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Tax on Land and Buildings

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The thing generally raised on city land is taxes.
—Charles Dudley Warner

I. Introduction

Taxes on immovable property, or land and buildings, as considered in this chapter generally take the form of an annual percentage of asset value. The simplicity of this concept can conceal a number of important drafting issues, some of which require a prior clarification as to the goals of the tax.[1] The primary reasons for imposing a property tax include incentives for efficient land use, a tax base that cannot be withdrawn from production, and establishment of an autonomous revenue source for local government.

Drafting a tax on land and buildings poses a number of challenges that may be surprising and frustrating in light of the simplicity of a typical property tax statute. These arise in part because many crucial issues regarding the tax resist uniform solutions. Instead, appropriate choices rely upon political, social, and economic judgments that must precede drafting but that are often not addressed until the drafting process brings them to policymakers' attention. Examples include whether to tax land and buildings together, to tax them separately at different rates, or to exempt structures; and whether the measure of the resulting tax base is to be market value, value in current use, acquisition cost, area, or some other quantity. A second set of critical issues concerning the operation of the tax may be too detailed to be addressed in the law itself, although it should be drafted with an understanding of, and an attempt to minimize, their potential difficulties. Numerous cases have addressed the meaning of "market value" when applied to property that has not been the subject of a recent sale; similar complexities arise with the definition of ownership and of property itself. In the case of a tax on land and buildings, the somewhat deceptive simplicity of the legislative language requires greater stress upon consideration of underlying policy issues. This chapter reflects that balance.

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[1]*See* Janet Stotsky & Zühtü Yücelik, *Taxation of Land and Property, in* Tax Policy Handbook 185 (Parthasarathi Shome ed., 1995).

A. Why a Property Tax?

A tax on ownership and other legal interests in land and buildings can serve important fiscal, political, and legal objectives. It is critical to identify these functions, for modest initial collections may not appear to justify the administrative costs of the tax on revenue grounds alone.

1. Local Government Finance

A property tax is often designed to provide an independent source of local government finance, whether or not collected and administered locally. A tax on land and buildings offers a revenue base that, unlike sales, payroll, or income, cannot readily shift to a neighboring jurisdiction. This is one reason that immovable property[2] is appropriate for a special form of taxation that does not extend to movable property, such as inventory, equipment, and household goods.

Land and building values are also frequently associated with services provided by local governments, such as fire and police protection and road maintenance. However, this benefit justification has important limitations. Often, the properties that place the highest burdens on local services and pose the greatest fire and safety risks are poorly maintained structures of low value. More expensive buildings may be better maintained, built more recently and to more exacting safety standards, and even protected by private security arrangements.

An equally limited but politically significant justification rests on ability to pay, demonstrated in part by ownership of valuable property. The weaknesses of this rationale are readily apparent, because the tax reaches only one form of property and even that generally in a gross rather than in a net form, with no offset for mortgage indebtedness. These objections argue against excessive reliance on a property tax but not against the tax itself. Particularly in light of the ascendancy of consumption-based taxes, there is an important place for a tax upon a significant segment of wealth, especially when that segment is often subject to favorable income and inheritance tax treatment.

2. Defining the Public Claim on Property Value

The role of a property tax in defining property rights may be among its most significant contributions to economies in transition, one often overlooked when the levy is considered solely as a fiscal instrument. A period of privatization and restitution presents critical choices as to the division of public and private rights in property. The economic advantages of a system of private ownership, together with intense political reaction against the abuses of state control, frequently conflict with deeply held beliefs in the need for a continuing public interest in the permanent and irreplaceable heritage of immovable property. This conflict can arise most strongly in the case of land, whose supply cannot be expanded and whose existence is not the result of individual effort, but

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[2]*See infra* sec. II(A); *supra* ch. 3, sec. V(D)(3).

similar issues arise with regard to the privatization of buildings. Clarification of a continuing public claim upon a portion of land value in the form of an annual tax can help reconcile these competing positions.

3. Inelastic Tax Base

The inelasticity of a land tax base offers a means of raising revenue without distorting the economic signals that guide the production process. The tax will not affect the supply of land (leaving aside for the moment specialized cases such as land reclamation) and thereby imposes a lower total economic burden than would an alternate means of raising the same amount that did affect the supply of the taxed good.

4. Equity Arguments

An important political debate sometimes centers on the nature of land value as an "unearned increment," an asset attributable to social growth and public investment rather than to individual effort, and therefore appropriate for special forms of taxation. This view of land value does not properly apply to value attributable to trade and investment that have relied upon long-established systems of property rights. In that case, land wealth can represent a purchase made possible by other forms of productive effort. Of course, any tax can upset settled expectations and investor reliance, and, with sufficient notice and a gradual introduction, these detrimental effects may be greatly diminished. But the difficulty presented by this particular rationale for land-value taxation extends beyond issues of transition and implementation. The justification for a tax on "unearned" wealth is undermined when that wealth represents an investment of accumulated earnings. The alternative of a split tax base that falls more heavily on post-acquisition gains than on initial investment presents a complex administrative challenge. Individual value increments are more easily captured by a tax on realized gains than by an annual tax on property value.

Conversely, the argument for land-value taxation can be most powerful when a system of property rights is in the process of development. At this point, establishment of a continuing public claim to some portion of that value can be taken into consideration by investors formulating their bids for the property. Problems of notice and reliance arise only when a new tax is introduced after these purchases are completed. They grow more acute if the tax is capitalized into property value and so falls entirely on the owner at the time of its introduction.

Equity considerations also arise with regard to the effect of a property tax on the distribution of ownership rights. As Bahl and Linn have written,

> [a]n equity argument may be at the heart of the matter: urban land prices are frequently so high that low-income groups cannot afford to purchase land, given their disposable incomes and the prevailing capital market conditions, which prevent access to mortgage credits at affordable interest rates. To the extent that the revenue from property taxes is capitalized into lower current

> land values (since the tax reduces the expected future private yield on the land), it partially expropriates landownership rights from the present owner and constitutes a loan to future owners, who can now acquire the land at the lower price but will have to pay property taxes in the future. If low-income groups cannot buy land because they lack liquidity and access to capital markets, property taxation may be one of the policy instruments to improve their access to landownership.[3]

Each of these rationales for property taxation applies equally to all types of land—agricultural, commercial, industrial, residential, and open space—as well as to land held by all types of private owners, whether individuals or enterprises. Similarly, the justification for a tax on buildings does not distinguish among them on the basis of type, use, or ownership. The multitude of special provisions that in fact differentiate among classes of land and buildings in nearly all systems of property taxation generally respond to political conditions and historical developments rather than to economic or legal considerations. For example, preferential taxation of owner-occupied housing reduces the tax burden on an important and affluent political constituency. Provisions of this type may be unavoidable to some degree, but simplicity and neutrality are best served when such preferences are minimized.

B. Drafting Issues

The elements to be specified in drafting a property tax are similar to those required for other levies: (1) definition of the tax base, (2) identification of the parties responsible for payment, (3) determination of the tax rate, and (4) assignment of administrative functions and tax revenues among levels of government. None of these has a single optimal resolution. The preferred method for addressing each issue will depend upon prior political and economic judgments, particularly with regard to the feasibility and desirability of autonomous local government. A practical evaluation of any proposed legislation must examine such questions as these:

- How is the system of identifying properties and taxpayers coordinated with current land and property records? What agencies will be responsible for maintaining this information?

