

INTERNATIONAL PROPERTY TAX INSTITUTE

**OPTIMIZING PROPERTY TAX SYSTEMS
IN LATIN AMERICA**

**EDUCATION AND TAX CULTURE:
HOW TO ACHIEVE PUBLIC ACCEPTANCE AND COMPLIANCE**

Thursday, September 30, 2004

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EDUCATION AND TAX CULTURE: HOW TO ACHIEVE PUBLIC ACCEPTANCE AND COMPLIANCE

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There is an economic reality in both transitional and developed countries. The State must raise revenue in order to do its job.

It is also becoming increasingly clear in recent years that property taxation may be an important tool to be used by the State in order to raise necessary funds.

The property tax system can be used for the benefit of all stakeholders, provided that it is accepted by the public and the State is able to collect the money.

It is important, therefore, to establish the basic elements of any proposed property tax system that might be necessary to achieve that goal.

Remember that property tax is a legitimate basis by which the State can raise revenues. It provides a secure and stable revenue source. A properly established property tax system is understandable and permits a fair distribution of the burden amongst the stakeholders. It can be administratively simple and efficient.

In order to achieve a level of public acceptance and an ability to collect the levy, there must not only be a firm foundation upon which the assessment of property is based, there must also be a quality levy and billing system. Efforts must be made to provide for collection integrity so as to avoid bringing the system into disrepute.

It is also important that special interests should not unjustly benefit from the system of property tax, as any such distortion of the basic system detracts from public confidence in the system.

That being said, it is imperative that the stakeholders understand the system and that the State communicate its intentions to the stakeholders. Property tax can be a source of significant revenue, but it must be presented to the stakeholders as truly necessary. The stakeholders must be assured that the revenues are being well spent.

It is important in developing a system of property taxation that a direct linkage between the taxes levied and the benefits flowing from the receipt of those funds be established. In order to achieve a level of public acceptance, property tax should be used primarily for the funding of local government services and not as a tool for wealth redistribution or the funding of broad social policy initiatives.

In many jurisdictions, property tax is restricted to the funding of those local services necessary and directly related to the benefit of the property owner or tenant responsible for the payment of the levy. Examples of such services are water, sewer, parks, police and fire services, and garbage collection. On the other hand, in some jurisdictions such as the Province of Ontario, Canada, property tax is being used to fund wealth redistribution and social services far beyond what is required for local government services. Two examples are welfare and social housing. This has led not only to a disproportionate burden amongst commercial and industrial properties within certain regions within the Province, but also a general reticence on behalf of taxpayers to accept the property tax system as an appropriate tool for funding of government services.

Property tax must remain a useful tool for the payment of local services and the funding of local municipal expenditures. It should not be developed as a more broadly based revenue source if a significant level of public confidence is to be achieved.

That being said, we must consider the use of property tax as a tool for urban development. Properly administered property tax incentives can be a valuable tool to

encourage urban development and redevelopment. Generally, there is enough flexibility in the property tax base to permit specific initiatives to improve the overall economic environment. In fact, urban development and renewal can be revitalized through tax schemes. For example, in North America the revitalization of surplus polluted industrial land is often linked to property tax initiatives that spur the cleanup and redevelopment of the polluted lands. This is often referred to as brownfields legislation.

Property tax is based upon the assessment and levy of tax against property. It is important that any property tax system be linked to appropriate tax policy initiatives developed by the State. Tax policy initiatives can significantly impact the actual use of land.

For example, the assessment and taxation of farmland in Ontario is subject to special rules. So long as the land is used for agricultural purposes, these special rules of low taxation apply irrespective of the value of the land for other purposes. In this way, the land will continue to be farmed until redeveloped, satisfying a government policy to maintain land in farm production as long as possible. Those jurisdictions that try to separate the property tax system from any realistic tax policy run the risk that they will not achieve public acceptance and will be unable to collect the necessary funds.

