Land and Property Taxation in 25 Countries: A Comparative Review

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Every country has some form of tax on land and property. Such taxes have historically been local in most countries (although there are a few exceptions, such as Latvia and Chile, where they are mainly central taxes) and are often important sources of local revenue. One reason is that property is immovable – it is unable to shift location in response to the tax. Another reason is the connection between many of the services typically funded at the local level and the benefit to property values.

In a recent book (Bird and Slack 2004), we reviewed the main property taxes in the 25 countries listed in Table 1. Based on this comparative analysis, in this paper we discuss briefly the major policy alternatives with respect to taxing land and property – the choice of tax base, exemptions, methods of determining the tax base, tax rates, and the differential treatment of different classes of property (farms, residences, etc.).[1]

What is taxed?

Land vs. land and improvements

Table 2 summarizes the tax base in our 25 countries. In most countries, the property tax is levied on land and "improvements" (a term that includes structures, buildings, irrigation systems, and other man-made features). In a few, however, only the land portion of the property is taxed (e.g. Kenya). In Tanzania, unusually, only buildings are taxed. In countries where both land and improvements are taxed, the land portion is sometimes taxed more heavily than improvements.

In principle, a tax on land value only taxes location rents (the returns from a particular location regardless of the improvements to the site). Since improvements to land (such as structures) are not taxed, the owner has an incentive to develop the land to its most profitable use. Compared to a property tax on land and buildings that discourages investment in property, a site value tax thus encourages building and improvements. Assuming land is in fixed supply, a tax on land falls on landowners and cannot be shifted to others. Increased site value taxes will thus be capitalized into lower property values. Since the tax is borne proportionately more by owners of land and land ownership is unequally

Table 1

Property tax as a proportion of local revenues

	Property tax as % of local revenues
OECD:	
Australia	37.7[a]
Canada	53.3
Germany	15.5
Japan	25.5
United Kingdom	33.0[b]
Central & Eastern Europe:	
Hungary	13.6[c]
Latvia	18.2[d]
Poland	9.7
Russia	7.0
Ukraine	9.3
Latin America:	
Argentina	35.0[e]
Chile	35.1[f]
Colombia	35.0[g]
Mexico	58.7[h]
Nicaragua	6.4
Asia:	
China	4.9
India	7.0 to 41.0[i]
Indonesia	10.7
Philippines	13.4
Thailand	1.4
Africa:	
Guinea	32.0
Kenya	15.0
South Africa	21.0
Tanzania	4.0
Tunisia	32.4

For most countries, data are for 2000 or 2001.
[a] Includes only local taxation and not the state tax on land. – [b] Includes the local council tax and the local share of national non-domestic rates. – [c] Includes other local taxes such as a tourism tax. – [d] Percentage of local taxes. [e] This refers only to the municipal tax. There is also a property tax at the provincial level. – [f] The property tax is a national tax earmarked for local governments; 40 percent of revenues remain with municipalities where property is located. – [g] Property taxes as a percent of total Colombian local taxes. – [h] Percentage of municipal taxes. – [i] The range depends on the state.

Source: Bird and Slack (2004).

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[1] Bird and Slack (2004) also discuss various aspects of tax administration (property identification, assessment appeals, and tax collection and arrears) as well as other taxes imposed on land, such as transfer taxes.

distributed, such a tax should be more progressive than a tax on land and improvements. Site value taxation thus scores well in terms of both equity and efficiency. Indeed, taxes on land are generally regarded as one of the least distortionary taxes, although more general taxes on property do of course distort decisions about improvements (investment) to property.

The valuation of land alone is difficult, however, because most urban real estate sales combine the value of land and improvements. The value of improvements thus needs to be subtracted to derive an assessed value for the land. While some consider such taxation unacceptably arbitrary, others argue that valuation of land alone is probably easier than valuation of property (Netzer 1998) and can often be estimated directly from sales and demolition records. The original arguments for site value taxation (George [1879] 1979) were made in a context in which cities such as San Francisco were growing rapidly. Land that was worthless one day was worth a fortune the next, owing largely to the rapid influx of population. Valuing land separately may be less of a problem in developing countries in which urban areas are growing rapidly (Bahl 1998). In many such countries, land and improvements are in practice assessed separately in any case, with land value being estimated on the basis of a land value map and building value in accordance with construction cost tables.

Another problem with taxing land only, however, is that, since the tax base is considerably smaller than the value of land and improvements combined, a higher and more distortionary rate is needed to generate comparable revenues.

Exemptions

In every country, some properties are excluded from the property tax base. Exemptions may be based on such factors as ownership (e.g. government), the use of the property (e.g. charitable purposes), or on characteristics of the owner or occupier (e.g. 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.

