

## Taxation – Lecture 5

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# **DIRECT TAX SYSTEM: PROPERTY TAXES (EVIDENCE FROM THE CZECH REPUBLIC)**

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# Property taxes – current state (world)

- **Taxes on land and property are among the oldest forms of all taxes.** Old taxes need not necessarily be ‘good taxes,’ as the saying has it, but they almost invariably have over the years become **encrusted with various peculiar features that are generally difficult to alter and that often obscure their impact.** **Modern features of property taxes in the world (based on OECD evidence):**
  - **Diversity - diversity in the application of land and property taxes** among the developed and developing OECD countries **is striking.** There are **differences** in the **determination of the tax base**, the **setting of tax rates**, and the **ability to levy and collect the tax.** In some countries, **one property tax covers all types of property.** In others, there are **different taxes for different components of real property.** Countries may, for example, have **separate taxes on land and buildings;** **separate taxes on residential and non-residential property;** or **separate taxes in urban and rural areas.**

# Property taxes – current state (world)

Moreover, not only are there **significant differences** in how land and property are taxed **across countries**; there are often **significant differences within countries**.

- **Revenue - taxes on land and property are minor revenue sources in all countries: (1) % of GDP** – for developing and developed OECD countries are **0.4 and 1** respectively; (2) **% of total tax revenues** – for developing and developed OECD countries are **2 and 4** respectively.
- **Importance/role – PT are much more important in rich OECD countries than in developing OECD countries** (based on % to GDP). **Level of GDP per capita and degree of urbanization are significant determinants of PT % to GDP: countries tend to rely more heavily on property taxes as income levels rise and they become more urbanized.**

# Property taxes – fundamentals

- **PT vs IT & CT** - as usually applied, **PT is a very visible tax. Unlike the income tax, for example, the property tax is not withheld at source. Unlike the sales tax, it is not paid in small amounts with each daily purchase. Instead, PT generally has to be paid directly by taxpayers in periodic lump-sum payments.** This means that taxpayers tend often to be more aware of the property taxes they pay than they are of other taxes. Moreover, to a considerable extent, the **PT finances services which are also very visible, such as roads, garbage collection and neighborhood parks. Visibility is clearly desirable from a decision-making perspective because it makes taxpayers aware of the costs of local public services.** This awareness enhances accountability, which is obviously a good thing from both an economic (hard budget constraint) and political (democratic) perspective. **It does not, however, make the property tax popular. On the contrary, it often appears to be harder to raise (or reform) property taxes than other taxes.**

# Property taxes – fundamentals

- **Tax base** - the base of the PT is invariably relatively inelastic, meaning that it does not increase automatically over time. **Property values** generally respond more slowly to annual changes in economic activity than do incomes. **Taxable area**, of course, responds even more slowly. As a result, in order to maintain property tax revenues in real terms, it is necessary to increase the rate of the tax. As with visibility, inelasticity leads to greater accountability (taxing authorities have to increase the tax rate to increase tax revenues) but it also leads to greater taxpayer resistance.

**Most taxes are based on flows** – income or sales. The tax base may sometimes be the source of argument between taxpayer and tax authority, but **there is**, in principle, **a measurable economic activity on the basis of which the tax is levied**. In contrast, **taxes on land and property are (generally) based on stocks – asset values**. **Unless the asset subject to tax is sold** (by willing buyers to willing

# Property taxes – fundamentals

sellers) in the tax period, **someone has to determine the value that serves as the basis on which to assess the tax.**

- **Valuation - valuation is inherently and inevitably an arguable matter. If there is a 'self-assessment' system, owners are likely to undervalue their property; if there is an 'official' (cadastral) assessment system, owners are likely to feel that their property is (at least in relative terms) overvalued. In the end, someone has to determine the tax base for the property tax in a way that is not true for any other significant tax. It is not surprising that the results are often perceived to be unfair and arbitrary. It is also not surprising that the process of obtaining 'good' (close to market, fair) valuations is not likely to be cheap. In short, to administer a property tax at the same level of fairness (non-arbitrariness) as most other major taxes is both a costly operation and one whose results are unlikely to be accepted as fair by most taxpayers.**

