smart taxes

A Submission to the Inter-Departmental Group on Property Tax

Contents

15th March 2012

1. Overview

This is a proposal by the Smart Taxes Network to replace the existing flat household charge with a residential site value tax (SVT). A site value tax is a tax on the value of land only. Unlike other property taxes, it encourages efficient use of land rather than discourages it, as socially productive investment in real estate (such as higher density in city centres or improved energy efficiency of homes) does not lead to a higher tax bill. While not a wealth tax, a site value tax is also progressive, with wealthier households paying more than those with less real estate. By shifting the burden of taxation from mobile factors such as capital and labour to land, SVT is not only efficient and progressive but also boosts Ireland's international competitiveness.

A Site Value Tax is one of the commitments in the EU-IMF Memorandum of Understanding and the 2011 Programme for Government. The 2009 Commission on Taxation was in favour of SVT in principle although had concerns about the practicality of its implementation. This proposal outlines how the structures are already in place to implement SVT, including a report that puts each of 4,500 districts in the country in to one of ten land value bands. This would allow the basis for self-assessment with a robust auditing function.

The remainder of this submission is structured around the terms of reference. SVT has the potential to raise between €1bn and €2.5bn, which would generate new revenues as well replacing a number of existing fiscal measures. The higher amount would cover current local government funding and could be levied in conjunction with a reduction in income tax or VAT. Site Value Tax would be a stable source of revenue for local authorities. It could be efficiently collected, using accredited self-assessment informed by existing estimates of the contours of land value and a range of easy payments options depending on circumstances, including at-source deductions for PAYE workers and liens for older citizens. The tax is inherently a fair one for both urban and rural households, where bigger rural plots partially offset large differences in land values between urban and rural areas. Auditing and enforcement would be based on the Danish experience, with biennial updates to site values and a three-tier appeals system.

2. Potential Revenue

"The property tax is to meet the immediate financial requirements of the EU/IMF programme."

Ireland needs to raise about €4.5bn in new tax revenues over the coming years (€4.65bn by 2015, according to the 2011 Medium-Term Fiscal Statement) and even if organic growth delivers the €1.4bn expected by the Department of Finance, a further €3.25bn will be needed through fresh taxation measures. In the Memorandum of Understanding between the European Commission and Ireland in December 2010 there was a clear commitment that the government would "establish a sound basis for sub-national finances through a new residential-property based site value tax".

It is useful to summarise the potential receipts of a SVT. One of the strengths of a Site Value Tax is that the tax rate can be set at any level to suit the tax receipts required. It is envisaged as part of this submission that SVT would replace a number of other taxes and charges.[1] A further consideration in relation to total revenues from SVT is any waiver applied or reductions for specific categories of tax payers (such as recent purchasers or the elderly).

Our research shows that an average charge of €400 per dwelling would raise approximately €1 billion while an average charge of €1,000 per annum would raise €2.5 billion. It is important to remember, though, that the unit of taxation under SVT is the acre (or hectare), not the household. Total revenues are greater as zoned land is also be liable, even allowing for de-zoning after the introduction of SVT – full details on the tax base for SVT will be available from the Department of Environment's DevPlanGIS system.

Current Government grants and subsidies for infrastructure add up to approximately €1.88 billion and development levies in the depressed market probably raise no

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[1] It is proposed that Site Value Tax replace Section 27 and 28 and Part V levies and special development contributions of the 2000 Act as amended to reduce the often prohibitive and unpredictable upfront costs of development that currently hinders needed development. Site Value Tax spreads these social, utility and amenity charges over all benefiting users over a wider area and over a longer period so that is not borne solely by new home purchasers and the developer. It provides a predictable revenue stream for local authorities so that they are not reliant on new development for levies revenue to upgrade services or provide social housing thereby removing a perverse incentive to grant permission for premature or unsuitable developments.

more than €200,000. Therefore €2.5 billion would cover all government subsidies and replace development levies and still leave enough to reduce commercial rates or contribute to national infrastructure.

Property tax compared to the alternatives

The potential revenue from SVT of between €1bn and €2.5bn can be viewed against current estimates of €700m for an additional 2% on VAT or for a 1% increase in income tax. Indeed, there is a strong case to be made on the grounds of political acceptability, competitiveness and equity, for introducing a high rate of SVT and concurrently reducing income Tax or VAT. If the SVT is required to raise a net €350 million in the first year then reductions of up to €2.15 billion in job-destroying labour taxes on unfair transaction taxes could be easily possible.

