



PRESIDENT'S MESSAGE

May 2024

I read a particularly pertinent article on property tax reform proposals in the USA that I thought I would share in this newsletter. The article is titled “The Practical Realities of Property Tax Reforms” and the author states: “It’s an election year, so nobody should be surprised to see eye-catching proposals for sweeping tax cuts in various jurisdictions. Some folks want to abolish the property tax altogether; others are pushing to eliminate their state’s income tax. Their proponents’ rationales are familiar and longstanding. Generally speaking, it’s progressives and liberals who think property taxes are regressive, whereas conservatives and libertarians despise income taxes - especially graduated levies - as soak-the-rich schemes that destroy incentives for production.

The fundamental problem for those who think they can simply eliminate either tax, of course, is that these levies provide revenue needed for basic governmental operations. No matter how much fraud, waste and inefficiency the tax-haters think they can find, it’s impossible to fund fire and police departments, schools, criminal justice systems, public transportation and other essential public services without some combination of one tax or the other. Likewise, the fiscal liberals seeking to equalize tax burdens between communities of differing wealth need to find viable replacement revenues.

Unless they can come up with something out of the blue to replace the foregone revenue, such as an integrated federal-state value-added tax, both sides of this political divide would be wiser to focus on property tax reforms - specifically smaller, incremental tweaks to the tax base that can be achieved in ways that neutralize some of the negative features of the unpopular levy, whose inflation-driven collections rose 6.9 percent nationwide in 2023. To prevent political blow-ups, pragmatism needs to prevail over ideology, as the Government Finance Officers Association’s recent report on equitable assessment techniques explains.

This past decade’s rapid run-up in residential property prices was driven foremost by super-low interest rates and a decade of insufficient new housing, coupled with a huge pandemic-

related increase in government spending and the Federal Reserve's accommodative monetary policy that propelled inflation. This real estate scenario had a clear precedent in the 1970s, when inflation pushed home values higher, which in turn spurred successful rebellious voter ballot proposals to curb property tax escalation.

The most famous of these was California's Proposition 13, which limited property assessments and the maximum tax rates that local governments could set. Other states adopted tax and revenue limitations of various kinds that capped the revenues of municipal governments and school districts. The common thread of these laws was that property value inflation should not automatically drive-up tax bills and boost governments' revenues at the expense of homeowners.

There are essentially two approaches to property tax limitations: Cap the growth of either property assessments or revenues. Prop. 13 did both, but its longer-lasting distortion of tax policy has been its limitations on individual property assessments, which are not allowed to exceed 2 percent annually unless and until a property changes hands.

Local voters in California can approve a tax-rate increase with a supermajority vote, but they cannot change the property assessment limits without a constitutional amendment. As a result, longtime businesses and in-place senior citizens enjoy valuations that were assessed 45 years ago. For perspective, while their assessments have increased by 150 percent since Prop. 13's passage in 1978, the CPI has increased by 370 percent and market values of California houses have risen by 1,070 percent. As a result, a first-time homebuyer inequitably bears a property tax burden 4.5 times as high as Granny living down the street, or the McDonalds and neighborhood strip mall held in an LLC all these years. Similar extreme inequalities have surfaced in New York City, where selective assessment limits also apply.

Such massive distortions of assessment valuations give huge incentives for property in such states to be held by legal entities and not "natural persons," the legal parlance for individuals rather than corporations, partnerships and trusts. Corporations and partnerships can often retain their perpetually preferential assessment basis as long as the entity remains intact. Family trusts and LLCs have been crafted to provide similar tax shelters to affluent residential owners. Meanwhile, most homeowners forfeit their tax limitations when they sell and buy anew. Such a privileged caste of long-term property holders is an anachronism that cannot endure forever.

Should such a reform come to pass, I'd suggest a reasonable and fair five-year transition period for artificially depressed assessments to revert to full market value, plus a windfall limitation - perhaps 4 percent annually - on how much additional overall tax revenue a local jurisdiction can capture simply as a result of the re-establishment of fair valuations. Beyond

that allowance, the local tax rates should be correspondingly reduced overall, for the benefit of all property owners. Being natural persons, sensible voters could be educated that it's in their own self-interest to clean up the mess that Prop. 13 has left behind after the past 45 years.

