between two local jurisdictions, there is the possibility that those with high incomes will move out of the progressive tax rate jurisdiction and those with low incomes will move in, other things being equal. Redistribution works better on a broader geographic scale, such as at the national or state level.

There are other arguments against progressive property taxes at the local level.<sup>8</sup> Although property values are correlated with the income of the owner or tenant, this correlation is not perfect (OECD 2021). That means it is possible that rates may be progressive in terms of property value but regressive with respect to income. Moreover, progressive tax rates may worsen the liquidity problems of asset rich and income poor households, such as seniors on a fixed income. Since there is no evidence that the benefits received from local services increase with the increase in property value, there is no argument on benefit grounds for higher tax rates on more expensive properties. From an administrative perspective, a uniform tax rate is preferable because it is simple, transparent, and predictable in terms of the amount of revenue that will be collected. Finally, the complexities of a progressive system may undermine its effectiveness. For example, if properties are divided into different classes according to value, there will be an incentive for those taxpayers at the bottom of a value class to appeal their assessment so that they can be taxed at a lower class rate. A study of the progressive land tax in Taiwan found that the higher rates were easily avoided, and that the tax actually declined with value in two major cities (Lin and Wu 2022, p. 440).

## 5. Appropriate Property Tax Relief

The special nature of an asset tax requires special measures to alleviate the difficulties faced by taxpayers, especially homeowners, who may be “asset rich” but without an equivalent cash flow.<sup>9</sup> At the individual level, the problems of the “asset rich” must be approached with care. An

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<sup>8</sup> If the issue is the burden on low-income taxpayers, however, there are better measures to increase the progressivity of the property tax (IMF 2013). Relief measures such as homestead exemptions and circuit breakers are discussed below. Tax deferrals have already been discussed.

<sup>9</sup> This is a central political issue for a property tax, but it bears mention that another problem may be faced by “asset poor” jurisdictions that lack a tax base sufficient to support quality local services. This has been a longstanding problem in the United States, where public schooling is often largely a local responsibility. Although this is often discussed as a property tax problem, it is a local tax problem, for any jurisdiction that lacks the ability to provide needed services will require assistance from a higher level of government.

asset tax not necessarily related to current income can create liquidity problems for taxpayers whose home value is not matched by their cash flow. Sometimes this is a long-term situation, as in the case of senior citizens on fixed incomes or homeowners with low incomes in gentrifying neighborhoods. Other taxpayers may face short-term cash-flow problems from temporary situations such as job loss or household emergencies. Property tax deferrals (discussed earlier) can assist taxpayers, especially seniors who have sufficient home equity to serve as collateral, and income-sensitive tax relief can help with both short- and long-term liquidity challenges.

“Circuit breakers” are a type of tax relief extended to owners whose tax bills exceed a given percentage of their income, the name indicating an effort to prevent a tax “overload.” These can be complex legislative enactments, with sliding scale relief decreasing as incomes rise, differing methods of calculating the relevant income, and age or other restrictions on eligibility.

Homestead exemptions are popular methods of reducing taxes on principal residences. They may be denominated in currency or as a percentage of assessed value. They may be tied to taxpayer income or to residential value, but they are more commonly available to all homeowners. This greatly increases their political popularity, but also increases their cost. As noted, homestead exemptions set in terms of a given amount of currency, rather than as a percentage of assessed value, have the great advantage of introducing an important element of progressivity. The difficulty of accurately valuing low-price property – and, often, very high-price property – means that residential valuations are often inherently regressive. A generous homestead allowance in currency terms can help redress this.

Many nations exempt properties or residences below a minimum value. This avoids administrative costs that can outweigh the revenue collected. Setting the minimum at too high a level may leave a large part of the voting populace without an incentive to stay politically aware of local tax and spending policies. To address this problem, the city of Boston, Massachusetts combines a generous homestead exemption with a requirement that each taxpayer be responsible for at least ten percent of the tax due before application of the exemption.

## **6. Dealing with Real-Life Challenges: The Perennial Unpopularity of an Excessively Visible Tax**

Even if local governments can design the right tax base, levy the right tax rates, and design appropriate tax relief, they may still face real-life challenges, such as the unpopularity of the tax, that can undermine its equity and efficiency.

One of the strengths of the property tax also turns out to be one of its weaknesses – the tax is very visible. It is visible because people generally know what they pay each year in property taxes, which is not often the case with income taxes that are withheld at source and sales taxes that are charged on individual goods and services but rarely totaled by the taxpayer. Visibility is a desirable feature of the property tax because it makes local governments accountable for the services they deliver, but it makes the tax very unpopular. John Stuart Mill wrote, “the very

reason which makes direct taxation disagreeable makes it preferable. Under it everyone knows how much he really pays...” (Mill 1848).