- Will the proposed division of revenue between local and central governments serve the goals set for the tax? For example, will it permit local governments to undertake new responsibilities, and will it offer the government agency responsible for administration of the tax an incentive for efficient collection?

- Will the interest and penalty provisions encourage a reasonable level of compliance, particularly if this is a new tax?

[3] Roy W. Bahl & Johannes Linn, Urban Public Finance in Developing Countries 168 (1992).

- Are land-policy goals for the tax, such as control of price inflation and discouragement of speculation, realistic?

This chapter will examine alternative approaches to these issues, and examine their benefits, drawbacks, and consequences.

C. Terminology

References to taxes on immovable property as "property taxes" require some clarification. In a technical sense, "property" consists of a set of legal rights pertaining to a specific object;[4] a property tax is not imposed on the physical land and buildings, but rather on intangible rights to them. Although differentiating between a tax on a building and a tax on the rights of ownership of a building may seem a semantic exercise, this distinction takes on practical importance when partial interests that do not rise to the level of ownership are subject to tax. For example, countries that do not recognize private ownership of land but recognize private rights of use of land still have a system of private property appropriate for taxation.[5]

With these caveats, this chapter will use the terms "property taxation," "taxation of immovable property," and "taxation of land and buildings" interchangeably to mean the taxation of legal interests in land and improvements to land, including buildings, with appropriate distinctions when a choice among technical terms would affect the substance of the legislation.

The term "assessment" often gives rise to confusion, because in the property tax context it is commonly used to mean "valuation." This chapter will refer to valuation as a part of the assessment function, which includes the entire process of establishing tax liability.

A "cadastre," or official property register, can take a number of forms. A legal cadastre lists title or ownership to land and buildings; a fiscal cadastre[6] contains tax information, such as valuations and assessments; and a physical cadastre deals with parcel boundaries and building information. Because these functions are closely related, cadastre is often used to refer generally to the combined set of records, an integrated or master cadastre.

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[4]Restatement of Property §§ 8, 14–18 (1936)("real property" defined as a set of estates).

[5]*See* CHN LT.

[6]"The basis of a good property tax practice is a full fiscal cadastre. This would involve describing and defining boundaries for every property (cadastral maps), establishing ownership or taxpayer liability, valuing the land, and if necessary describing and valuing all improvements on the land." Bahl & Linn, *supra* note 3, at 109 (footnotes omitted).

II. Legal Issues in Defining the Tax Base

A. Types of Property Subject to Tax

A wide variety of definitions of property have been used in determining the base of a property tax. Where this levy was expected to function as a wealth tax, as in the United States during colonial times, an expansive definition encompassed all types of property, whether movable, immovable, tangible, or intangible. Often termed a general property tax (as opposed to an immovable property tax), this type of gross wealth tax became untenable as financial assets and other intangibles that are inherently difficult to identify and assess grew in importance. Replacement of the general property tax with a tax on immovable property, complemented by an income tax, was an important goal of nineteenth-century tax reform. The Russian model of a balance sheet tax on enterprise assets is a specialized example of a general property tax, limited to one particular sector of the economy. It functions more as a specific business tax than as a property tax.[7]

A property tax limited to tangible assets may still reach movable property, such as inventory, machinery, and household goods. Their inclusion in modern property tax systems is generally justified only on grounds of revenue. Like financial assets, they are difficult to identify and assess and are readily concealed and easily removed from the taxing jurisdiction. Particularly when such property is held by individuals rather than by businesses, attempts to tax it can result in an administrative burden out of proportion to revenue yield. One exception is the taxes sometimes imposed on registered assets, such as automobiles, whose ownership and approximate value are a matter of record. Again, these function more as specialized fees than as property taxes. They are not a natural component of a tax system intended to reach land and buildings. A number of countries impose a broad tax on net wealth; this is discussed in chapter 10.

Within the category of immovable property itself, an important choice exists between a tax on land and a tax on land and buildings alike. Buildings do not share many of the unique characteristics that recommend land as the base of a special tax—its true immovability, its inelastic supply, and its value drawn from nature and social development rather than from individual effort. However, unless a tax on land is to function as a "single tax" and the sole source of government revenue, it will operate in conjunction with other levies of a different nature. A tax on buildings, considered on its own merits as a component of a mixed revenue system, may logically be enacted together with a tax on land. In this case, however, specifying distinct rates for land and for buildings permits the option of taxing land more heavily, as may be appropriate for a commodity in inelastic supply.

The definitions of immovable property or of land for purposes of the property tax may differ from the definitions of those concepts that are given in the civil code or in other legislation. The definition of buildings or of immovable property is the subject of many disputes in marginal cases, such as those dealing with otherwise movable property

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[7] *See* RUS TAE.

incorporated into immovable structures ("fixtures," such as elevators and heavy machinery) or small buildings such as kiosks, or large equipment such as transmission towers and pipelines that may or may not be considered movable. The definition of land can give rise to similar complexities when land and improvements are distinguished for tax purposes. Improvements other than buildings, such as grading, irrigation, and paving, could properly be considered outside the base of a land tax designed to encourage investment by reaching only site value.

A typical definition of "land" that does not try to address these issues states "`[l]and' means the solid material of the earth whatever may be the ingredients of which it is composed...."[8] *Black's Law Dictionary* includes such definitions as "any ground, soil or earth whatsoever; including fields, meadows, pastures, woods, moors, waters, marshes, and rock," and "the material of the earth, whatever may be the ingredients of which it is composed, whether soil, rock or other substance, and includes free or occupied space for an indefinite distance upwards as well as downwards, subject to limitations upon the use of airspace...."[9] This last reference makes the important point that not only surface rights but also air rights and mineral rights must be considered in defining the property subject to tax and determining how it is to be assessed when these rights are held by different taxpayers.

B. Measure of the Tax Base

Definition of the tax base requires a number of crucial choices with regard to determination of the property attributes that will be valued for taxation and the form that valuation will take.

1. Market Value as a Tax Base

Legislation implementing a value-based system, the most prevalent in international practice, must take into account the measure of that value and the degree of precision with which it is to be estimated. Statutory definitions of market value vary from the terse to the expansive, from the standard of a willing buyer and willing seller to the following suggested language from the 1976 Layfield Commission report in Great Britain:

> The value of the hereditament shall be the amount which the hereditament might reasonably have been expected to realize if sold by a willing vendor in the open market freehold with vacant possession at the relevant date with the benefit of any easement or other right inuring for the benefit of the hereditament and subject to any easement or other right subsisting for the benefit of other land and to any other restriction statutorily imposed upon the hereditament and on the assumptions that the use of the hereditament would be permanently restricted to that existing at the time of the valuation, including any change of use for which no planning permission would be required, that no alteration to the hereditament

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[8] Cal. Water Code § 34014 (West 1984).

[9] Black's Law Dictionary 789 (5th ed. 1979).