In other states, the most prominent form of property tax limitation has been a curb on the annual growth of local tax receipts derived from inflating property assessments. A good example is Michigan's 1978 "Headlee amendment," which limits increases in each jurisdiction's property tax revenues to the lesser of the latest CPI increase or 5 percent annually, plus growth from improvements to the properties. These revenue caps are far less prone to abuses and inequitable distortions. Governing bodies that seek more revenue than allowed by the statewide cap can present a referendum option for voters to tax themselves at a higher rate. That policy model should satisfy all but the most ardent tax-haters, if they actually believe in democracy.

The important concept here is that property assessments should continue to reflect fair market value, and revenue limitations are derived from applying limits or rollbacks to the tax rate times the total tax base. Revenue rollbacks like these are at least equitable solutions to the problem of property price appreciation that outstrips household budgets.

A third approach is to exempt a certain portion of property taxes for "homesteads" or senior citizens and other natural persons deemed to be deserving of protections. In most states, the local tax collector is responsible for administering this tax relief, and in most of those cases the dollar amounts are relatively trivial in the context of total local government revenues. State laws typically make no distinction between elderly poor or elderly rich, and it's a nightmare to try to invoke an income test in the formulas at the local level.

Emerging technology may offer a new and smarter way to provide property tax relief. A few states offer it indirectly through their income tax deductions, but the shortcoming in that approach is that the economics are right, but the politics are not: Those tax breaks are typically viewed as state income tax relief and not local property tax relief. It hasn't been possible to show income-based credits on property tax bills. Soon, however, computerized data-sharing interfaces linking local jurisdictions with state income tax authorities could apply artificial intelligence to confidentially match local property parcels with owners' latest state income tax returns.

Such a network could enable state revenue departments to calculate and reimburse personalized income- and needs-based credits to apply on local property tax bills and perform the unique calculations for each household, sending a customized parcel-specific data file to

local tax collectors. The result would be precision-targeted property tax relief for eligible homeowners.

The beauty of this AI-based system is that its application could be limited to natural persons and provide relief only to those who file state tax returns with incomes below a statutory threshold, with proportionally larger credits for those with lower incomes, which could greatly reduce the regressive drawbacks of the property tax. AI could even make it possible to provide equivalent relief to tenants through rent-reduction vouchers or credits on their utility bills. The question for tax reformers is how comfortable they and their constituents would be with such Big Brother databases.

Ultimately, the challenges facing state and local policymakers when these proposals to eliminate property and income taxes are advanced is that they never include a specific list of what should be cut on the expense side of the ledger. The anti-taxers may believe that they can just starve the beast, to shrink the size of government overall, but most of them have never sat through a budget session. Maybe it's time for more state controllers and treasurers to schedule meetings every year with the various taxpayer unions and would-be reformers, if only to make their leaders aware of how things actually work in the real world of financial administration." I hope you will agree this is an interesting and thoughtful article.

Moving on to IPTI activities, we have recently delivered another webinar in the series that forms part of our partnership with the Institute of Municipal Assessors (IMA). The latest webinar dealt with the topic of "Developing Cap Rates" and was based on the premise that any interest in real estate that is capable of generating income can be valued using the direct capitalization approach. This approach requires an appropriate derivation of the capitalization rate. Depending on the quantity and quality of available data, there are various techniques used. This webinar covered the challenges assessors and valuers face in deriving capitalization rates in the application of the direct capitalization methodology.

On the topic of data, we also provided another in the series of six webinars dealing with the issue of "Mass Appraisal Valuation". The latest webinar was titled "Data Readiness" and outlined the critical role the valuer plays in the mass appraisal process by having a clear understanding of the population of data through statistical analysis of the supply.

In terms of forthcoming events, I would like to remind readers about our online 2024 Mass Appraisal Valuation Symposium (MAVS) which we will be delivering jointly with the International Association of Assessing Officers (IAAO) on 26-27 June 2024. Another future date for your diary is our annual Caribbean conference, run in partnership with the Royal Institution of Chartered Surveyors (RICS), which will be held in Montego Bay, Jamaica on 2-3 October 2024.