# Property taxes – fundamentals

- **Functions of PT –**

- **Finance local governments – PT generates a significant proportion of local government revenues in developed OECD countries. In most developing countries, however, PT provides only a small, though not insignificant, share of the revenue available for local governments.** Property tax revenues are low in many developing economies in part **because of the way in which the tax is administered:** as a rule **the coverage of the tax is not comprehensive, assessments are low, as are nominal tax rates, and collection rates are also often low.** Low tax rates are sometimes imposed by higher-level governments and sometimes by local governments themselves, which find rate increases in this most visible of taxes very difficult to sell politically.



# Property taxes – fundamentals

**In general, revenues would be higher if the property tax were based on the value of land and buildings (instead of just on land), if there were few exemptions, if there were no favorable treatment of particular property classes, if the nominal tax rate were set higher, and if the scope for local tax competition were limited.**

- **Affect land use** - local governments can affect urban form not only with planning tools but also with **municipal financial tools**. In some cases, municipal financial tools work together with planning tools, but in other cases they may have the opposite effect . **PT is one fiscal instrument that can clearly influence land use patterns, especially in urban areas**. In terms of the **impact on the density of development, for example, increases in property tax should be expected to result in a reduction in density** (other things being equal). **Where the tax is levied on the assessed value of property**

# Property taxes – fundamentals

(land and improvements), **any investment that increases the value of the property** (such as any improvement to the property including an increase in the density) **will increase the assessed value and make the property subject to a higher tax. Higher property taxes thus provide an incentive for less densely developed projects – for example, scattered single-family houses rather than apartment buildings. On the other hand, a tax on land only will provide an incentive for greater density relative to a tax on both land and improvements.**

**Although the property tax cannot be regarded as a direct ‘user fee’ through which individuals pay directly for the services they receive, where both tax rates and service levels are determined locally, it can often be thought of loosely as a benefits tax to the extent that public services provided to the property-owner enhance the value of the property and result in higher property taxes. In reality, taxes on land and**

# Property taxes – fundamentals

property **are seldom matched by service benefits**. For example, **non-residential properties are often overtaxed relative to benefits received compared to residential properties**; tax competition among municipalities often does not reflect differential service benefits; and **favorable tax treatment of farm properties can create distortions**.

In summary, **a number of policy choices can be made with respect to the structure of the property tax that will have an impact on land use**. Such choices include **what is included and excluded from the tax base, how property value is defined for different classes of property** (for example, residential, farm, commercial and industrial properties), **what percentage of the value is taxable, and how effective tax rates vary within and between classes of property**.

# Property taxes – object of PT & its asses-t

- **Object - PT are generally levied on all types of properties – residential, commercial and industrial, as well as on farm properties.** Sometimes different categories of property are treated differently. Sometimes certain classes of property, or property owner, or uses of property, are exempt. Sometimes only land is taxed.
  - **Exemptions** - In every country, some properties are excluded from the property tax base. **Exemptions may be based on various factors such as ownership** (for example government-owned property), **the use of the property** (such as properties used for charitable purposes), or on **characteristics of the owner or occupier** (such as age or disability). In some countries, **exemptions are granted by the central or state government**; in other countries, **exemptions are granted locally**; in some, **both levels can grant exemptions.**

Although **there is great diversity in the use of exemptions, some properties are exempt in most jurisdictions.** For

# Property taxes – object of PT & its asses-t

example, **property owned and occupied by government is generally exempt from property taxes.** Other property types that are often exempt include **colleges and universities, churches and cemeteries, public hospitals, charitable institutions, public roads, parks, schools, libraries, foreign embassies and property owned by international organizations.** In some countries, agricultural land and principal residences are also tax exempt.