> would be made other than any alteration for which no application for planning permission would be required, and that the hereditament was in the state of repair at the time of valuation which might reasonably be expected by an occupier of the particular property having regard to its character, its environment, and to the neighborhood in which the hereditament is situated.[10]

This extremely unwieldy formulation was offered by the Department of the Environment as "A Possible Definition of Capital Value for Rating Purposes," and its intent may have been to make the change to a capital value base appear as awkward as possible. In fact, most states in the United States implement a capital value base with no more than the willing buyer-willing seller statutory language.[11]

This lengthy definition is useful, however, in attempting to respond to numerous potential questions as to the interpretation of "market value." It points to issues that will need to be addressed, whether by legislation, regulation, litigation, or custom. For example, legal interests in property are frequently divided among multiple parties, whether through public regulation such as zoning, rent control, and environmental restrictions or through private arrangements such as leases or trusts.

The need to recognize a diminished market value by reason of such restrictions in some but not all such cases produces the most complex legal challenges to property assessment. It may seem unfair to ignore an involuntary, government-imposed restriction such as zoning, but zoning restrictions may be changed and market prices may reflect that expectation. Most private, voluntary, profit-motivated restrictions may be considered similar to joint ownership arrangements,[12] which need not affect property assessment. Just as the assessor is not required to examine all legal agreements in order to attribute the appropriate amount to each partner in a shared tenancy, so can the effect of leases and other divisions of rights in property be subsumed under a unitary valuation of the undivided estate. While this approach is logically impeccable, it encounters severe resistance when it produces a high assessment upon property whose owner is laboring under the burden of an unfavorable lease or other legal arrangement.

A similar definitional problem arises when the value of property to its owner diverges drastically from its sale value. Specialized manufacturing and assembly plants may constitute a major portion of a jurisdiction's property value on the basis of their depreciated cost but command a market price that reflects only salvage value. Problems such as these have led to criticism that the willing buyer-willing seller standard identifies "not what a real buyer and a real seller, under the conditions actually surrounding them, do, but what a purely imaginary buyer will pay a make-believe seller, under conditions which do not exist."[13] The imaginary nature of the buyer and seller is not necessarily

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[10] Layfield Commission, Local Government Finance Report, 1976 Cmnd 6453, at 441.

[11] *See, e.g.,* Cal. Rev. & Tax. Code § 110 (West Supp. 1995); 98 NY Jur. 2d, Taxation & Assessment § 303 (Law. Co-op. 1992).

[12] *Cf.* vol. 2, ch. 19 (discussion of ownership interests in legal persons).

[13] McGill v. Commercial Credit Co., 243 F. 637, 647 (D. Md. 1917).

objectionable if the computation leads to an otherwise acceptable tax base. The greater problem is the lack of certainty introduced by speculation upon the bargain that would be reached by imaginary parties.

Complex valuation issues of this type arise under any nonformulary approach to measuring the tax base, but this does not establish the superiority of a formula in any specific situation. Formulary elements are also subject to dispute and necessarily provide less information on the wealth or ability to pay represented by the asset being taxed. In a functioning market system, property owners are often extremely well informed as to the value of their holdings and are thus able to supply an immediate check on the accuracy of their assessments.

2. Capital Value and Annual Value

Property taxation in the United Kingdom was traditionally based on the annual rent a parcel would command if vacant and available for let, while in the United States the tax was based on sale price or capital value. Where the current use of property is also the most economically profitable one, these two measures will stand in a predictable relationship to one another. A tax on annual value can be expressed as a tax on capital value, and vice versa, by reference to the rate of return expected from income-producing property.

The two standards diverge when a prospective purchaser would bid an amount unrelated to current yield in the expectation of a different and more profitable use in the future. The capital-value base has the advantage of more closely approximating a tax on immovable property wealth and more effectively discouraging speculative withholding of land ready for development. These economic advantages are political drawbacks, however. The annual-value base follows more closely the realized cash income with which owners may expect to pay the tax and exerts less development pressure on open space and agricultural land bordering urban regions. There is no need to elaborate the political reaction to taxation at levels requiring sale or mortgage of family farms, open space, and elderly taxpayers' residences.

The problems of "cash-poor" taxpayers deserve special attention because they illustrate the potential conflicts between economic and political considerations with respect to tax structure. One economist has commented that "welfare cases should be treated by the welfare system on an impartial basis, without special favor to property owners. To use property tax relief as a substitute for welfare is to distribute welfare in proportion to wealth, surely an odd notion."[14] From an economic perspective, this problem might be resolved by the availability of financial intermediaries willing to extend loans secured by the property subject to tax. However, few taxpayers have participated in programs in the United States and Canada in which taxing jurisdictions offer extremely low-interest tax deferral to senior citizens willing to accept this debt as a lien upon their property. Intense concern for preserving family property as an

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[14] Mason Gaffney, *quoted in* Henry J. Aaron, Who Pays the Property Tax? 76 & n.9 (1975).

unencumbered asset rendered these programs unacceptable to most of their intended beneficiaries.

Similar issues of highest and best use arise in the valuation of structures. If a building no longer represents the most profitable use of its site, may the land value assume that a purchaser would plan to replace it? In the United Kingdom, the answer is generally negative, under the principle of *rebus sic stantibus*, which requires that property be valued in its present condition. In the United States, considerations of highest and best use would permit this approach—valuing the property not as if the replacement had already been built, but in light of alternate potential uses. These divergent approaches to valuation may reflect the United Kingdom's more restrictive interpretation of private development rights, illustrating the close relationship between property law and the structure of an appropriate property tax system.

3. Income-Based Valuation

The problem of cash-poor property owners has sometimes given rise to another form of preferential assessment, one based upon an estimate of the income earned from the current use of the parcel. This "current use" taxation is designed to reduce development pressure on farmers and owners of open space ready for development in the urban fringe. When drafted simply as a tax reduction, this provides no guarantee that the land will not be developed in the future, and so perversely subsidizes speculation by reducing the cost of withholding land from the market. The net result may simply be an exacerbation of sprawling development as new construction leapfrogs past the urban fringe. However, any attempt to impose a legal restriction on future development could prove unworkable and certainly inappropriate for an introductory property tax draft. Because owners of land ready for development in the urban fringe hold a valuable resource, it would be desirable to avoid extending tax preferences to this group. A compromise alternative requires repayment of the tax reduction enjoyed for a specified number of years before development occurs. There is no similar distinction between "current use" and "highest and best use" in the case of farmland located in agricultural areas that are not ready for urban development. Subsidies for these taxpayers are more likely to concern tax rates and exemptions for growing crops. Like other inventories, crops fluctuate in value throughout the year, and taxing them as of a specific date penalizes those farmers whose yield is at a maximum value at that time. Where profit from farm operations is subject to income taxation there is no need to include an arbitrary and unpopular assessment of crops in the property tax as well. A more difficult issue is presented by trees and other long-lived plants. A tax that includes improvements to land will have to specify whether such plants are included in the tax base.

4. Area-Based Taxation

A true area-based tax taking no account of differences in land value has the obvious drawback that "residents who own undesirable land must pay at the same effective rate as residents who own highly desirable land in a prime location with access to all services and amenities."[15] For this reason, property taxes based on area have generally been replaced by ad valorem measures, as in the Netherlands, or by a proliferation of special provisions designed indirectly to recognize gradations in value.[16] This latter situation negates the simplicity of application that is the prime recommendation for an area-based measure. Much simplicity can be retained without sacrificing the equitable benefits of a value-based tax through the use of zone and benchmark approximations of market value, discussed below.