Common exemptions include government property,[2] universities, churches, 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.

Exemptions have been criticized on a number of grounds. First, to the extent that people working in exempt institutions use municipal services, they should be taxed. Second, the differential treatment between taxed and exempt properties has implications for economic competition among businesses and between businesses and government. Third, differential tax treatment affects location decisions, choices about what activities to undertake, and other economic decisions. Fourth, exemptions narrow the tax base and thereby increase taxes on the remaining taxpayers, reduce the level of local services that can be offered, or both. Finally, since the proportion of tax-exempt properties varies by municipality, disproportionate tax burdens are created across communities. This result is especially troublesome when higher-level governments determine what is exempt from local taxation.

If a case can be made for favoring certain property holders (such as churches and charitable organizations) to encourage their presence in the local community, these organizations should be rewarded directly with a grant rather than on the basis of their property holdings (Kitchen 1992). 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. Only when this is done – which is unfortunately almost never the case in practice – will the full cost of land use for a particular purpose be taken into account in resource allocation decisions.

How is it taxed?

The next step is to determine the value to which the tax rate is to be applied. In general, two distinct assessment methodologies are used for property taxation: area-based assessment and value-based assessment, with the latter being divided into capital and rental value approaches (Youngman and Malme 1994). In addition, some countries use a system of self-assessment. Table 2 sets out the extent to which these approaches are used in the countries studied.

Area-based assessment

Under an area-based assessment system, a charge is levied per square meter of land area, per square

[2] In some instances governments make payments in lieu of taxes on their properties. Such payments are generally negotiated and are often much less than the property taxes would be.

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 metre 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. When the groups are defined narrowly enough, 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.

As Table 2 shows, area-based assessments are commonly used in Central and Eastern Europe 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. A common example of unit-value assessment is in the assessment of agricultural land. In many countries, farm property is assessed 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.

Market value assessment

Market value (or capital value) assessment, used in all the OECD countries studied[3] and some others, 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.

[3] The council tax in the United Kingdom uses a variation of the market value approach. See Bird and Slack (2004) for a description of how it works.

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 relatively unique. 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.

Rental value assessment

Under the rental value (or annual value) approach, property is assessed according to estimated (not actual) rental value or net rent. One rationale for using net rental value is that taxes are paid from income (a flow) rather than from wealth (a stock). In theory, however, there should be no difference between a tax on market value and a tax on rental value. When a property is put to its highest and best use and is expected to continue to do so, rental value will bear a predictable relationship to market value – the discounted net stream of net rental payments will be approximately equal to market value.

This relationship does not always hold, however. First, gross rents are often used rather than the economically relevant "net" rents that build in an allowance for maintenance expenditures, insurance costs and other expenses. Second, most countries tend to assess rental value on the basis of current use. There can thus be an important difference between market value and rental value. A property that is under-utilized would be assessed at a much lower value under the rental value approach than under the market value approach. From a land use perspective, a tax based on value in highest and best use is more efficient than a tax based on current use because it stimulates use to its highest potential by increasing the cost of holding unused or under-used land.

There are some problems with the use of rental value assessment. First, it is difficult to estimate rental value when there is rent control. Controlled or subsidized rents cannot be directly used to assess market rents unless the majority of properties are rent controlled. This has been an important problem in India. Second, because vacant land is not taxable under a tax based on rental value in current use (since there is no current use), an incentive is created for low return uses over high return uses. It may even become worthwhile to withhold rental properties from the market altogether.[4] If vacant properties are not taxed, the tax has to be higher on occupied properties to yield the same amount of revenue. These higher taxes further discourage investment.

In terms of tax administration, there are some additional difficulties with rental value (Netzer 1966). First, rental value is often difficult to estimate because there is little information on the annual rent of comparable properties for unique commercial and industrial properties. Second, net rents can be difficult to calculate because the distribution of expenses

[4] As noted above, if rental value were based on highest and best use, then vacant land would be taxable; the value would have to be estimated on the basis of other properties. Even if rental value were based on current use, it might be possible to assign a non-zero value to vacant land.