**Query: Need the Property Tax be Excessively Visible?** An asset tax imposed without regard to cash flow will always present special difficulties. The current attention to economic inequality, the role played there by land and housing, and new calls for wealth taxation, should all provide an incentive for policy improvements to help an asset tax succeed. One very significant step is to move from large annual or twice-yearly tax bills to monthly payments similar to all other expenses of homeownership. This has proved successful in several jurisdictions (Langley 2018), and enabling legislation has been passed in California, only to be vetoed because of opposition from assessors. Taxpayers seem to be more willing to pay taxes when they do so incrementally rather than in a lump sum. In Ireland, they go one step further and hide some of the impact of the tax through withholding mechanisms (Turley 2022), allowing taxpayers the option of having property taxes withheld from their monthly income. Doing so reduces transparency but increases ease of payment and political acceptance. England has been a leader in automatic direct-debit systems, with millions of council tax and business rate payments made in this way (Hutchinson 2008, p. 10),

There are other tax design features that could make the property tax more acceptable to taxpayers. Tax deferrals, discussed in detail earlier, are a good option, especially for seniors with liquidity constraints. Annual reassessment provides another way to reduce the impact of property tax increases. If assessments are allowed to lapse for many years, when a reassessment does occur, the sticker shock can be very high. In the absence of annual assessments, taxpayers in areas where growth is slow or declining will be overtaxed and will subsidize taxpayers in areas where property values are increasing, resulting in inequities. The longer the delay in undertaking a reassessment, the greater the opposition because, after several years, taxes may increase dramatically for some taxpayers.

The legislation often called “Truth in Taxation,” or “Full Disclosure,” increases visibility but may, at the same time, improve acceptability (Um 2024). This measure requires that tax increases due to rising values go through the same process as would an increase in the actual tax rate – which may involve individual notices to taxpayers, a comparison of taxes before and after the proposed change, public hearings, and a vote by the local governing body. Truth in Taxation does not prohibit tax increases or place a limit on tax collections, but its transparency and accountability can have a notable effect on tax increases (Cornia and Walters 2006). After California’s “Proposition 13,” assessment limits often became the first element in tax revolts, but they are also the measure most damaging to assessment equity. As an administrative measure that has potential to reduce pressure for assessment limits, Truth in Taxation is worthy of note.

In some cases, local governments are required to make assessment increases revenue neutral, meaning that any increase in assessment (not including new construction) must be matched by a concomitant decline in the property tax rate so that property tax revenues overall do not change.

Although these measures are intended to avoid “silent” tax increases, they reduce the elasticity of the property tax. For example, in New York State, local jurisdictions (not including New York City) are subject to a property tax revenue increase limit calculated annually; in 2024 this limit was 2% for the third consecutive year (DiNapoli 2023).

**Query: Can people be convinced to pay property taxes?** For the property tax to be an effective tool for fiscal decentralization, there needs to be political buy in and that requires acceptance on the part of taxpayers. Taxpayers are more likely to support property taxes if they can see the connection between the payments they make and the services they receive (Slack and Bird 2014). Fish (2018) suggests showing taxpayers where their dollars are being spent by putting signs on visible projects such as bridges or road maintenance that say, “This work has been completed with your tax money” (Fish 2018, p. 24). The goal is to link visible taxes to visible services. Of course, if the services are lacking, taxpayers will complain that their taxes are being wasted.

Another way to reduce opposition to the property tax is to consult taxpayers. For example, they should be consulted about issues that concern them such as how their properties were valued or how the tax rate was calculated. Taxpayers may not agree with the information provided but they need to at least feel that have been heard (Slack and Bird 2014). An important way to increase taxpayer support is by holding meetings where they can express their concerns and receive a response. Communications that include various stakeholder groups and the broader public may also help to overcome some of the obstacles to property taxes (Brys 2011). Communications have to be in a form that taxpayers understand, however. Fish suggests banners, regular radio programs that link the local council with taxpayers, and more (Fish 2018).<sup>10</sup>

Taxpayer education is also a critical element in gaining taxpayer acceptance. The problem is that the design of the property tax is often so complicated that it is difficult for experts to explain how it works. One example is where there is a revenue-neutral general reassessment. It is hard to explain to taxpayers that their taxes would only increase if their assessed value went up by more than the average increase for the municipality. Moreover, they could see a decrease in their property taxes if their assessed value increased by less than the average. It is hard to explain, in part because taxpayers do not believe that their taxes will go down and they are partly right if taxes are going up for budgetary reasons. It is difficult to isolate the impact of the reassessment from other factors that influence the level of taxes. Nevertheless, communications need to be simple and easy for taxpayers to understand. And taxpayers need to feel that they have been treated fairly.