5. Acquisition Value

In 1978 California voters amended the state's constitution to shift its property tax from one based on fair market value to one based roughly on acquisition cost. The actual California system uses a 1975–76 base-year value for property that has not changed hands since that time,[17] a 2 percent maximum annual inflation adjustment,[18] and many provisions defining the type of change in ownership that leads to reassessment at market value.[19]

This unusual system has engendered strong political support and strong criticism. Its great benefit is its predictability, allowing a taxpayer purchasing property to calculate the level of future tax obligations with great accuracy. This is a direct response to California's rapid housing price inflation of the 1970s, when property tax bills increased sharply as local governments failed to reduce tax rates in proportion to the rising tax base. This predictability carries with it a concomitant simplicity of administration: values need only be assigned upon a change in ownership, which usually yields sales data as well.

These benefits are obtained at a heavy price. Particularly in a time of rapid price increases, acquisition costs can diverge sharply from market values and therefore from property wealth as an index of ability to pay. This tax base can confer a perverse reward on owners experiencing an increase in their net wealth while burdening newer purchasers who have paid a higher price for similar property. Alternatively, to the extent the increase in tax is capitalized, the burden may fall in part on the seller, but this is also capricious and creates a lock-in effect. An acquisition value base can provide a strong disincentive for changes in residences, penalizing those whose jobs or family situations require mobility.

It has been argued that, under this system, property will be revalued at least once every generation. In fact, California permits the acquisition value tax base for a home to

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[15] Sandra Bettger et al., The Economic Impact of and Strategy for Implementing an Ad Valorem Property Tax: A __se Study of Krakow 7 (International City/County Management Association Report to the U.S. Agency for International Development 1994).

[16] Joan Youngman & Jane Malme, An International Survey of Taxes on Land and Buildings 157–73 (1994).

[17] Cal. Rev. & Tax. Code §§ 50, 110.1 (West 1987).

[18] *See id.* § 619(f).

[19] Cal. Rev. & Tax. Code §§ 60–69.3 (West 1987 & Supp. 1995).

be transferred between parents and children.[20] This greatly extends the potential duration of disparities in taxes faced by owners of similar properties and exacerbates the antimobility effects of an acquisition value base. Like many of the extensions of the California tax limitation measure, this was not part of the original legislation but was approved in a later popular election as an expression of antitax sentiment.

6. Other Tax Bases

Some form of enterprise value, going-concern value, or measure of business income is often found in the base of a tax on business property, even when the tax is nominally intended to reach only tangible property. Strictly speaking, a tax on land and building values should not include going-concern or enterprise values. The value of the immovable assets should be set at the amount a prospective purchaser would bid for those assets alone, not for the assets as part of an ongoing business. However, in practice it is not unusual to encounter hybrid taxes that combine these elements of a property tax and an enterprise income tax, sometimes producing a result inferior to both.

After property taxes in California were severely curtailed in the 1970s, some of them were replaced by per-parcel taxes or flat fees for each property unit. Equivalent to a poll tax on property rather than on individuals, these flat fees serve as an equally crude basis for distributing the cost of community services, justified only when specific limitations or historical developments leave other alternatives even less desirable. They represent an alternative to property taxation as discussed in this chapter rather than a means of implementing it.

C. Special Assessments and Betterment Levies

Special assessments finance capital improvements through additional taxes on properties within the area that benefits from such investment. These present some questions not raised by recurrent taxes used for general revenue purposes, such as whether voter approval is to be required for this imposition and whether collections will be limited to the cost of the improvements. However, for most purposes they may be analyzed as a variety of property taxation, and many of the issues discussed in this chapter, particularly with regard to valuation, will arise in the drafting of legislation to implement special assessments as well.

D. Market Value Taxation in Developing Economies

A certain degree of circularity accompanies the process of establishing public claims on land and building values through annual taxation in the early stages of a transition to a new regime of property rights. The market data needed to estimate the sale value of properties that have not themselves recently changed hands in an arm's-length transaction will become available only after investors have made purchases in reliance on the existing system of property rights. Therefore, some alternate method of estimating the

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[20] *See* Cal. Rev. & Tax. Code § 63.1 (West Supp. 1995).

value base will be required in the initial stages of the tax, even if a more sophisticated approach is adopted after market data are more widely available. Estonia, for example, "has taken the bold step to base the new land tax on values, even though the lack of market information will make it necessary to decide models for market values until proper estimation can take place based on sales prices."[21]

Even when such data are available, a statutory formula based on objective criteria designed to approximate market value may be preferable, on grounds of certainty and ease of administration, to an explicit market value standard. For example, Chile bases property taxes upon a formulary "fiscal value" of land and buildings, rather than on their market value.[22] Land within a given zone is assigned a fiscal value reflecting sale transactions, soil quality, and development in the zone. Buildings are valued according to specific characteristics and size, reflecting construction costs in the Santiago area, with adjustments for other regions.[23] Buildings are depreciated at a constant yearly rate determined by the type of construction, but total depreciation is limited to 25 percent of the initial fiscal value.[24]

This approach avoids many complications inherent in determining the meaning of "market value" for properties that have not been the subject of recent sales. Computer-assisted mass appraisal can provide strong grounds for estimating the sale price of properties that share characteristics of many similar properties, such as apartment houses and single-family residences. Often, however, valuable property will be of a type not frequently bought and sold, for example, specialized manufacturing sites. In these cases, market value can be defined either literally to mean the actual amount for which the property could be sold to an unrelated party (a figure that may be well below both the value to the current owner and the depreciated reproduction cost) or as a cost-based figure reflecting the special value to the current owner (which contravenes the general rule of market-based assessment that governs the taxation of other property). Some problems of this type will arise under any approach to value-based taxation, but the special difficulties of determining market value may recommend use of a formulary alternative even after sufficient data are available for market prices to be utilized in valuing property directly.

Within the formulary approach, three variations merit special consideration. The first and least accurate index of market value considers only a very limited number of

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[21]Danish National Survey and Cadastre, Land Taxation and Valuation in Estonia 29 (1993). "The factors that are used in valuation models are pollution, water supply, land quality, valuation factors, location, roads, etc." Jussi Palmu & Jaisa Vuorio, Defining of Suitable Value for Estonian Settlement Where As No Land Market Exists (Seminar on Taxes on Land and Buildings, sponsored by the Danish National Survey and Cadastre and the Estonian National Land Board, 1993). Similarly, factors such as utility service, transportation access, zoning, soil quality, and infrastructure entered a recent model valuation of land in Poland. The Price of Land in Poland (U.S. Agency for International Development, Office of Housing and Urban Programs Working Paper 1990).

[22]Youngman & Malme, *supra* note 16, at 105, 110–11.

[23]*Id.* at 110–11.

[24]*Id.* at 110.

factors. In the case of agricultural land, the existence of detailed data on soil analysis and productivity may permit classification on this basis. For example, in Moldova the Ministry of Agriculture has developed tax valuation charts for all forty regions (rayons) and for four cities, based on fertility measure and type of land: crop fields, forests, vineyards, hay fields, and pasture.[25] This classification does not reflect locational advantage, even though distance from markets could affect the value of land, and development potential may be more important to the value of land in the urban fringe than its agricultural productivity. A second type of index takes into account an expanded but still limited and legislatively prescribed number of factors. Finally, the specification of these factors may be delegated to the administrative body responsible for valuation. Such delegation provides the greatest flexibility but also risks the greatest sacrifice of legislative oversight. Where appropriate, it can provide the readiest transition to full market value taxation as more price data become available.