In any case, **it is clear that when property tax exemptions are granted for any reason, in the interest of transparency and accountability all exempt property should still be assessed in the same way as other properties so that the value of the exemption is known.**

# Property taxes – object of PT & its asses-t

- **Assessment approaches -**

- **Area-based assessment** - under an area-based assessment system, a charge is levied per square meter of land area, per square meter of building (or sometimes 'usable' space), or some combination of the two. Where measures of area are used for both land and buildings, the assessment of the property is the sum of an assessment rate per square meter multiplied by the size of the land parcel and an assessment rate per square meter multiplied by the size of the building. The assessment rates may be the same for land and buildings, or they may be different. For example, a lower unit value per square meter might be applied to buildings to encourage development.

**A strict per unit assessment results in a tax liability that is directly related to the size of the land and buildings. With unit value assessment, the assessment rate per square**

# Property taxes – object of PT & its asses-t

**meter is adjusted to reflect location, quality of the structure, or other factors. Market value has an indirect influence on the assessment base through the application of adjustment factors.** For example, the **assessment rate per square meter might be adjusted to reflect the location of the property within a particular zone in the city.** Although the specific location of the property within the zone is not taken into account, properties in different zones will have different values.

**The adjustment factors are derived from average values for groups of properties within each zone and do not reflect the characteristics of each individual property.** When the groups are defined narrowly enough, the unit value begins to approximate market value. For example, a zone could be defined anywhere from an entire city to specific neighborhoods to properties on one side of a street.

# Property taxes – object of PT & its asses-t

**Area-based assessments are commonly used in CEE where the absence of developed property markets makes it difficult to determine market value.** They are also used in parts of Germany (in the former GDR), China, Chile, Kenya and Tunisia.

**Another common example of unit value assessment is in the assessment of agricultural land.** In many countries, farm property is assessed at so much per square meter, with the unit value varying with the location (region, accessibility to markets), **fertility** (irrigation, climatic conditions, soil conditions, hilliness), and sometimes **with the crops grown.** Such values are sometimes established on the basis of detailed cadastral studies, and sometimes on the basis of sales data on comparable property.



# Property taxes – object of PT & its asses-t

- **Market value assessment - market value (or capital value) assessment estimates the value that the market places on individual properties.** Market value is defined as the price that would be struck between a willing buyer and a willing seller in an arm's length transaction.

**Three methods** are commonly used to estimate market value:

- **The comparable sales approach** looks at **valid sales of properties that are similar to the property being assessed.** It is used when the **market is active and similar properties are being sold.**
- **The depreciated cost approach** values property by **estimating the land value as if it were vacant and adding the cost of replacing the buildings and other improvements to that value.** This approach is generally used when the **property is relatively new, there are no comparable sales, and the improvements are specific.**

# Property taxes – object of PT & its asses-t

The cost approach is also normally used **to assess industrial properties.**

- **Under the income approach**, the assessor estimates the **potential gross rental income the property could produce and deducts operating expenditures.** The resulting annual net operating income is converted to a capital value using a capitalization rate. This approach is **used mainly for properties with actual rental income.**

**Market value assessment is used in all the OECD countries**, as well as a number of others, including Indonesia, the Philippines, South Africa, Latvia, Argentina and Mexico.

# Property taxes – object of PT & its asses-t

- **Self-assessment** - requires property-owners to place an **assessed value on their own property**. In Hungary, for example, the current local tax system is based on the principle of self-identification. **Taxpayers are obliged to register and report their tax obligations to the local tax administration.** The determination of the tax on buildings and tax on idle land in Hungary requires **verification only of the property size and not its market value.** In practice, **self-registration is not particularly effective because not all owners comply.** **Consequently, the number of potential taxpayers or taxable assets is generally unknown.** The determination of **tax liabilities also requires verification of the self-assessment submitted by the taxpayer.** The **lack of personnel to make field inspections of each property in Hungary means that verification is inadequate.** The rental value tax on housing in Tunisia is based on the number

# Property taxes – object of PT & its assess-t

of square meters. Taxpayers are required to submit a self-declaration form. Some municipalities verify the declared square meters against existing information, for example from the roll for the rental value tax that existed before 1997, but most municipalities do not.