If the €3.25bn needed through fresh taxation measures does not come from property tax, then it will have to come from income taxes or consumption taxes. Higher income taxes damage international competitiveness and Ireland has already some of the highest marginal rates in the OECD. Higher consumption taxes hit poorer households hardest – and at 23%, Ireland already has one of the highest rates of VAT in the OECD. Should income or consumption taxes increase further, this could undermine economic recovery.

3. Stable Revenues for Local Authorities

"The new property tax is to provide a stable funding base for the local authority sector in the medium and longer terms incorporating an appropriate element of local authority responsibility subject to any national parameters."

Reform of local government will undoubtedly form a key element of change in response to evolving economic, social and environmental circumstances in Ireland. Fair and efficient local taxes will be critical to this process. A large literature in urban economics shows that property prices reflect amenities nearby and therefore a property tax can be used as a means of paying for the maintenance of existing amenities and investment in new ones. Because amenities are capitalised in to land values, SVT creates a stronger link between local authority revenues and amenities than a property tax based on estimated market values.

SVT presents the opportunity for Local Authorities to engage with their constituents about the provision of new services and infrastructure, making the case for additional tax to pay for new infrastructure. The strong link between facilities and amenities provided and the revenue raised will support democratic functions and responsible local decision taking. SVT recovers the increased land values created by Local Government investment in social and physical infrastructure in a virtuous feedback loop. Most importantly, unlike a property tax on buildings that excludes undeveloped land, SVT eliminates incentives for land speculation, land banking and pressures for premature zoning.

SVT & property market cycles

Site Value Tax works to smooth out volatile economic cycles inextricably linked to both the price of land and property and the availability of finance. As Ireland has experienced, such volatility is difficult to manage in a single market and common currency. When property taxes are tied to transactions as with VAT, Stamp Duty and Development Levies and Social Housing provision, the government becomes dependent on maintaining the boom momentum. If property taxes are decoupled from transactions, the annual SVT can rise to cut off incipient bubbles while it increases receipts which encourage prudent countercyclical policies. The lag in annual tax receipts on the down-cycle also moderates the economic effect of recession and buys time for appropriate government responses.

Irish households heavily rely on property to underpin bank borrowing so that household consumption is highly sensitive to perceived property wealth. Declines in house prices impact household spending, thus further exacerbating difficulties in the general economy. The tax system should therefore levy a charge against the least volatile element of the property price: land. SVT anchors tax rates to the less mobile and less volatile element of property asset values and so offers much stronger internal stabilisation potential than a general property tax.

4. Efficient Collection

"A property tax needs to be collected centrally by the most cost efficient and effective means."

Evidence from Denmark, where Site Value Tax forms an important part of their tax structure indicates that the valuation and administration of S.V.T. including an appeal system are extremely efficient at around 2.5% of annual revenue. As a tax on a fixed asset, it is virtually impossible to evade unlike other potential taxes, particularly should individual markers be linked to Revenue Commissioner records.

Even though SVT may be collected centrally (at least initially) for efficiency sake, the receipts relating to each local authority area should be distributed to the relevant local authority. This is very important for democratic accountability and to foster the efficiency of planning and investment decisions by local authorities. In effect, SVT should replace centralised funding of local authorities, specifically the system of hypothecated financing by vehicle taxes. However, this general principle does not preclude a portion of redistribution from richer to poorer local authorities under clear, objective and transparent criteria.

Local authorities should be given the powers to levy further SVT rates for specific projects that have been approved by their communities. On no account should local authorities be allowed reduce the standard national SVT to attract residents or investment to their area - this is an ultimately self defeating policy as proved by many US examples. Competition between authorities should be on the basis of the quality of the amenities and services provided by the local authority based on the nationally set level of SVT.

Collection could be devolved to a smaller number of amalgamated local authorities after reform using economic boundary information generated by the SVT.

5. Easy Payment by Households

"A new property tax must facilitate easy and/or phased payments by households; be easily determined (e.g. on a self-assessment basis), and having regard to available information on residential property and/or house ownership details."

Our research, in particular the report by Ronan Lyons[2], shows that the information infrastructure for Site Value Tax is largely in place. The Property Registration Authority of Ireland (PRAI) has Land Registry records which associate title-holders with plots of land for the vast majority of the land surface of Ireland.[3] Where necessary, these can be supplemented by Geodirectory records connecting addresses with particular plots of land. Where SVT only applies to residential land, the DevPlanGIS system implemented by the Department of the Environment, Heritage and Local Government outlines which land is residential and ensures zoned but unoccupied land is included in the tax.