E. Taxation *In Rem* or *In Personam*

Debate sometimes arises as to whether a tax on land and buildings is to be designed as one *in rem* or *in personam*, and what consequences follow from that distinction. Terming the tax as *in rem* generally denotes consideration only of property characteristics, and not personal attributes of the owner, in the assessment process. Three particular consequences may be intended. First, assessments may name the property but not rely upon identification of the owner to establish tax liability; instead, publication may be deemed to notify all interested parties of this claim. A second consequence may be a corresponding absence of personal liability, remedy for nonpayment being limited to seizure and sale of the property itself. Finally, this approach may be intended to avoid considerations of the personal status of the owner in determining the amount of the tax.

There is no need to avoid combining the characteristics associated with *in personam* and *in rem* taxation. As an American jurist wrote, "[a]ll proceedings, like all rights, are really against persons."[26] The tax may be levied in the first instance upon the owner, while at the same time publication may put all other interested parties on notice that a default may jeopardize their property rights. In fact, such mixed enforcement measures may be highly desirable. Useful as it is to maintain the option of collection through seizure of the property and foreclosure of a tax lien, this is a cumbersome and draconian means of securing payment of what in many instances may be a relatively small sum. The availability of personal enforcement against the owner may actually increase compliance when seizure of a home is deemed undesirable or infeasible.

For these reasons, it is preferable to avoid any references to *in personam* or *in rem* taxation in legislation and regulations, addressing instead the specific liability and enforcement issues raised by this distinction. The taxing authority may be directed to

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[25] Acte Normative privind impozitul funciar i modul de impozitare, 1994 (MDA). This approach provides no basis for estimating the market value of urban land.

[26] Oliver Wendell Holmes writing for the Court *in* Tyler v. Judges of the Court of Registration, 55 N.E. 812, 814 (Mass. 1900).

draw up a tax roll, listing as liable for payment any person "owning, claiming, possessing or controlling"[27] an interest in the property on the lien date. Under such a rule, more than one person—for example, the owner of a property and the lessee of the property— may be jointly and severally liable for the tax. Parties aware of this legal regime can be expected to allocate the tax liability among themselves by contract, as through a lease contract specifying that taxes are the responsibility of the owner. This provision in the contract would not, however, prevent the tax administration from collecting from the lessee; it merely specifies the lessee's contractual right against the owner for reimbursement of the tax if the lessee must pay it.

This flexible approach to a definition of the taxpayer differs from the more familiar method of specifying only one person as primarily liable for a tax, but its broad terms offer important administrative advantages. Initially, the tax administration will, according to its usual procedures, send only one tax bill for a particular property, normally to the owner. Only if the owner fails to pay will the tax administration seek to collect the tax from others who are made liable under the law. If both the owner and the lessee are made liable under the statute, then the tax administration will not be required to show that it had made the requisite effort to collect from the owner before being able to go after the lessee. If the statute specified that the lessee would be liable only if the owner failed to pay, then the lessee might be able to avoid the tax by arguing that the tax authority had not made a sufficient attempt to collect from the owner.

This hybrid of personal and *in rem* liability raises administrative issues that may require special attention if they are not adequately addressed by general taxation provisions. The first concerns notification procedures, particularly in two special cases: where multiple parties claim an interest in taxable property (as in a joint tenancy) and where no party does. Both illustrate the benefit of the *in rem* aspects of a mixed enforcement system. Where legal interests have been divided among a number of individuals or entities, it is not feasible to require the assessor to determine the proportionate shares for which each is responsible. Because the tax is a lien against the property, all interested persons are on notice that their interests may be eliminated by foreclosure if the tax is not paid in full. Of course, this approach must be carefully coordinated with the *in personam* aspects of the enforcement provisions if the owner of a small partial interest is not to be liable for seizure of other property or funds to pay the entire amount of the tax. In the case of property with no identified owner, some statutes provide that "such land may be assessed to `unknown owner' or `unknown owners.'"[28] Although this may be useful in establishing a lien, it is always preferable to identify a named party claiming an interest in the property. The situation of unknown owners must be distinguished from systems of communal land tenure with no private ownership.[29] Property

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[27]This language is taken from Cal. Rev. & Tax. Code § 405 (West 1987), but similar counterparts are found in many other statutes. For example, the Canadian Indian Act, § 83(1)(a), refers to persons "occupying, possessing or using" the property.

[28]Or. Rev. Stat. § 308.240(2) (1992).

[29]The property tax implications of communal ownership are discussed with regard to African personal taxes in R. Bird, Taxing Agricultural Land in Developing Countries 57–63 (1974).

taxation is appropriate under such a regime only if nonownership rights, such as long-term or renewable rights of use, are to be considered property for purposes of the tax.[30]

The converse issue concerns identification of those parties who may contest an assessment—both in cases where multiple interests exist[31] and in those where no claimants are identified. In the former instance, it is important to avoid potential repetitive claims; in the latter, steps must be specified for clearing title or foreclosing the tax lien within a given period, to encourage return of the property to the tax rolls and to the market.

A very interesting procedural issue sometimes arises with regard to a taxpayer's ability to protest the underassessment or improper grant of an exemption to a neighboring property.[32] This issue rarely needs to be addressed in the initial legislation introducing the tax, but considering the issue may help focus discussion on the practical questions that will arise with implementation of the tax.

F. Defining the Unit

Per-unit exemptions and progressive rate structures require a determination as to which contiguous or related parcels will be considered as one for purposes of the tax. The complexity inherent in progressive rate structures limits their applicability, and only an explicit political decision can justify their administrative costs, particularly in the case of a new tax or an economy in transition.[33]

The *in rem* aspects of the tax are in conflict with progressive rates, particularly when assessment must proceed in the absence of conclusive ownership information. Progressive rate structures assume an individual's ability to pay to be proportionate to the value of all property owned, however divided into parcels or among different tax jurisdictions. Even under a flat-rate tax, some parcel definition may be required if exemptions are designed to remove low-value parcels or structures from the tax base. Otherwise, these exemptions may be expanded by artificial subdivision of single parcels

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[30]*See infra* sec. III.

[31]Sometimes tenants obligated by the terms of their lease to pay taxes have been found eligible to protest an assessment issued against the landlord as owner. *E.g.,* Ewing Township v. Mercer Paper Tube Corp., 8 New Jersey Tax 84 (1985); Riso v. Pottawattamie Board of Review, 362 N.W.2d 513 (Iowa 1985).

[32]*See generally* Annotation, Standing of One Taxpayer to Complain of Underassessment or Nonassessment of Property of Another for State or Local Taxation, 9 Am. L. Rep. 428 (4th ser. 1981). Massachusetts permits any ten taxpayers in a single district to bring a court action to determine the legality of public actions to raise funds, expend money, or incur obligations. Mass. General laws, ch. 40, sec. 53. In Cabot v. Assessors of Boston, 138 N.E.2d 618 (Mass. 1956), *appeal dismissed*, 354 U.S. 907 (1957), a group of owners of parking garages located near Boston Common invoked this provision to protest the exemption of a portion of the property below the common leased to a private party for use as a commercial garage.

