PRESIDENT'S MESSAGE

July 2024

I must start this newsletter by thanking all the speakers, moderators and sponsors who participated in our recent Mass Appraisal Valuation Symposium (MAVS). The 2024 MAVS was a two-day, online event delivered jointly by IPTI and IAAO on 26 and 27 June. We covered a wide range of topical subject-matter and our many expert presenters from around the world shared their knowledge and experience in a way that I am sure the global audience really appreciated. If anyone who was unable to attend the MAVS would like to obtain a copy of the recording, please send an email to: lkonet@ipti.org.

Moving on, as many readers will be aware, there is a UK General Election being held on 4 July. Whilst IPTI remains strictly impartial when it comes to politics, it is interesting to see that UK property taxes feature in many of the political party manifestos. The proposed policies range from abolition or reform of some property taxes, to some, as yet undefined, replacement for existing property taxes. Many independent commentators have stated that it is disappointing that the main political parties are not committing to a revaluation for council tax – the residential property tax in the UK – as the banded capital values on which the present system in England and Scotland is based relate to values at as 1 April 1991 which is hopelessly out of date and very difficult for taxpayers to understand. We will wait with interest to see what changes, if any, are made to the existing UK property tax systems once the new government is in place; watch this space!

I read an article recently with the somewhat striking title of "Tax the Filthy, Stinking Rich". Such a provocative title achieves the desired result of attracting attention. The author of the article is referring to the financial problems impacting the city of Seattle, but the issues he raises could apply to almost any jurisdiction. The article was written by an author from the "Policy Lab" and appears in a journal called "The Urbanist". I include some selected extracts from it below. If anyone would like to read the original article, it is available via the link below: https://www.theurbanist.org/2024/06/01/policy-lab-tax-the-rich/

The author states: "The City of Seattle has a quarter-billion-dollar budget problem to solve. In his "state of the city" speech earlier this year, Mayor Bruce Harrell said he rejects notions of austerity. Good for him! I'm here to help. Let's chart a way out of this crisis that doesn't involve slashing city services, laying off city workers, and hobbling our progress on housing and homelessness. In other words, let's talk about taxing the rich. But first, a brief primer on how we got here.

The City's $1.7 billion general fund is its most flexible pool of money and comprises just over a fifth of the total budget. Base revenues flowing into that fund have fallen short of expenses for some years now. Why? A host of factors, which mostly boil down to the economic blow dealt by the Covid pandemic, roaring inflation, the (consequently) rising cost of paying city workers, and the state-imposed 1% annual limit on general-purpose property tax rate increases.

So far, that gap between revenue and expenses has been masked by the addition of temporary funds, including federal pandemic relief dollars and infusions from the JumpStart big business tax that was passed in 2020. JumpStart's long term spending plan focuses on affordable housing, equitable development, small business support, and climate resilience, but the tax also came to the rescue during the pandemic, preventing the deep cuts many other cities have had to make.

But starting in 2025, those one-time transfers disappear and a yawning shortfall opens up, most recently estimated at $258 million or about 15% of the general fund. We're already getting a taste of what the fallout might feel like. Seattle Public Library announced 1,500 hours of closures this spring, after an anticipatory hiring freeze made staffing shortages worse. This year over 60% of the library's funding, or $62 million, came from the general fund.

But why are we talking about cuts? Harrell says he's not an austerity mayor, so let's talk about new revenue instead. Specifically, let's talk about taxing the person who will be moving into that multimillion-dollar penthouse at the top of the First Light condo tower, soaking in the rooftop jacuzzi and vrooming around downtown in a McLaren supercar. Let's talk about taxing the rich. How could we do it, if the political will were there? Let us count the ways.

1. Capital gains tax

Our future penthouse owner needs to sell off some assets to plunk down that $5.1 million. When they do, Washington state will be taking a cut. In 2021, the legislature passed a bill that taxes capital gains in excess of $250,000 at a rate of 7%. This was challenged in court as an illegal graduated tax on income, but last year the Washington State Supreme Court ruled that it's actually an excise tax. This decision paves the way for Seattle, which has broad authority to levy excise taxes, to adopt its own local capital gains tax.

Some other US cities tax capital gains, including San Francisco and New York, but they do so by default as part of a broader tax on income, and their local income taxes are an added increment on top of a state income tax. A local capital gains tax not paired with an income tax would be a first.

