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Reforming the Property Tax

Thomas A McDonnell

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SUMMARY

Residential property is a major component of wealth and the introduction in the Republic of Ireland of the Local Property Tax (LPT) in 2013 was a positive and necessary reform. Almost all advanced economies have some recurrent tax on immovable property.

Evidence suggests that recurrent taxes on immovable property (RP taxes) are more growth-friendly than other taxes.

The Republic's revenue yield from such taxes was 1.0% of economic output (GNI*) in 2017, while EU revenue from these taxes was 1.6% of output (GDP).

There appears significant scope to increase the yield from these taxes in order to improve Ireland's growth potential. We argue for immediate revaluation to 2019 property prices coupled with modest annual increases in the rate over a 10 year period.

KEY POINTS

- There are strong theoretical arguments in favour of recurrent taxes on immovable property (LPT in the Irish case). Such taxes are growth-friendly and reasonably stable throughout the economic cycle.
- Hardship arguments are best resolved through a deferment system for low-income households with the deferred amount paid on sale or transfer of the property. This resolves hardship issues while protecting government revenue.
- The case for different property tax rates in different geographic areas has very little merit. Horizontal equity requires that two properties worth the same amount should be liable for the same charge.
- Compared to other EU countries the Republic has a relatively low revenue yield from LPTs.
- There is significant scope to increase the yield from property taxes and doing so would be beneficial to long-run economic growth.

Nevin Economic Research Institute (NERI)

31/32 Parnell Square
Dublin 1
+ 353 (1) 8897722

e-mail: info@NERInstitute.net
Web: www.NERInstitute.net

Carlin House
4-6 Donegall Street Place
Belfast
BT1 2FN
Northern Ireland
+ 44 28 90246214



Research for new economic policies

Introduction

Residential property is a major component of wealth and the introduction in Ireland of the Local Property Tax (LPT) in 2013 was a positive and necessary reform. Almost all advanced economies have some recurrent tax on immovable property.

The economics literature generally considers taxes on immovable property and taxes on land as the least distorting to economic activity and the least damaging to economic growth. These taxes are also very difficult for the super-wealthy to avoid because the underlying asset lacks mobility and is impossible to hide.

The case in favour

Evidence from a 2010 OECD study showed that the tax structure influences growth performance. In particular, the OECD examined the impacts of various taxes from an economic efficiency perspective and found that recurrent taxes on immovable property are the least damaging (i.e. most beneficial) to long-run per capita GDP growth prospects.

There are strong theoretical arguments in favour of recurrent taxes on immovable property (the LPT in the Irish case):

- a. LPTs have been shown empirically to have a minimal negative impact on GDP; in other words, they are growth-friendly taxes;
- b. LPTs are very difficult to avoid or evade;
- c. Unlike transaction-based property taxes, LPTs are reasonably stable throughout the economic cycle and therefore provide a reliable tax base;
- d. LPTs do not, by and large, penalise productive activity;
- e. Taxes on immovable assets are particularly appropriate in the context of increasing globalisation where the factors of production (labour and capital) are increasingly mobile;
- f. LPTs do not create a barrier to labour mobility (unlike transaction based property taxes¹ which potentially add an additional cost to moving for economic reasons);
- g. LPTs can encourage investors to redirect capital to more productive sectors of the economy;
- h. LPTs can be progressive if correctly designed and
- i. LPTs enable the State to recoup some of the costs of public infrastructure provision through the increased (and unearned) value that will accrue to local housing.

Considering the case against

As property taxes are taxes on the ownership of property, they will disproportionately fall on wealthier households. Even so, the strongest argument against an LPT is the potential to cause economic hardship in a small number of cases. This is of course a concern common to almost all forms of taxation – not just LPTs – and does not invalidate the many arguments in favour of property taxes.

The hardship argument is best resolved through a deferment system for low-income households. Such a system is already in place in Ireland with interest charged on the deferred amount. The deferred amount along with the accumulated interest is payable on the sale or transfer of the property. This resolves the hardship problem while simultaneously protecting government revenue over the long-term.

There is a secondary argument that the family home is not wealth. However, the argument ignores the fact that the principal residence is a capital asset that the owner can buy or sell and that accounts for significant inter-generational wealth transfer. In addition, owning a house allows

¹ E.g. Stamp Duty

owners greater access to financial markets (e.g. for loans). Over the long term, people who rent often pay as much, if not more, on annual housing costs as people who purchase housing, but only the homeowner ends up with a valuable asset.

Property tax design

The key objectives of a tax are to:

- A. Raise a meaningful amount of revenue for the exchequer;
- B. Adhere to the principles of horizontal equity² and vertical equity³ within the tax system;
- C. Minimise administration and compliance costs while assisting the fight against tax evasion and avoidance; and
- D. Minimise the distortion to savings and investment decisions and minimise the risk of capital flight.
- E. In some cases, there is also a desire to promote or disincentivise certain behaviour and activities.