Nonetheless, **self-assessment is an appealing procedure for poor countries with little administrative capacity. It does not appear to require expert assessment staff, and it seems to be easy to implement.**

In general **self-assessment seems likely to lead, over time, to inaccurate estimates of property values, with a tendency toward underestimation. It violates the principle of fairness on the basis of ability to pay because people with comparable properties will not necessarily pay comparable**

# Property taxes – object of PT & its asses-t

**taxes.** Generally lower-valued properties have a lower rate of underestimation than do higher-valued properties, making this assessment approach regressive (that is, taxes are relatively higher on low-valued properties). **Underestimation also obviously erodes the size of the tax base, with the usual detrimental effects on tax rates and/or on service levels. In the end, there is no easy way to get people to tax themselves in the absence of a credible verification process.** To minimize the obvious problems of understatement associated with any self-assessment system, **the government must be prepared to obtain (costly) expert assessments of individual properties in cases where it believes self-assessment is inaccurate.**

# Property taxes – Czech Republic

- **Real Estate Tax** - the real estate tax also belongs to direct taxes in the Czech Republic. It is divided into two parts:
  - Land Tax
  - Tax of Buildings and Units
- **Land Tax** - the object of land tax is **land on the territory of the Czech Republic registered in the Real Estate Cadastre.**
- The land tax is not imposed on some lands:
  - **lands within the area of the ground plan of building** which is built on,
  - **woodlands, if they involve protective forests and forests of special determination,**
  - **water areas except ponds used for commercial fish-farming,**
  - **lands used for defense of the state.**
- In most cases the **taxpayer is the owner of the land**, sometimes it is

# Property taxes – Czech Republic

**the leaseholder or user of the land.**

- **The Land Tax = Tax Base x Tax Rate**
- **Agricultural lands**
  - **The tax base of agricultural land** such as arable land, hop-fields, vineyards, gardens, orchards and permanent grass growth **is the price of land determined as a multiple of the actual area of the land in square meters and the average price per square meter of the land laid down in a decree.**
  - **The tax rate is 0,25% for permanent grass growth and 0,75% for the other agricultural lands.**
- **Commercial Forests and Ponds used for Fish-Farming**
  - **Assessing the tax base**, the taxpayer can choose, **preferable tax base for him**: whether to use the **price of the land as determined pursuant to the price regulations valid on 1st January of the taxable period** or the **actual area in square meters multiplied by 3,80 CZK**. **The tax rate is 0,25%.**

# Property taxes – Czech Republic

- **Built-On Areas and Courtyards, Development Lands and Other Areas**
  - The **tax base** of other land is **the actual area of the land in square meters, as ascertained on 1st January of the taxable period.**
  - The **tax rate per square meter** is different for these lands:
    - **Paved areas of land** used for business or in connection with:
      - ✓ **Primary agricultural production, forestry and water industry – 1 CZK**
      - ✓ **Other business – 5 CZK**
    - **Built-on areas and courtyards – 0,20 CZK**
    - **Building land – 2 CZK multiplied by coefficient according to the number of inhabitants**
    - **Other areas – 0,20 CZK**



# Property taxes – Czech Republic

- **Tax of Buildings and Units**

- **The objects of this tax are finished or used buildings and units (flats).**
- **In most cases the taxpayer is the owner of the building or unit, sometimes it could be the leaseholder or user.**
- **The tax base is defined as built-up area in square meters as on 1st January of the taxable period. For taxable units, the tax base is multiplied by a coefficient of 1,22.**
- **The tax rate varies for different types of buildings:**
  - **Residential buildings and other structures that provides facilities for residential buildings (excess of 16 m<sup>2</sup>) – 2 CZK/m<sup>2</sup> of built-up area; the rate is increased by 0,75 CZK per each additional above-ground floor; this rate shall be multiplied by a coefficient according to the number of inhabitants.**