Unfortunately, local politicians are adverse to considering the impact of property tax policy. More often, these local politicians prefer to receive central subsidies for the funding of their initiatives. Efforts should be made to give those local politicians the responsibility of levying the taxes which are then used to pay for their initiatives.

Such a concept may not be politically acceptable given the tendency of local politicians to look to central funding sources. In this way, they avoid having to take responsibility for raising revenues to fund their projects. In many countries, it is the local politicians who are often the most opposed to the establishment of a property tax system,

preferring rather to complain to another level of government than to take responsibility for their actions.

Once again, we see this dichotomy in recent activities of the Federal Government in Canada. The Federal Government has realized that there is a need to direct resources to cities within Canada. It has announced initiatives for that purpose. The debate now is whether the cities should be funded by grants from the Federal Government, or alternatively given the tools to raise revenues locally. Should, for example, urban municipalities share a portion of the gas tax presently levied by the Federal Government?

With the empowerment to raise taxes comes the entitlement to political power. This raises real political questions as to the distribution of power among the various levels of government. If local politicians wish to exercise political power, perhaps they should be entrusted with political responsibility.

Whatever the result of this debate, it is important as these initiatives are developed that there are effective communications with the stakeholders so they can be made fully aware of both the debate and its consequences.

On a more practical note, good communication leads to financial stability of a property tax system. It creates confidence in the system that supports compliance.

The communication, however, should not be frivolous. From a taxpayer's perspective, the property tax system must be open; it must be expedient; it must be transparent; it must create equity amongst the taxpayers.

The integrity of the property tax system can best be proven through a system of readily available information that can be sourced efficiently and cheaply. By making

information readily available, unfair distortions can be easily identified and the system held accountable.

On the other hand, it is important in establishing such openness to protect the confidentiality of information necessarily received by the assessment authority in the course of its duties. The release of confidential information, particularly that received from commercial and industrial taxpayers, can seriously imperil the efficiency of the property tax system. Those taxpayers willing to comply with requests to supply necessary information will only comply if they are satisfied that the information will not be misappropriated so as to compromise their business interests.

A balance between access to information and protection of confidentiality must be established. The balance of interest must be genuine and protective. The basis of any requirements for disclosure must be communicated in an appropriate manner to the stakeholders. Only in this way can the transparency of the system be balanced with the need to protect the privacy of individual stakeholders.

A key element to any property tax system is the need to provide appropriate tools for enforcement. Property taxation lends itself to enforcement by its very nature. The establishment of appropriate liens and charges against the property subject to the tax becomes an important enforcement tool.

Other initiatives, however, make enforcement more practical.

Many properties are subject to a mortgage or other charge. By including property tax as a part of a mortgage payment, the tax is buried tax within the charges otherwise levied against the property on a regular basis. Default in the payment of those charges

triggers enforcement of the mortgage without the need for independent enforcement of the payment of the property tax.

The timing of the payment of the levy is also an important tool in ensuring payment. In Canada, there are those who suggest that one of the major concerns with respect to residential property taxation is the tendency of local governments to levy the tax in lump sum amounts as opposed to on a regularly scheduled basis. The need of the residential taxpayer to pay in that manner targets the tax as an unreasonable levy when, if it were otherwise levied on a periodic basis, the amount might not be so highlighted. Clearly, for a periodic levy to be practical, the property tax levied must be substantial enough to allow for the additional administrative costs associated with any such periodic payments. A property tax system that does not raise sufficient funds to allow such costs is absolutely a waste of time anyway.

Clearly, however, in transitional countries, in order to establish appropriate enforcement tools, there is a need to provide the legal infrastructure for those purposes.

Similarly, with respect to the basic foundation of a property tax system, namely, the assessment of real property, there is a need to create an environment into which that system can be placed.

There is a need for methods of standardization to create a transparent real estate market which can be used to establish an understandable assessment system.

It all starts with a title registration system by which the real property can be identified for purposes of its assessment. A market criteria is necessary to form the foundation by which a fair and equitable assessment base can be considered. There is a need for appraisals and valuation standards that can be uniformly applied in a manner that can

make the system understandable. Experts in the field are required to implement the system.