These objectives or ‘principles’ have certain implications for how best to design a property tax.

To ensure **horizontal equity** between households the tax must be a fixed proportion of value. In other words, two taxpayers with properties worth €250,000 should pay the same amount of property tax regardless of geographic or other factors. A deferment does not break this principle as it merely changes the timing of the payment.

Reduced or indeed increased rates set at a local level and applied consistently across an entire local area could still be justified provided the entirety of the revenue from the tax is ring-fenced for

² Horizontal equity is the idea that we should treat persons or groups with the same taxable capacity, or ability to pay, equally, and that they should pay the same amount of tax. Exemptions, reliefs, or favourable valuations or rates all undermine horizontal equity.

³ Vertical equity is synonymous with the principle of progressive taxation – i.e. that those with greater taxable capacity should bear a proportionally heavier tax burden.

use at that local level. A higher rate should yield better services and vice versa. However, in the case of a reduced local rate, the central government should not then increase its own subsidy to the local authority area in order to offset the lost revenue. The taxpayer in the local area with the lower rate is exchanging a lower property tax payment with reduced public services and facilities in the area.

Much of a property’s value and the benefits accruing to its owner derives from the property’s location including its proximity to infrastructure (e.g. rail and roads), as well as other public services (e.g. schools and hospitals) paid for or subsidised out of general taxation.

Local authority revenue excluding grants from central government is a small fraction of total general government revenue. Clearly, the overall impact of a lower property tax rate on a local area will not remotely lead to a commensurate percentage decline in the overall value of public services available to residents in the local area. As such, the argument for allowing significant local deviations from a nationally set property tax rate is limited.

Scrapping the equalisation fund and retaining all revenue at the local level would constitute a positive reform to the LPT. This would reduce localised opposition to the tax and it would simplify the structure of local authority funding. If additional funding is then required to ensure that local authorities have sufficient baseline funding to account for demographic and other factors then that funding should come directly from central government rather than from other local authorities.

The principle of **vertical equity** could justify a progressive structure involving higher tax rates on more valuable properties. On the other hand,

too many rates might lead to an overly complicated structure and violate the principles of simplicity and transparency. Too many rates would also increase the sensitivity of the LPT yield to property price fluctuations.

Property tax yield

Evidence suggests that recurrent taxes on immovable property (known as RP taxes) are generally more growth-friendly than other taxes and this in turn suggests that a greater reliance on these types of taxes will be growth enhancing.

Ireland got just 2.6% of its aggregate tax and SSC revenue from RP taxes in 2017, whereas the average for the EU was 4.0%. Irish revenue from RP taxes was 1.0% of output (GNI*) in 2017, while EU revenue from RP taxes was 1.6% of output (GDP).

Ostensibly, there appears significant scope to shift the composition of revenue away from other forms of taxation in order to improve Ireland's growth potential, or alternatively, to increase RP taxes to fund increases in public spending.

Commercial rates accounted for 71.7% of RP taxes in 2017 compared to just 28.3% for taxes on residential property. This suggests that most of the potential scope for increase is in relation to the LPT.

Recurrent taxes on immovable property would have needed to be €2.9 billion in 2017 in order to reach the EU average as measured by proportion of economic output. An indicative 50-50 split in the yield between commercial rates and taxes on residential property (i.e. €1.45 billion from commercial rates and €1.45 billion from the LPT) would imply almost an additional €1 billion needed from taxes on residential property, or a trebling of the current yield.

The government's interdepartmental review of the LPT estimates the annual

yield in Ireland rebased at November 2019 values and including some previously exempt properties, with no local increases or reductions. Applying this at the central rate of 0.18%, would yield €771 million. That implies the rate would need to almost double to bring the Irish yield in line with a €1.45 billion target.

Caution is required when making comparisons in this way. For example, in Northern Ireland, the property tax pays for services such as water and bin collection, but this is not the case for all properties in the Republic of Ireland.

Notwithstanding this caveat, there is a strong efficiency and equity case for increasing the yield as a proportion of output. In practice, this means increasing the rate and updating valuations.

Political economy realities mean that rate increases would need to happen gradually over a multi-year period. An increase of 0.01% per annum would imply an annual increase of €27.50 (€0.53 cent per week) for the median property rebased at November 2019 values.

An annual increase of 0.02% in the rate over a 10 year period, combined with revaluations every 3 years, should be politically feasible and would be economically desirable.

References

This NERI *Research inBrief* accompanies NERI Working Paper No 63 (July 2019), [Taxing Property: Suggestions for Reform](#)

Working Paper No 63 contains a list of the references and findings used in this *inBrief*.

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