[33]Taiwan Province of China and Korea provide examples of highly developed progressive property tax systems. "When the various aspects of this question are seriously considered, it seems that the case for progression far outweighs the advantage of administrative simplicity of a flat rate." John Riew, *Property Taxation in Taiwan: Merits, Issues and Options*, 68 Industry of Free China 13 (1987).

into multiple units. Simplification is always best served by minimizing exemptions and avoiding progressive rate structures.

Another aspect of parcel identification concerns structures under construction or destruction. It is desirable that buildings under construction be assessed according to their state of completion at the time of valuation. The alternative of exempting such property until completion risks long-term tax evasion through deliberate noncompletion. Sometimes plans are deliberately drawn for large multistory buildings when only small structures are actually contemplated, solely to avoid taxation. Although property may produce no income until completion, it is not without value, and the property tax is not limited to income-generating assets. Similarly, buildings destroyed by fire or other cause during the tax year should be taxed as of their status on the valuation date, with such hardship relief as is contained in general administrative (or even nontax) provisions. A prorated property tax refund will rarely be the most effective means of disaster assistance.

G. Exemptions

Exemptions present a particularly dramatic example of the interplay among economic, legal, and political factors in the development of property tax systems. Typically, an array of complex provisions reflects the perceived social benefits of subsidizing particular property uses and owners. At the same time, considerations of economic neutrality and administrative efficiency recommend that exemptions be as few as possible.

Among the most common exemptions are those granted to property owned by charitable organizations. It is important to consider the commercial use of property that will negate the exemption and the effect of division of interests in property between charitable and noncharitable uses and owners. Many practical issues also arise with regard to the status of uses that are not charitable in themselves but are ancillary to an exempt purpose, such as parking lots and administrative offices. Often, such determinations will be too detailed and factual for consideration in the statute itself, but it is important that they be addressed explicitly, whether by decree or by regulation.

Where feasible, a charge in lieu of a tax on exempt property can serve both land use and revenue functions by reflecting the cost of property-related services, particularly if this amount is set as some proportion of the tax that would be due absent the exemption.

The taxpayer claiming the exemption should be required to file appropriate documents establishing the exempt status of the property. In practice, such filings are sometimes required annually and sometimes only on a change in status.[34]

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[34]*See, e.g.,* Cal. Rev. & Tax. Code § 254 (West 1987) (colleges, libraries, and museums required to file annually); *id.* §257(c) (religious institutions required to file only when exemption is first established).

III. Property Rights and Valuation

A. What Is "Ownership"?

A legal view of property as a set of intangible rights raises a question as to which rights are being valued for tax purposes.[35] While the physical dimensions of a parcel of land or of a building may be objectively established, this does not determine which rights constitute a property interest in those physical elements. Two particularly important issues concern the extent to which restrictions on the owner's use or enjoyment are to be considered in assessment and the manner in which partial interests are to be taxed.

All property rights are subject to some restrictions that may affect market value, whether in the form of building codes, zoning, health and safety regulations, environmental protection or remediation measures, rent control, or other publicly imposed limitations on use. In addition, a wide array of privately negotiated provisions, such as leaseholds, easements, and restrictive covenants, may diminish or redistribute the value of the original undivided interest.

Public legislation that has reduced the value of an owner's interest may be considered part of the overall legal structure of property rights within which the valuation is to take place. Private agreements stand on a different footing. Permitting these to reduce taxable value runs a clear risk of encouraging non-arm's-length agreements, such as disadvantageous leases designed solely to lower property assessments. Even legitimate, profit-motivated agreements need not be allowed to reduce the tax base if owners are on notice before concluding them that tax liabilities will remain unchanged if the contract reduces the market value of their holdings. Actions that reduce property value (such as failure to modernize or maintain a building) must, however, be clearly distinguished from those that redistribute that value (such as a disadvantageous lease, which increases the value of the tenant's interest even as it reduces the value of the landlord's position). Disregarding the former actions violates the goal of taxing property values and risks unverifiable and subjective valuations. Disregarding the latter, however, simply effectuates the aim of taxing all private interests in property. It is equivalent to requiring only a single assessment of property held by joint tenants.

An owner who conveys property rights to another party has clearly diminished the sale value of his or her remaining interest. For example, property encumbered by rights of access or limitations on building will not command as high a market price as it would in the absence of these provisions. Many legal disputes have arisen with regard to the property tax treatment of such encumbered property. On the one hand, assessors generally disregard most private and voluntary divisions of interests to avoid the administrative difficulties of dividing property value among lessors, lessees, mortgagors, mortgagees, life tenants, holders of a remainder interest, and other holders of property

[35] It is important to consider this point within the context of existing property law. Civil law systems, for example, are more likely to consider "ownership" indivisible than are common law countries. *See* John Merryman, *Ownership and Estate,* 48 Tulane L. Rev. 916 (1974).

interests. This result is fair as long as parties to these agreements are on notice that it is their own responsibility to allocate an undivided tax bill among themselves. On the other hand, certain interests in property, primarily easements, will affect the value of other taxable parcels, and it is important that the tax treatment of the two properties be consistent. For these purposes, an easement may be considered any partial, nonpossessory interest in property, such as a right of way over it or a right to prevent construction upon it. If the easement is ignored in the assessment of the property whose value it diminishes, it should not be allowed to raise the assessment of the property whose value it enhances.

An early case addressing this issue[36] dealt with the assessment of Gramercy Park in New York City, a private park laid out in 1831 by Samuel Ruggles, a real estate developer who then sold 66 building lots on the perimeter of the park. The purchasers of those lots received rights to the park and keys to its gates, an arrangement that continues to the present day. The trustees holding title to the park argued successfully in court that the park itself had no market value in its encumbered state and that its value had been transferred to the adjoining lots. Although this result avoids inconsistency, it may encourage tax-motivated encumbrances. Land-use agreements may raise, lower, or leave unchanged the value of all affected parcels; there is no necessary conservation of taxable value when private arrangements of this type are permitted to determine property assessments.

One area of current interest with regard to taxation of restricted property concerns conservation easements, which prohibit or restrict development on environmentally sensitive land through an agreement between the landowner and a conservation organization or governmental institution. Although the land remains in private ownership, its market value may be greatly reduced by such an arrangement. Unlike the appurtenant easement, a conservation easement does not transfer rights to neighboring landowners, leaving the *Gramercy Park* rationale inapplicable. However, the development rights might be viewed as property interests held for charitable purposes by a tax-exempt organization. If charitable interests held for charitable purposes are generally exempt from property tax, then there would be an argument by analogy for taking the easement into account in valuation. In the United States, some states have addressed this problem directly by statute; in others, it has been left to the courts to determine according to general principles of property tax law. Both approaches have produced a range of results.[37]

Where ownership rights are uncertain or in the process of being established, the *in rem* attributes of a property tax may permit assessment against the property itself. All persons with interests in the property are then on notice to arrange for payment in order to

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[36]People *ex rel.* Poor v. O'Donnel, 124 N.Y.S. 36, *aff'd mem. sub nom.* People *ex rel.* Poor v. Wells, 93 N.E. 1129 (N.Y. 1910).