Last fall, City staff estimated that a 2% local capital gains tax, structured just like the state tax, could raise $38 million in its first year. A few percentage points on top of the state's 7% isn't going to solve the general fund problem, but it would make a dent. This is a volatile revenue source, as we're seeing at the state level now, so the City couldn't count on consistency from year to year. But it would likely be popular.

2. Wealth tax

Seattle already taxes wealth - in the form of real property, like land and houses. If you're a middling homeowner, most of your wealth is tied up in your home, and you're paying taxes on it. If you're a renter, you're still indirectly paying property taxes, even though you don't enjoy the benefits of ownership and may well have zero or negative wealth. But if you're very rich, like the future inhabitant of the First Light penthouse, you're probably also sitting on a huge pile of intangible assets, such as stocks and bonds. And those are tax free.

Here in Washington, a state-level wealth tax has been a hot topic in the last couple legislative sessions. In 2021, HB 1406 was proposed to "[improve] the equity of Washington state's tax code by creating the Washington state wealth tax and taxing extraordinary financial intangible assets." This one percent tax would have exempted the first $1 billion of assessed value. A new version proposed in 2023 (HB 1473 and SB 5486) lowered the exemption to $250 million and was estimated to raise $3 billion annually.

3. Mansion tax

When the First Light penthouse is eventually sold, the City will collect a real estate excise tax (REET) amounting to 0.5% of the sale price. When a more modest home changes hands, that transaction is taxed at the same rate.

But some cities have so-called mansion taxes, with steeper rates for high-dollar property transactions. In 2022, Los Angeles voters approved a 4% tax on property sales above $5 million, rising to 5.5% on sales over $10 million. It's raising hundreds of millions a year - and stirring up a lot of controversy. San Francisco and New York City also have progressive real estate transfer taxes with graduated rates, rising to 6% on property sales above $25 million in San Francisco and 3.9% in New York.

4. Double down on taxing big business

Taxing businesses is an imperfect means of taxing the rich, because there are ways they can pass some of those costs on to the rest of us. But a well-designed tax minimizes that effect, and Seattle's JumpStart payroll expense tax, focused on large corporations with high-salary employees, likely does a great job."

The author goes on to look at other potential additional revenue sources including luxury taxes (excise taxes on the sale or purchase of specific goods); a professional services excise tax; and estate and inheritance taxes. Lots of interesting food for thought.

Moving on to IPTI activities, we are currently working on a series of varied and interesting projects with a number of different clients.

With regard to IPTI events, I have already mentioned our recent online MAVS which was a great success. We also delivered a number of webinars last month including another in the series of webinars we offer in partnership with the Institute of Municipal Assessors (IMA). The latest in the current IMA-IPTI series was titled "The Valuation of Excess Land and Surplus Land" and our two experienced presenters identified and clarified the differences between excess and surplus land. They also discussed how these differences affect calculating value using the income approach to value. Our speakers focussed on how to accurately estimate the value of such "extra" land considering local zoning bylaws and the shape and placement of existing improvements on the land.

Looking ahead, we have a number of both online and in-person events details of which can be found on our website: www.ipti.org

Now it's time for a quick look at what is making headlines concerning property taxes in selected jurisdictions and countries around the world. For more information, and links to the original news articles, please refer to IPTI Xtracts which can be found on our website: https://www.ipti.org/ipti-xtracts

Starting with Sri Lanka, the government has published what is described as "justification" for its new controversial property tax. The Finance Ministry has said that the wealth tax will be focused on property aimed at affluent not average income earners. It will include a suitable tax-free threshold to ensure that the tax is targeted on very high value property or multiple properties. There will be appropriate set off mechanisms to avoid double taxation and a move for the tax to be implemented as an imputed rental income tax. However, the government admits that significant administrative work will be required in terms of improving existing valuation mechanisms and databases. It refers to property taxes being implemented in many countries since they are highly efficient, progressive, and non-distortive.

The Sri Lankan government also makes clear that the tax will go through the regular legal process of amendments to the required legislation and is expected to come into force in April 2025. The government added that property in Sri Lanka is already subject to existing taxes such as local authority Rates and Stamp Duty hence there is significant precedence for a new property tax. The government states that the new property tax is to yield 0.2% of GDP by 2025 and 0.4% of GDP in a full year in 2026. The government added that a failure to reach the required level of tax revenue that can fund public expenditure would lead to a recurrence of the economic crisis that had devastating impacts on the entire country.

