Property Tax: What Are The Options?

By Cormac O'Sullivan

The Household Charge is due to be replaced by a Property Tax next year. Here we look at some of the options open to the government in terms of designing a Property Tax. Each option is discussed separately, but it is worth being mindful of the tradeoff between a workable tax and a perfect tax; any Property Tax will need to be both administratively straightforward and easy for the tax payer to understand.

A design proposal from publicpolicy.ie is available on our website (Submission to Expert Group on Property Tax)

What should be taxed?

The first issue to be decided is the basis on which the tax will be levied. The present Household Charge, for instance, is a simple flat fee charged to homeowners. The main alternatives are to base the tax on the market value of the property, the value of the site, or on size.

Market Value

The market value of the house is the price it would achieve if it were sold today. It is the most comprehensive measure of the wealth associated with the property, so that a tax on market value would essentially be a wealth tax solely aimed at houses.

Site Value

Site value refers to the price of the land on which the property sits. Site values are rarely observed in urban and suburban settings, so they would have to be calculated by separating the market value into a component based on the value of the structure and another based on the value of the land. The advantage of taxing only the value of the land is that by excluding the value added by those who have built on the land, the remaining value is influenced mainly by factors such as services and the local community. These factors add value to the land, but are created by society and not the individual land owner. A Site Value Tax would recoup some of this value for the society that created it.

By excluding the value of the structure component, a Site Value Tax would be less of a pure wealth tax than the Market Value Tax. On the other hand, a Site Value Tax provides added incentive to maximise the use of land by not imposing an extra cost on those who seek to improve their properties.

Size

A size-related tax could use either floor area or site size as its base. Its advantage is that size is a much easier variable to ascertain than value, but it would lead to significant rural-urban inequities.

Each tax base has its advantages and disadvantages, which are summarized very briefly in the table below. Regardless of which tax base is chosen, there will be winners and losers vis a vis the other options. The options are not mutually exclusive – you could, for instance, adjust a Market Value Tax by house size so as to shift the incidence of the tax away from urban centres and towards rural property owners – but a mixed solution would bring added complexity.

	Main Advantage	**Main Disadvantage**
Market Value	Most comprehensive measure of property wealth	Discourages home improvements
Site Value	Encourages the most efficient use of land	Conceptually complex and hard to measure
Size	Easy to measure	Generally unrelated to household wealth, penalises rural properties

How can we value houses?

In more normal times, people generally have an idea of the price of their property – even if it was not up for sale – by observing the sale prices of similar properties in similar areas. But the current slump in the housing market has left many in the dark about the value of their property. The government has attempted to remedy this problem through the creation of a property price register, which provides data on the date of sale, price, and address of all residential properties sold since the beginning of 2010.

Alternatively, we can value properties using a method called hedonics. The value of a house is essentially the combined value of its characteristics – location, size, number of bedrooms, bathrooms, garden size, proximity to amenities etc. Using a dataset of house prices and house characteristics, we can determine the value of each characteristic. To value a property, you would then simply add up the value of each of its characteristics.

Who does the valuation?

Getting people to assess and report the value of their own property would be by far the easiest and cheapest means of collecting a Property Tax. There are, however, two issues that need to be addressed. The first is that by and large people will find it difficult to value their properties with any kind of accuracy given the recent price collapse and thin market. The National Property Price Register will help in this regard, as would having large tax bands (people may not know the exact value of their house, but are more likely to have a rough idea within large bounds). The second issue is that property owners will have an incentive to underestimate the value of their house.

Alternatively, values may be determined by a government agency. This approach is used successfully in Northern Ireland, but would be a more complex and costly option. A professional valuation service would have the added advantage of being able to use more sophisticated valuation techniques such as hedonics.

Hard Issues

Protecting the Poor

Although a Property Tax would relate to the wealth associated with residential properties, there is some concern over those on low incomes who may find it difficult to pay such a tax. Two options are open to policy makers;

- Income Exemptions: People who have income below a certain threshold could be made exempt from paying a Property Tax. Any such threshold would be somewhat arbitrary, and could act as a disincentive to work for fear of going over the threshold. It should also be noted that, for a given revenue target, the burden on those paying the tax will become greater the larger the number of households that are given exemptions.

- Payment Deferral: Property Tax owed by those who cannot pay could be deferred until the house is sold and then taken from the proceeds. Some rate of interest would need to be applied in order to ensure those who can pay do so.

Legacy of Stamp Duty

Many of those who bought their houses during the height of the boom paid significant sums of Stamp Duty. As such there may be a desire to protect them from further property-related taxation, at least for a period. This could be achieved via a once-off tax credit, or a tax credit that reduces over time. Such a policy would bring added complexity to the administration of a Property Tax

Mortgage Debt

In principle, a relief should be made available for mortgage debt, but Mortgage Interest Relief on income tax is currently being phased out and will be gone by 2018. Instead, a relief for mortgage debt could be applied to the Property Tax. Such a move could also go some way to reducing the burden on those in negative equity, those who paid large sums of Stamp Duty, and those in mortgage distress.