[37]*E.g.,* Idaho Code § 55-2109 (1994): "The granting of a conservation easement across a piece of property shall not have an effect on the market value of property for ad valorem tax purposes, and when the property is assessed for ad valorem purposes, the market value shall be computed as if the conservation easement did not exist." Village of Ridgewood v. The Bolger Foundation, 517 A.2d 135 (N.J. 1986) (finding conservation easement to reduce property value).

protect their rights. This could permit a tax system to begin operation and to become an element in purchasers' bids and in contract negotiations, even before property owners are registered or identified. The absence of a designated owner may also give rise to multiple claims to property, but it is unlikely that these would be avoided by delaying imposition of the tax. In fact, it may encourage payment of the tax by those who hope to use this to buttress their claims to ownership in the event of a later challenge.

B. Property Rights and Tax Liability

The problem of divided legal interests in property raises a question as to whether interests that do not rise to the level of ownership may be subject to taxation. In some property tax systems, they may. In the United States, claim of a right to use charitable or public property for profit may potentially leave the holder liable for property tax on that interest or even on the value of the full, undivided property.[38] However, the perceived unfairness of this result has prevented states and localities from exercising this power broadly.[39] It is more important that a new tax specify precisely when partial interests in otherwise exempt land or buildings will themselves be taxable. Examples may include grazing rights on public land, concessions and restaurants in public parks, and commercial activities of religious, educational, or charitable institutions. If no tax is due on property owned by an exempt organization but leased for a commercial use, the exempt lessor will simply be able to command higher net rents than are available to its private competitors.

[38]United States v. City of Detroit, 355 U.S. 466 (1958).

[39]The harshness of this result may be debated in specific cases. For example, it could be argued that a lessee with the right to occupy the property for the full taxable year should be responsible for the full property tax that year. A dissenting opinion in one U.S. case wrote, "[t]he single, the most important incident of ownership of industrial goods is possession *and the right to use them in a business conducted for profit*. That right is coextensive with other forms of ownership if it is borne in mind that the tax covers but a one-year period." Continental Motors Corp. v. Township of Muskegon, 135 N.W.2d 908, 915 (Mich. 1965) (Adams, J., dissenting). The alternate perspective would allocate the market value of the entire property between the value of the tenancy and the value of the remainder and base the respective tax liabilities of the tenant and the (possibly exempt) landlord on that division.

C. Valuation of Land and Buildings

Different tax rates for land and buildings can raise many complex issues as to the allocation of value between the two, because sales data will generally reflect transactions in which the land and the structures upon it were sold as a unit. In some legal systems, it is possible to convey ownership or rights of use in a building without rights in the underlying land. In reality, any use of the building, including moving it to a different location, requires some use of the underlying land. The right to keep the building in a particular location implies surrender of all alternate uses of the land. The converse, a transfer of rights to land without any rights to the structures located on it, suffers from similar artificiality. From this perspective, the land and building constitute two integral components of a larger entity whose value cannot be divided in a meaningful way. In his 1937 treatise on property valuation, Professor James Bonbright wrote

> [a]lthough a separate valuation of land and of improvements is called for by many of the statutes as well as by the practice of assessors, the fictitious nature of this separation is apparent.... The attempt to do so would result in the same error that would be committed were we to seek the value of Raphael's Sistine Madonna by adding the separate value of the lower half of the canvas to the separate value of the upper half.[40]

Conundrums of this type can be avoided by specifying that land values are to be based upon sale prices of comparable unimproved land. Building values may then be specified either as the residual of the combined land and building value or as the product of a formulary approach such as construction cost of a new building less depreciation.

IV. Legal Issues in Setting the Tax Rate

A. Use of Assessment Ratios

Some tax rates are set by a two-step process in which a fractional assessment ratio is first applied to property value and a tax rate is then imposed on the resulting figure. This results in a distinction between the nominal tax rate (the specified rate applied against the diminished value) and the effective tax rate (the proportion of full value represented by the tax; the product of the assessment ratio and the nominal tax rate). In some cases, this may be a necessary response to special legislative or political constraints. Where a nominal rate must be set by law and can be changed only rarely or with difficulty, there may be reasons for administrative discretion to vary the effective rate in this way. Absent an unusual situation of this type, it is far preferable to determine the tax by applying a specified rate to full market value. Because assessment ratios diminish taxpayers' ability to understand and challenge their assessments, "extralegal" fractional systems often develop as a means of reducing taxpayer protests by concealing

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[40]James Bonbright, 1 The Valuation of Property 485 (1937).

the relationship between assessed values and tax bills. There are no grounds for establishing such a situation if extraneous factors do not require it.

B. Responsibility for Setting Tax Rates

The status of the property tax as a central or a local levy will affect the assignment of responsibility for setting tax rates. Where the tax will function as an autonomous local revenue source, it is possible to allow local governments to set rates, or to set them within bounds established by the central government. Over thirty years ago, Ursula Hicks wrote the following:

> If local bodies are to play any significant part in economic or social development, they must clearly have access to adequate finance. If they are both to act responsibly and to show initiative, some, not negligible, part of this control over resources must be independent, in the sense that the local councils are free to choose the rates (and to some extent the conditions) of their taxes or service charges.[41]

Some local governments will be limited by their administrative capacity and competence as to the autonomy they can responsibly exercise with regard to revenue. Debate on this point is by no means restricted to newly formed local governments or to economies in transition. The past two decades have seen many initiatives in the United States and the United Kingdom to curtail local control over tax rates. In particular, the nationalization of business rates in the United Kingdom reflected suspicion that local governments sought to place an undue tax burden on nonvoting property owners. A 1986 Green Paper stated: "There is no voting right attached to the payment of non-domestic rates [i.e., business property taxes]. However much a business might contribute to the income of a local authority, it cannot exercise any direct electoral influence over local taxation decisions that can affect its competitiveness and its scope for investment."[42]

Actual rates of tax vary widely in international practice, and a lack of reliable data on assessment practices prevents ready translation of reported nominal rates to effective levels. For example, in Boston, Massachusetts, the nominal rate was 25 percent before the property tax was reformed in the late 1970s; however, this represented a far lower effective rate based on current market values because assessed values--with some exceptions--generally tended to be a very low percentage of full market value.

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[41]Ursula Hicks, Development from Below: Local Government and Finance in Developing Countries of the Commonwealth 277 (1961).

[42]Parliamentary Green Paper, Paying for Local Government, 1986, Cmnd 9714, at 14.

V. Administrative Issues

A. Assignment of Responsibility

The tension between the goals of local autonomy and central control, particularly where local administrative capacity may be lacking and central government resources overstretched, will require special attention in dividing responsibility for tax administration. One alternative allows local responsibility subject to oversight by the central government. In a typical example of legislative language addressing this point, the Massachusetts statutes provide that the state Commissioner of Revenue shall set forth "rules, regulations and guidelines" for assessment, develop forms, and conduct mandatory training programs for local tax officials.[43] Another possibility is to divide property into categories assigned to local tax administration, such as residential and commercial property, while the central government values and assesses complex properties and those spanning multiple jurisdictions, such as public utility property, railroads, and pipelines.

If administrative responsibilities with regard to the tax are shared between two or more levels of government, it is important to provide each with a share of collections at least sufficient to cover its costs and to specify how any refunds later found owing are to be financed.