For contours of land value, research has been conducted on over one million property listings, establishing both the contours of land value across the country and an econometric model that can be easily used on new datasets such as the Revenue Commissioner/PRA house price register (due to be launched by June 2012). This research underpins a forthcoming map to be published by the All-Island Research Observatory at NUI Maynooth, where individuals will be able to go online and see average prices in their district.

It is proposed that Site Value Tax would be done on a self-assessment basis. An initial communication to the titleholder would advise them of the approximate value of land in their area, using the existing research by Ronan Lyons which allocates 4,500 regions in the country to one of ten land value bands. A tax credit in the first year would allow landowners to have the cost of their site formally valued written off their tax bill, with accredited valuers similar to the BER system.

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[2] http://smarttaxes.org/report/

[3] The bulk of missing information relates to Dublin between the canals, which is predominantly non-residential land and where Ordnance Survey and Dublin City Council records are an adequate substitute.

It is proposed that SVT be collected on a monthly basis with at source deductions through the PAYE system, with the potential for automatic opt-in (rather active opt-in) based on Revenue Commissioners records. Self-employed would pay in two instalments as they currently do for all their taxes. A lien can be placed on property for elders who may be asset rich and cash poor, and concessions can be set for home (not investment property) purchasers during the overheated boom period on a sliding scale.[4] An alternative would be for people to be able to pay through the electricity bill.

Sanctions for non-payment should be underpinned by the legal lien on the property for the unpaid SVT plus interest.

6. Urban & Rural Fairness

"A property tax should ensure the maximum degree of fairness between and across both urban and rural areas."

Site Value Tax automatically reflects differences in amenity value. Land worth €15,000 an acre is judged by the market to have access to 1% of the amenities that land worth €1,500,000 an acre. These amenities range from access to consumer and jobs markets, to public services such as schools and hospitals, to transport facilities and to factors such as social capital. All of these are capitalised into land values and reflected in a smaller SVT charge on rural properties.

There may be a concern that SVT would be principally an urban tax, given the large differentials in land values between urban and rural sites. However, this is offset to some extent by the fact that homes in rural areas are on larger sites. Therefore, Site Value Tax offers the fairest compromise between the larger plots enjoyed by rural households and the greater amenities enjoyed by urban households.

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[4] Further time-limited concessions for over 60s should be considered in the early years of operation of the SVT as it will take time for cultural attitudes to property to change. Irish people use their own home as a way to save for retirement instead of holding a more balanced wealth portfolio. More variety of housing type and size within neighbourhoods would assist downsizing without losing touch with family and neighbours – this will take some time.

There are other elements of fairness. SVT is progressive and wealthier households will pay significantly more than poorer households, many of whom do not own any land. There is also the possibility of shifting the burden from used land to unused land, by increasing the SVT rate but introducing per-person green space tax credits (explained more fully in the report by Ronan Lyons).

SVT on commercial and public buildings

A final element of fairness is residential versus non-residential land. While beyond the specific terms of reference, Site Value Tax can be easily extended to include commercial and public land. In relation to commercial SVT, there are many advantages to replacing the current rates on businesses with a SVT. Vacant buildings are currently relieved of all or some of the burden of rates which impacts negatively on adjoining businesses who have to trade in semi-vacant streets. A tax on sites only would encourage re-letting as quickly as possible at whatever rent level can be got.

There are also considerable benefits to introducing SVT on public property. A central one is the quantification of any under-use of land and the implicit subsidies of publicly owned property. The direct beneficiaries of the location are the occupants even if the State is the owner and it is psychologically important that they also see the relationship between their local taxes and the amenities and services they enjoy. The HEA has €4.2 billion of fixed assets. Efficiency in their use is just as important for the State as it is for the private sector.

7. Robust Auditing & Enforcement

"A robust audit function; appeal system and strong enforcement and penalty provisions for non-compliance."

The land valuation map can be updated in real time as market information becomes available. A two year delay between revaluations is preferred as noted before, to smooth economic cycles. Denmark, which has a SVT system, updates residential valuations every other year (with commercial valuations updated in alternate years).

The administration system proposed in the Ronan Lyons research report is tiered from an initial broad and easy appeal process to legal appeal and the High Court. We are confident most people will be satisfied with the easy appeal as long as they see that their neighbours are paying the same fair share, as per the Danish experience.

Auditing would be informed initially by existing estimates of the contours of land value in Ireland (see the report by Ronan Lyons) and updated as new datasets (such as the house price register) become available. Ideally, this would involve the site value element of property sales and rental agreements being registered with the PRA separately to that of buildings by solicitors acting for buyers. This task should not prove difficult as similar dis-aggregation was required for the Section 21 tax concessions. Auctioneering and valuation professionals will develop CPD (Continuing Professional Development) modules to cover the appropriate methods and calculations.