Once again, in considering the development of a sustainable property tax system and its utilization to raise significant funds for local government services, there is a continual need for communication with the stakeholders throughout.

At all times, it is important to consider the implementation of a property tax system from a long term perspective. Short term fixes do not work.

We only need to look at the debacle in the Province of Ontario to understand that short term fixes do not work. The commercial/industrial assessment base within the Province of Ontario is probably amongst the worst in the developed world.

In 1998, the Ontario Provincial Government determined that outdated assessment values needed to be updated to a current value assessment base. The government proceeded to implement a current value assessment. When faced with serious backlash from certain property owners within the commercial sector, the government panicked and provided a system by which tax increases and tax decreases arising from the revaluation of the real estate would be cushioned.

These “temporary measures” originally established for a three-year period have now become permanent. Six years after the reassessment of commercial/industrial property within the Province of Ontario, there is now a complete disjoint between the assessment valuation and the real property taxes actually levied.

The system is not understandable; there is no fair distribution; it is not administratively simple and efficient; there is no quality assessment system in place at all.

The lunacy of the system can best be described by an illustration.

In 2003, the City of Toronto, Canada suffered a series of serious economic setbacks. It was hit by the fallout of 9/11; the SARS epidemic; and a major electricity blackout. As a result, the tourist industry was devastated. Hotel occupancy fell to 20 percent. Receivership was in vogue. In updated assessment values to be used for the 2004 levy, the local assessment authority recognized the loss in value in this sector and reduced assessed values.

Unfortunately, the quick fix of 1998 prevented any property tax reduction. In fact, instead of paying a fair property tax based upon these reduced values, the hoteliers continue to pay a 25 percent surcharge based upon some historical calculation of previous worth.

It is only the predisposition of Canadians to meekly accept their government's direction that allows for continued collection of the levy.

It is important in considering the implementation of a real property tax system that the adversarial nature of assessment and taxation needs to be avoided. Traditionally, the assessment authority is considered as the opponent to the taxpayer. The taxpayer is considered the enemy of the assessment authority.

These circumstances should be avoided if possible.

By providing transparency and creating a fair and equitable system, confrontation can be avoided.

From a taxpayer's perspective, access to information should allow the taxpayer to be satisfied as to the fairness of the system. Taxpayers' rights should be provided by the taxation authority established using common and understandable standards.

The scheme of independent appeal of assessment should be firmly entrenched itself as a transparent and equitable recourse. All too often assessment review tribunals are predisposed to support the assessment authority. This predisposition is often interpreted as bias. Bias destroys the system.

In the short term, the establishment of taxpayer friendly tools may cause some disruption, but in the long term it is imperative for those tools to be in place to allow for public acceptance and compliance.

All of the stakeholders should be brought into the system. The assessment authority should not be the adversary of the other stakeholders. The local governments should work closely with taxpayer groups to facilitate the implementation of an appropriate real property tax system. All of the stakeholders should be identified.

Knowing who the stakeholders are allows for appropriate communication with them. It is important to increase the awareness of the importance of property taxation to the ongoing functioning of the State.

Linking the revenues to expenditures creates an environment by which a benefit can be seen by the taxpayers arising from their payment of the levy.

Property tax should be identified for what it is. It is a capital tax on real estate for the funding of government services.

All too often, the identification of a property tax has not been communicated to the taxpayer. Looking only to direct benefit to the property, many taxpayers complain that property tax is a regressive tax inappropriate in the twenty-first century. By identifying the tax for what it is and by linking it to local government services not property specific, it can be communicated into the broader sphere as a viable tax from which benefit can accrue.

Taking the proper steps to achieve public acceptance of a property tax system is essential to its successful implementation.

By maintaining the integrity of the system; by utilizing proper communication skills; by including all the stakeholders; by minimizing the adversarial process; and by putting in place the proper tools for implementation, a truly successful property tax system can be established and a secure and stable source of revenue achieved.