Although not necessarily addressed in property tax legislation itself, the treatment of the property tax for purposes of income taxes or other central government levies is an extremely important aspect of intergovernmental fiscal relations.[44] In effect, a deduction or credit serves as a central government subvention to local authorities. Such transfers have been praised as supporting autonomous local government and appropriately recognizing the diminished ability to pay resulting from local tax liabilities. They have also been criticized as hidden subsidies for free-spending localities and deductions for payments that are equivalent to personal consumption, funding as they do local amenities and services rather than large-scale transfer payments and national programs.[45] These are political issues that cannot be resolved by tax legislation, but that must be taken into account in its drafting.

B. Enforcement and Liens

One frequently mentioned advantage of property taxation is the immovable nature of the asset securing its payment. A lien upon land and buildings serves to assure the taxing authority of eventual payment; at some point, a purchaser will require unencumbered title and the outstanding tax liability will be met.

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[43]Mass. Ann. Laws ch. 58, §§ 1–3 (Law. Co-op. 1990).

[44]*See supra* ch. 2, sec. V(B)(6).

[45]*See, e.g.,* U.S. Treas. Dept., The President's Tax Proposals to the Congress for Fairness, Growth, and Simplicity: General Explanation 62–64 (1985).

In the absence of the drastic step of foreclosure and sale of the property, a lien itself may or may not be a powerful enforcement tool. Owners who are preparing to sell may be motivated to lift this cloud on their title and may also have the cash with which to do so, but the lien may have little effect on others. Foreclosing the lien and selling the property, particularly when it constitutes the residence of poor or middle-class taxpayers, may have unacceptable political consequences, which will be exacerbated if the tax represents a small percentage of the value of the property seized. This weakness of liens recommends a combined approach: the option of foreclosure and auction, which can be exercised in a few well-publicized instances of flagrant tax evasion, together with the alternative of personal remedies, such as fines and attachment of assets other than the property itself. It is particularly important to apply a market interest rate to outstanding liabilities if interest on unpaid tax is not addressed in the general tax law.[46]

C. Revaluation Cycles

Ideally, all information affecting the property tax base would be taken into account in an annual assessment process. However, a complete revision of the valuation or formulary basis of the tax may be feasible only on a periodic cycle. It is far preferable to establish a multiyear cycle, possibly with interim provisions for indexing values for inflation, than to allow an unrealistic goal of annual valuation to be ignored. Taxpayer reliance upon inaccurate assessments that, over time, are capitalized into land and building prices can prove an almost insurmountable political obstacle to revaluation. This was a major reason for the failure of domestic rates in the United Kingdom, where the law required a reassessment every five years but where none had been undertaken in England and Wales since 1973.[47]

If a cyclical system is instituted, it is desirable to address directly the issue known as "spot assessment," that is, revision of one assessment to reflect increases in market value, as upon a recent sale, when other parcels in the jurisdiction are not similarly revalued. If it is practical to keep valuations reasonably up to date, it would not be unfair to utilize new information of this type. More commonly, whatever cycle is permitted as the maximum interim between revaluations becomes the norm; if more frequent individual changes are allowed, partiality and inequity may result.

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[46] *See supra* ch. 4, sec. II(J).

[47] *See* Peter G. Richards, *The Recent History of Local Fiscal Reform, in* The Reform of Local Government Finance in Britain 28 (Stephen J. Bailey & Ronan Paddison eds., 1988). In 1986, legislation was passed to implement the Community Charge or "poll tax" in Scotland in 1989. Similar legislation passed in 1988 implemented the Community Charge in England and Wales in 1990. *See* David Butler et al., Failure in British Government: The Politics of the Poll Tax (1994), App. 1. "A revaluation of all rated property might have caused an eruption, given the relative increase in the value of property in the south-east since the previous valuation in 1973." *Id.* at 61.

VI. Checklist of Issues for Legislative Drafting

The preceding discussion has identified a number of items to be clarified in establishing a new legislative approach to property taxation. These may be summarized as follows:

A. Scope of the Tax

- What kinds of property are to be subject to this tax? Alternatives discussed here have included all property, all tangible property, land and buildings, land alone, and unimproved site value alone.

- How does the definition of property in the taxing statute coordinate with the property law of the jurisdiction? For example, are mineral rights to be taxed to the owner of the surface land?

- How is property to be identified? Is this identification coordinated with the work of other government agencies, such as title or deed registries, cadastres, and mapping offices?

- How is an individual parcel to be identified if progressive rates or per-parcel exemptions require such identification?

B. Identification of the Taxpayer

- Is the taxpayer a person standing in a particular relation to the property, such as the owner or occupier? The alternative, *in rem* approach gives public notice of the outstanding amount and requires all parties interested in the property to arrange among themselves for its payment.

- How is tax liability allocated among multiple parties holding partial interests in a single property?

C. Exemptions

- What specific types of property are to be exempt? Examples include charitable, religious, and educational property.

- Does the exemption stem from ownership of the property by a specific type of organization or from its active use in furtherance of an exempt purpose?

- Are governmental properties exempt? If so, is this exemption limited to property held by the level of government imposing the tax? Do treaty obligations or other agreements require that properties held by foreign governments or international organizations be exempt?

- Is the burden of establishing the exemption on the property holder?

- Must the exemption be reviewed or renewed periodically?

- How are commercial uses of exempt property treated for tax purposes?

- What is the tax liability of private persons holding partial interests in otherwise exempt property?

D. Concessions and Preferential Assessments

- Are there specific concessions for special groups, such as low-income, handicapped, or elderly taxpayers?

- Do these concessions take the form of a reduction in the tax or an extension of the time within which to pay it?

- Do specific types of property, such as farmland, forestland, or residential buildings, qualify for special assessment procedures? Are growing crops and forests subject to taxation?

E. Measurement of the Tax Base

- Is the tax based on a market-value measure? Alternatives discussed here have included formulary computations, an area base, acquisition cost, and per-parcel fees.

- If the tax is based on market value, is this capital value or annual value?

- If the tax is based on a formula designed to approximate market value, what provisions have been made for periodic review and revision of the formula as more market data become available?

- What is to be the assessment of property under construction as of the valuation date? Of property destroyed after the valuation date but before the close of the tax year?

F. Setting the Tax Rate

- What level of government is responsible for setting the tax rate?
- May the rate vary annually? If so, within what limits?

- Do other elements in addition to the tax base and rate (e.g., assessment ratios) enter the tax calculation?

G. Intergovernmental Issues

- How is responsibility assigned for assessment, collection, oversight, and regulation?

- How are tax collections to be divided among levels of government?

- Is any portion of tax collections earmarked for specific purposes?

- Will payment of the tax give rise to a deduction or credit for purposes of other taxes?

- What level of government bears the burden of reduced collections as a result of exemptions and concessions?

- Are values assigned to property for purposes of this tax coordinated with values used for other tax purposes, such as eminent domain (compulsory purchase) awards and calculation of capital gains?

H. Procedural Issues

- Are specific collection procedures or collection points called for by this tax?

- What is the required or permitted frequency of revaluations?

- May individual parcels be revalued in the absence of a general revaluation?

- What procedure governs tax appeals?

I. Collection and Enforcement

- Do unpaid taxes give rise to a lien upon the property? If so, what steps are required for foreclosure and sale?

- What is the priority of such a lien? Does a foreclosure sale convey a new and clear title?

- Does the lien arise as of the date of assessment or at another time?

- May recourse for unpaid taxes be had against the taxpayer personally, with seizure of other property, to satisfy this obligation?

- How is liability for tax payment allocated when multiple parties hold partial interests in the same property?