Appendix 1: About Smart Taxes

In September 2008, Feasta, the Foundation for the Economics of Sustainability, was awarded multi-annual funding from the Irish Department of the Environment for a Smart Taxes policy research project. The purpose of the Smart Taxes project was to develop policy options to reform fiscal and other financial and monetary mechanisms in Ireland to deliver environmental, social and economic sustainability.

The project is led by **Feasta,** but involves a network of the organisations including An Taisce, DIT School of Real Estate, the School of Philosophy and Economic Science as well as individuals with particular interest and skill in the topic.

The network has considered a number of fiscal topics such as Modern Monetary Theory and Green Job Guarantees, but Land Value Tax (LVT) has been a core interest following on from Feasta Land Conference conferences in 2003. More recently research has been commissioned to corroborate international experience and to consider the feasibility of initiating a partial LVT that of a Site Value Tax (SVT) in Ireland. Selected reports of this work are attached. Smart Taxes has also collaborated with Comhar and the European Environmental Agency (EEA) in a two day conference on environmental taxes in 2010 in which a SVT for Ireland was discussed. The Urban Forum has held three colloquia on S.V.T. over the last three years with key participants from the Public and Private Sector debating the issues.

There is growing acceptance of the environmental credentials of this form of taxation.. SVT is not a wealth tax per se although it is broadly progressive in its effects. It is more usefully thought of as a charge for the use of a common resource – or a location benefit levy[5]. Charging for the use of scarce common resources is central to internalizing the cost of their use and/or depletion within a market system. A 'Tax Shift' from taxing labour and capital to charging for resource use would reduce wealth differentials over time thereby supporting social cohesion as a great deal of private wealth derives from the 'enclosure' or privatisation of unregulated and unprotected commons. This shift is also the single most effective economic reform

[5] Quoted from Dave Wetzel of Labour Land Campaign

that could address climate change, biodiversity loss, and resource peak in the coming decades.

We must ensure that we are prepared for a range of possible futures and SVT brings the flexibility to respond to a range of challenges whether economic, fiscal or environmental.
Good agricultural land seemingly abundant now, is Ireland's greatest natural asset but will come under pressure with natural population increase and in-migration due to climate change. SVT aligns economic incentives with sustainable planning objectives to foster more compact, better serviced settlements to reduce land take from food and energy production and limit the need for transport.

Ireland currently faces compounded crises. Widely fluctuating economic cycles and tax receipts have thrust the economy into turmoil, budgets are askew and the entire construction industry is almost at a stand still. Site Value Tax (and associated Local Government Reform) will make a major contribution to moderating fiscal receipts and help prevent a recurrence of a land value bubble in the future.

Over-zoning, which played a significant part in producing an over supply of housing in the wrong locations in the boom era, is disincentivised by Site Value Tax at the same time as development is encouraged on suitable, serviced, zoned land. The tax falls on the site, not the buildings so that the owners of derelict sites and underused buildings are taxed the same as nearby owners of properly utilized and developed buildings. Upgrading and extending one's home will not incur a higher tax as it would for a property tax that falls on buildings. Similarly as a town grows, zoned land not yet developed will be valued the same as residential developments nearby that share similar facilities. It is in the owners' best interest to develop zoned land quickly to offset tax against income from the development. In this way land speculation, hoarding and lobbying for premature zoning will be discouraged.

See www.smarttaxes.org for numerous reports and media articles about Site Value Tax

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Appendix 2: Existing Research by Smart Taxes

See also

The economic benefits of a site value Tax, by Constantin Gurdiev 2009

http://smarttaxes.org/wp-content/uploads/2009/05/macroeconomic-impact-of-a-land-value-tax-c-gurdgiev.pdf

Implementing a Site Value Tax, by Ronan Lyons. 2012.

http://smarttaxes.org/wp-content/uploads/2012/01/Site-Value-Tax-in-Ireland-Identify-Consulting-final-report.pdf

An outline of the general benefits to society, the local economy and the environment. 2011

http://smarttaxes.org/wp-content/uploads/2011/05/SVT_brochure_sm.pdf

Further environmental tax reform – illustrative potential in Ireland

Prepared for the Environmental Tax Reform Workshop Dublin October 28 and 29, 2010, hosted by Comhar Sustainable Development Council, and organised with University College Dublin Earth Sciences Institute, Smart Taxes and Feasta.

http://www.comharsdc.ie/_files/2010_BriefingNoteETRWorkshopDublinRevised%20_pap.pdf