IPTI will also be facilitating the next Conference of Valuation Agencies (CoVA 2024) to be held in Dublin on 29-30 October 2024. Details of all our forthcoming events 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>

In Japan there is concern that the current preferential treatment in property tax for residential land, which reduces taxes by up to one-sixth, incentivises owners not to demolish vacant homes. With Japan's ageing population and declining birth rates, it is reported that the number of abandoned homes is rapidly increasing. According to a survey by the Ministry of Internal Affairs and Communications, the number of empty homes has risen 1.5 times to about 8.49 million units over the 20 years leading up to 2018. This equates to about one out of every eight homes being empty, and it is estimated that by 2038, the number of empty homes will rise to 23.03 million units. A survey reveals that approximately 90% of the long-term empty homes, left untouched without being sold or rented, are single-family houses. Among them, about 70% were built before 1980. The risks posed by poorly managed empty homes, such as collapse due to ageing, deterioration of hygiene and aesthetics, and adverse effects on the living environment of residents, can lead to a decline in the value of residences and neighbourhoods. The government enacted the Vacant Houses Special Measures Law in 2015 to address the increasing number of empty properties. This legislation designates high-risk properties, such as those at risk of collapse if abandoned, as "specified vacant homes." According to the law, owners of these properties must either demolish or repair them, with the government authorized to enforce demolition at the owner's expense if they fail to comply. Commentators say that the property tax system should be changed to impose penalties on owners who choose to leave these houses empty.

Last year, France introduced a requirement for property owners to declare whether they were using a property themselves as a main residence or second home, if it was vacant, or if it was occupied by tenants. This *déclaration d'occupation* was to determine the type/amount of property tax due. Empty properties are subject to vacant property taxes (*taxes sur les logements vacants*), and *taxe d'habitation* is payable where properties are used as second homes. The latter is no longer payable when the property is occupied as a main home. The declarations should have been made online via the property owner's personal tax log-in (*espace particulier*) on the French tax site by June 30, 2023, at the latest. Property owners were warned that failure to make the declaration could lead to a €150 fine. However, so many owners struggled to make the declaration that the deadline was pushed back twice, and it

was revealed that no fines would be issued in 2023. The authorities have made it clear that people only need to submit a declaration in 2024 if their circumstances have changed, if they recently bought the property, or if they have still not managed to make their first declaration. This year, fines of €150 are expected to be imposed if the declaration is still not made after a reminder has been sent. Property owners with more than one property must make the declaration for each property or risk multiple fines.

And finally, I saw a recent article with an intriguing title: “Do We Need A Property Tax For Space?”. The author refers to what is described as “an outwardly modest but potentially pivotal policy proposal: the imposition of an excise tax on private space companies, such as SpaceX. At its core, the excise tax is an acknowledgment of the logistical effort borne by air traffic control whenever a rocket is launched - an occurrence that is becoming more common by the day, with the substantial increase in private satellite deployments over the last decade.” The proposal, it states, is not merely a government money grab or a “tax the rich” penalty levied on billionaire space entrepreneurs; it represents the first policy steps to address a growing concern that could very well redefine how we allot and afford the use of near-Earth space. The author goes on to advocate the use of a property tax in space, but states that simply applying the policies of property tax used on earth to space is fraught with issues as it is difficult to put a value on a given area of space. But, he says, the core concept is sound and translatable: that is, injecting market forces to ensure the cost of deploying a satellite isn’t solely limited to the launch and deployment, but the “space” taken up by the deployed satellite is also accounted and paid for. He continues: “Thus, any space property tax must take into consideration things like the size of the satellite deployed, the lifespan of the satellite, and how it’s safe removal from operation has been designed for. The tax would encompass compensation to society for the use of the space and a contribution to a fund for mitigating future issues. The levied tax should thus also account for the frequency of launches, the operational altitude of the satellite, and the potential for collision.” He continues: “Any successful space property tax policy will need to be developed and implemented internationally, through dialog with the international community, negotiation between stakeholders, and the establishment of shared objectives and concerns. This will not be without challenges - after all, cross border tax issues have proven a thorny issue even here on boring old earth.” I have in the past, somewhat tongue-in-cheek, suggested that IPTI’s expertise might be used to develop a property tax for virtual worlds such as the metaverse. It now seems we may have to expand our horizons and advise on how a property tax in space might be introduced. Perhaps at the same time we should change IPTI’s name to the “Interstellar Property Tax Institute”!

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