# Property taxes – Czech Republic

- **Houses and family houses used for individual recreation – 6 CZK/m<sup>2</sup> of built-up area**; other structures that provides facilities for these houses except garages – 2 CZK/m<sup>2</sup> of built-up area.
- **Garages constructed separately from residential buildings – 8 CZK/m<sup>2</sup> of built-up area.**
- **Other taxable buildings – 6 CZK/m<sup>2</sup> of built-up area.**
- **Other taxable units - 2 CZK/m<sup>2</sup> of built-up area.**
- **Tax rate of structures used for business activities:**
  - ✓ **Primary agricultural production, forestry and water industry – 2 CZK/m<sup>2</sup> built-up area.**
  - ✓ **Industrial production, construction industry, transport, power and other agricultural production – 10 CZK/m<sup>2</sup> built-up area.**
  - ✓ **Other business activities - 10 CZK/m<sup>2</sup> built-up area.**

# Property taxes – Czech Republic

- **The tax return must be filed by the taxpayer by 31st January of the taxable period.** The tax return is not necessary to be filed every year. If there are no changes, the taxpayer does not have this duty. Every year the Financial Office sends the assessment with the tax duty to the taxpayer. If the duty does not exceed 5 000 CZK, it shall be payable no later than 31st May. If it exceeds 5 000 CZK, it is payable in four equal pays no later than 31st May, 30th June, 30th September and 30th November.
- **The revenue from real estate tax is the income of the municipality, in whose district is the real estate situated.**

# Property taxes – Czech Republic

- **Real Estate Transfer Tax** - the aim of this tax is to draw a part of purchase price obtained from the sale of real-estate. The object of this tax is acquirement of ownership rights to real estate against remuneration.
- **The taxpayer is transferer of ownership rights of the real estate** if transferer and acquirer do not say otherwise in the contract.
- **The tax base is:**
  - ❑ **acquired value determined to the date of change in the Real Estate Cadastre, or**
  - ❑ **guideline value (value which compares real estates in the same territory, time, age, condition, etc.).**

# Property taxes – Czech Republic

- **The tax rate is 4%.**
- **The tax = tax base (rounded up to hundreds CZK) x tax rate**
- **The tax return must be filled by the end of the third month following the month when registration of such transfer was made in the Real Estate Cadastre. The tax must be also paid up to this date.**
- **The revenue from real estate transfer tax is the income of the state budget.**

# Road tax – Czech Republic

- **The road tax belongs to direct taxes collected in the Czech Republic.**
- **The objects of the road tax are:**
  - ❑ **All motor vehicles registered and operating in the Czech Republic, used or determined for running business.**
  - ❑ **Vehicles of the total maximum allowed weight of 3,5 tons, registered in the Czech Republic and exclusively intended for goods transport.**
- **The objects of the road tax are not:**
  - ❑ **some vehicles such as special tracked vehicles, tractors and their trailers, vehicles with special number plate, vehicles with special registration number.**
- **The taxpayer is the operator of the vehicle whose name is entered in vehicle registration papers.** The taxpayer is also an employer which sends his employee to a business trip and the employee uses his own vehicle.

# Road tax – Czech Republic

- **The tax base differs from type of the vehicle:**
  - **For motor cars the tax base is the engine capacity in cm<sup>3</sup>,**
  - **For trucks and semitrailers the tax base is the sum of the highest permissible weights on axles in tons and the number of axles.**
- **The annual tax rate is fixed for every vehicle.** In the case when employer sends employee to a business trip and he uses his own vehicle, the employer is obliged to pay special tax rate 25 CZK per day.
- **The taxpayer which buys a new car is tax-preferred for the first 9 years after the first registration of the vehicle. The first 36 months after the first registration he pays only 48% of the annual tax rate, the next 36 months 40% of the annual tax rate and the last 36 months 25% of the annual tax rate.**
- **On the other hand the taxpayer which has a vehicle registered before 31st December 1989 has to pay tax rate increased by 25%.**

# Road tax – Czech Republic

- **The tax return on the road tax must be filed by 31st January of the next year. The taxpayer has to calculate his tax obligation for all vehicles he owns in his tax return.**
- The tax must be paid also by 31st January of the next year. But taxpayer is obligated to pay tax advances during the year. There are four terms to pay the tax advance: 15th April, 15th July, 15th October and 15th December.
- **The whole revenue from the road tax is the income of State Fund of Transport Infrastructure.**



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