## 7. Other Roles for a Well-Functioning Property Tax

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<sup>10</sup> Fish makes a series of very detailed suggestions to help these efforts succeed. For example, banners need to hang properly, so they are visible and do not fall. Permanent signs need few words with simple messages, and pictures that show local public services.

A well-functioning property tax not only brings in revenues for local governments, but it can also serve other purposes.

### *Land Value Capture Instrument*

There has been great international interest in land value capture in recent years. In 2022 the OECD released a “Global Compendium of Land Value Capture Policies,” intending to bring together “land value practices of 60 countries around the globe” (OECD 2022, p. 4).

Land value capture is designed to recoup some or all the unearned increment in private land values arising from two sources – public investment in infrastructure and changes in land use regulations. When governments invest in public infrastructure, for example a new transit line, property values increase for neighboring landowners. The resulting increment in land values is sometimes captured through special assessments or betterment levies as a specific charge that is added to existing property taxes on those properties that benefit from the investment. The funds are used to pay for the additional or improved capital outlays.

When governments change land use regulations, for example by increasing the allowable density on a site (sometimes referred to as density bonusing), land values increase, through no effort on the part of the landowner. There are several ways to capture the increased land value to be used for public purposes. The local government can require that the developer provide affordable housing or pay for local amenities, such as parks or streetlighting. In this case, the local government must determine the amount of the increment and the portion to be paid for by the developer. Often, these determinations are *ad hoc* and are negotiated with the developer. Sometimes they are estimated by a formula. In São Paulo, building rights are sold at public auction, so the market determines the value of the unearned increment (Smolka 2013).

Land value capture provides a strong case for levying a property tax. A well-functioning property tax based on market value assessment, updated annually, should automatically capture the land value increases from public investments or changes in land use regulations without the need for additional instruments. At the same time, the property tax should also capture the losses that may be incurred by some property owners when large-scale projects impose costs on properties that are negatively impacted by the investment. It is natural that any major construction that significantly raises values in one neighbourhood may change traffic patterns and in other ways reduce values elsewhere. One of the earliest calls for land value capture was the 1978 book *Windfalls for Wipeouts* (Hagman and Misczynski 1978) which suggested using revenue from such value increments to assist property owners suffering a loss in value from the same public actions, with some parallels to “inverse condemnation” cases (Wolf 2013).

The concept of value capture is often presented as an untapped and innovative source of local revenue, an equitable claim on a portion of value increments due to public action. Forms of value capture that are truly innovative, such as the sale of building rights on a public exchange in São Paulo, would require heroic political initiative and face certain opposition. A more

straightforward tax on the value increase would need to be distinguished from the existing property tax on the same amount and would encounter the difficulties involved in identifying an “unearned increment.” Property values can be calculated more easily than the causes of their fluctuations can be identified. A price rise subject to a special value capture levy might be considered by the owner to be due to private improvements. A well-functioning property tax would track both value increases and decreases following public investment, without the political difficulties facing the introduction of a new revenue instrument.

### *Workable Form of Wealth Taxation*

Recent concerns over economic inequality have led to a renewed call for wealth taxation. Sometimes this takes the form of anti-property-tax advocates calling for a “modest 4 percent wealth tax” on multimillionaires to replace the property tax (Kahrl 2024).

History suggests that property taxes, although continually under political attack, are more durable and practical than wealth taxes. A wealth tax faces all the valuation challenges of a property tax, and in addition must assign a value and a tax location to investments and other intangible property. A large portion of a wealth tax would be levied on financial instruments that can easily escape detection or change location on the assessment date. The state of Florida, which has no general income tax, had a longstanding tax on intangible property, but political opposition led to so many exemptions, and the ease of avoidance was so great, that the tax was largely abolished in 2007. In 1990, twelve countries in the Organisation for Economic Co-operation and Development (OECD) imposed net wealth taxes, but by 2017 only four remained (OECD 2018), and after that France replaced its wealth tax with a real property tax (Bunn 2022). Wealth taxes have been found unworkable even in nations with strong redistributive policies, such as Sweden, Germany, Denmark, and Finland (Hansson 2010).

The experience of the property tax in the U.S. helps explain the challenges of wealth taxation. In the eighteenth and nineteenth centuries, the property tax often did attempt to reach all property of whatever kind – a type of wealth tax. In the late nineteenth century this “general” property tax became unworkable as new financial instruments with no fixed location grew in importance. The difficulties of locating and assigning accurate values to stocks, bonds, and other intangible assets led to investors escaping a tax that the farmer could not avoid. An early twentieth century reform movement worked to limit the property tax primarily to real estate and to reach investments through a tax on their income instead (Seligman 1931).