In Hong Kong, the progressive rating system for domestic tenements will be implemented as proposed in the 2022-23 Budget and take effect from the fourth quarter of 2024-25 onwards, the Government announced. The Rating (Amendment) Bill 2024 was published in the Gazette on 31 May and introduced into the Legislative Council on 12 June to give effect to the proposal. For domestic tenements with a rateable value (RV) of $550,000 or below, rates will continue to be charged at 5% of the RV. For domestic tenements with a rateable value exceeding $550,000, rates will be charged at 5% for the first $550,000 and at 8% for the next $250,000, then at 12% for the value exceeding $800,000 of the RV. Non-domestic tenements, including those tenements occupied for the purpose of business activities or social services such as hotel, children's home, nursery, home for the elderly, youth hostel and holiday camp, will not be subject to the progressive rating system. The Government noted the progressive rating system endeavours to strike a balance between upholding the “affordable users pay” principle and minimising the number of ratepayers affected, adding that due regard is given to the need to maintain a simple rating system. The proposal will only affect domestic tenements with an RV exceeding $550,000, i.e. a monthly rent of about $46,000 or above, which accounts for about 1.9% of the total number of private domestic tenements in Hong Kong. The progressive rates for the applicable cases will be reflected in the quarterly demands for the fourth quarter of 2024-25 to be issued to ratepayers in December. Government revenue will increase by about $820 million each year.

A recent report from the Altus Group titled “US Real Property Tax Benchmark Report 2024” analyses property tax issues across ten major US cities. The report leverages effective tax rates to make better “apples to apples” comparisons across regional tax jurisdictions which can wildly differ due to local laws and property valuations. The report examines markets and commercial real estate sectors where there might be opportunities for property tax appeals as well as areas where taxes could be on the rise. The report states that for most commercial properties in the United States, property tax represents the single largest operating cost – nearly 25% of net operating income for the average US property. It also explains that there are currently over 17,000 property tax districts in the US, each with its own assessment authority, legislation, and tax policy. Because of this, it can be a formidable task to assess and prioritize issues to address opportunities for appeal. Altus compared real property tax for office, retail, industrial, and multi-family properties in each of the 10 cities using the following metrics: effective property tax rates (taxes paid relative to assessed fair market value); sales ratios (property tax costs as a percentage of 2023 sale prices); market parameters (changes in appraisal parameters between Q1 and Q4 2023); and benchmark taxes per square foot (estimated taxes per square foot for a benchmark group of properties in each city). A copy of the report is available via this link: https://www.altusgroup.com/featured-insights/united-states-property-tax-benchmark-report/

And finally, we all know about the "law" of unintended consequences, but here is an example of how that can spill over into the property tax world. Press reports from the UK indicate that a family has been left "confused and financially worse off" after the garage in which they housed Ukrainian refugees was given a council tax band, i.e. a separate residential property tax assessment. The garage and space above it was built before the family bought their home and was used for storage and an office. It was made into a liveable space to house Ukrainian refugees and was reported to the Valuation Office Agency (VOA) as a "self-contained annexe" by the local council. The family must now pay an increased level of council tax on their home in addition to a separate council tax bill for their garage. The council said it had asked for an "urgent review" of the taxing decision. A council communities team visited the space to ensure it was suitable for someone to live in under the Homes for Ukraine scheme, which enabled UK sponsors to register to host Ukrainian refugees for at least six months. A family of three moved in and shared utilities, the garden, letterbox, washing line and the driveway with the host family. Under the scheme, council tax should be paid by the hosts or refugees for "self-contained accommodation". A letter addressed to "The Annex" was received and contained a council tax bill for more than £3,000, backdated to November 2022 when the Ukrainian family had arrived. Two letters from the VOA followed to notify "The Annex" that the property was in band A and the main house had been moved from band F to G. The taxpayer has appealed the VOA's decision. A council spokesperson said the authority had asked the government for an urgent review, adding: "When the government launched the Homes for Ukraine scheme, they stated that hosts would not be financially worse off because of providing a home to refugees at their time of greatest need. Our view is that council tax banding on an annexe like this should be paused when a Homes for Ukraine guest is being hosted. We have not yet had a response." A VOA spokesperson said it was appreciated that their action was a "challenging situation for the homeowner", but said it had a legal duty to assign a council tax band to "any property capable of being lived in, including self-contained units connected to a main property". Let's hope this issue can be resolved satisfactorily.

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