Here is where a well-functioning property tax could play a major role in taxing wealth and providing a stable, long-term revenue source. It has been suggested that the large increase in the wealth-output ratio noted by Piketty (2016) has resulted in large part from increases in one component of wealth -- the value of land (Stiglitz 2015). Since property is such an important component of wealth, a property tax that is levied on the assessed value of real estate assets goes a long way towards implementing a wealth tax. And, as Mirrlees et al. (2021) and Atkinson (2015) note, a property tax based on up-to-date property assessments can be an important way to

address economic inequality. Of course, key to this statement is that properties are assessed at their market value and updated annually.

### *Reduce Pressure on Land Transfer Taxes*

Land transfer taxes (also known as stamp duties) are popular in many countries, often bringing in more revenues than the property tax. It is relatively easy to implement a land transfer tax because it is based on transactions that are readily identified and measured (Mirrlees 2011). The tax is a one-time levy at the time of sale of the property and is calculated as a percentage of the purchase price. There can be variations on land transfer taxes -- for example, the tax sometimes increases with the value of the property, and, in some cases, higher taxes are imposed on non-residents.

From an economics perspective, land transfer taxes are considered to be distortionary. By increasing the cost of buying and selling a house, land transfer taxes can reduce the number of real estate transactions. They can also reduce household mobility by keeping people in houses that are too big or too small or too far from where they work (Dachis et al., 2012). They can encourage the under-reporting of sales prices and thereby degrade property records (Youngman 2023). The temptation to understate a sales price is universal. Many readers introduced to Provence by Peter Mayle's series of best-selling books read about the procedure for a house purchase, where the buyer was instructed to leave a large amount of cash for the seller in addition to a normal bank payment for the remainder of the price (Mayle 1989).

Unlike a property tax, a land transfer tax has no relationship to the benefits received from local services. Perhaps the biggest problem for local governments, however, is that land transfer taxes can be volatile as real estate markets change, so they are less reliable as a revenue source for local governments that need stable and predictable revenues to meet their budgetary requirements.

Property taxes are more politically difficult, as noted earlier, in part because of their visibility. Yet, they provide a stable source of revenue with fewer economic distortions than a land transfer tax. As Mirrlees (2011, p. 404) contends, “[T]here is no sound case for maintaining stamp duty and we believe that it should be abolished.” A 2017 German study found a “substantial welfare cost of real estate transfer taxation” (Buettner 2017). A well-functioning property would reduce the need to rely on distortionary and unstable land transfer taxes.

## **8. Conclusion**

The property tax is an essential element in making decentralization work, as Jorge's contributions over the years have taught us. It provides an independent source of local government revenue and the characteristics of the tax -- immobility, connections to local services, efficiency, equity, and stability and predictability of revenues -- make it particularly suitable for local governments, especially if they have some ability to set the tax rate. If properly designed, the property tax also acts as a value capture instrument and a form of wealth taxation.

Although it is a good tax for local government, the property tax can be very challenging to implement well. Nevertheless, the tour of countries in this paper suggests that many have done a reasonable job at making the property tax work. That does not mean that they have always followed the conventional wisdom on what works best, but rather that they have implemented a tax that is workable in their context. For example, the conventional wisdom is that market value is the gold standard for assessing the property tax base. Yet, not all countries have the resources and capacity to implement a pure market value system and perform annual updates. Some have, however, been successful in levying property taxes using an area-based or points-based system that takes account of the characteristics of the property along with locational factors. While not market value, these systems can move to a market value system over time by adding more characteristics. In the meantime, the property tax can provide a significant source of revenue for local governments.

Even more than other taxes, the property tax is unpopular with taxpayers largely because it is a visible tax. Some countries have addressed this problem with more frequent payment options, the use of direct debit, and the withholding of property taxes from income. Property tax relief measures have also been implemented to help those taxpayers who are asset rich but income poor with deferral schemes, exemptions, and circuit breakers. These measures increase taxpayer acceptance of the property tax.

Reviewing the many different property tax systems around the world makes it clear not only that it is often difficult to implement the ideal tax from the ground up, but also that there is no one property tax system that will work everywhere. We have tried to show some good examples-- as well as some bad examples -- of how the property tax is levied in different countries. The ability to apply the lessons from these examples will depend on the individual circumstances in each country. Given the importance of property taxes to decentralization, we think it is well worth the effort to make the property tax work.

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