Table 2

Tax and assessment bases

	Tax base	Basis of assessment
OECD:		
Australia	Land or land and improvements	Market value or rental value or combination
Canada	Land and improvements (sometimes machinery included)	Market value
Germany	Land and improvements; farm properties also include machinery and livestock	Market value (rental income/construction costs); area in former GDR
Japan	Land, houses, buildings and tangible business assets	Market value
United Kingdom	Land and improvements; some plant and machinery	Market value for residential; rental value for non-residential
Central & Eastern Europe:		
Hungary	Unimproved value (plot tax); buildings (building tax)	Area or adjusted market value
Latvia	Land and buildings	Market value
Poland	Land, buildings, and structures	Area
Russia	Land for land tax; structures for property tax; assets for enterprise property tax	Area; inventory value of structures; value of assets
Ukraine	Land	Area
Latin America:		
Argentina	Land and buildings	Market value
Chile	Land and improvements	Area by location for land; construction value for buildings
Colombia	Land and buildings	Market value
Mexico	Land and buildings	Market value
Nicaragua	Land, buildings and permanent improvements	Cadastral value
Asia:		
China	Occupied land; land and improvements	Area; market value or rental value
India	Land and improvements	Mostly annual rental value; limited use of area and market value
Indonesia	Land and buildings	Market value
Philippines	Land, building, improvements and machinery	Market value
Thailand	Land and improvements (buildings and land tax); land (land development tax)	Rental value; market value
Africa:		
Guinea	Land and buildings	Rental value
Kenya	Land (but can use land and improvements)	Area; market value; or a combination
South Africa	Land and/or improvements	Market value
Tanzania	Buildings, structures or limited development[a)]	Market value (or replacement cost, if market value not available)
Tunisia	Land and improvements (rental housing tax); land only (tax on unbuilt land)	Area; rental value

[a)] Land belongs to the state and is not taxed; land rents are paid to the national government.

Source: Bird and Slack (2004).

between landlords and tenants differs for different properties. Third, assessors may not have access to rental income information because rental income is not always in the public domain in the same way as sales prices. Rental value assessment is used in a number of countries around the world, however, as Table 2 shows.

Area-based vs market-based assessment

Where it is possible to use market value, it is generally regarded as a better tax base. First, the benefits from services are more closely reflected in property values than in the size of the property. For example, properties close to transit systems or parks enjoy higher property values. Second, market value has the advantage of capturing the amenities of the neighbourhood, amenities that have often been created by government expenditures and policies. For example, two properties of identical size and age where one is located next to a park and the other is adjacent to a factory will pay the same tax under an area-based assessment system. A value-based assessment system would be fairer because the property next to the park would pay higher property taxes. Third, area-based assessment results in a relatively greater burden on low-income taxpayers than high-income taxpayers when compared to value-based assessment because it taxes all properties that are the same size the same amount, whether they are in high-income or low-income neighbourhoods. Similarly, older houses in a bad state of repair but with a large floor area will pay relatively high taxes. Furthermore, if a relatively poor neighbourhood becomes richer, there would be no tax change. A tax system that fails to take account of changes in relative values over time will result in inequities. If one value per square meter is chosen for all single-family homes, for example, and relative property values change as some locations become more desirable, then over a period of years inequities in the assessment system will result.

One advantage often claimed for unit value assessment is that property taxes tend to be less volatile than under market value assessment because they do not change when property values change. However, this "advantage" can also be a disadvantage, exacerbating inequities. It has also been argued that unit value assessment is easier to understand and cheaper to administer than value-based assessments particularly where the real estate market is not well developed. This is not true, however, for the multi-residential rental, residential condominium, commercial, and industrial properties that constitute the bulk of the tax base in most countries.

One problem with such properties, for instance, is what to include for tax purposes. Should atrium floors, servicing shafts, elevator spaces and so on be taxed even though they produce no direct revenue? Another problem is how to allocate shared facilities such as common entrances, halls, exits, aisles, atria or malls, among owners/tenants. Such common areas can be shared on the basis of the size of each unit relative to the total, the rent charged to each unit, or some other measure. A third problem in market economies has been the tendency towards the proliferation of multipliers that are applied to the area of improved property to reflect relative differences in value. In the Netherlands, for example, the system became so complex through such adjustments that it was finally abandoned (Youngman and Malme 1994).

At present, many transition countries employ some variant of area-based assessment. This choice no doubt reflects the nature of the available information on the physical area of building and land recorded in the old central planning records. As zones become more narrowly defined over time, however, it seems both likely and desirable that these systems will evolve into something closer to a market value system.

Self-assessment

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. In Thailand, self-declaration of property owners is made to local assessors who assess the self-declared value and identification in terms of how well it matches their data. Self-declaration of properties by landowners is also required in the Philippines, once every three years. The local assessor then prepares the assessment roll.

Where properties are assessed at market value and there is self-assessment, the taxing authority in some countries has the right to buy the property at the assessed value.[5] A system where the taxing authority can buy the property will only be credible if it actually can and will buy the property. In practice, this right

[5] Taiwan is an example (Youngman and Malme 1994, p. 12). This idea is an old one, used in Australia in the 19th century, for example, as noted by Bird (1974). It has seldom been effective.

seems to have been exercised only rarely, presumably because of the political and budgetary impossibility of large-scale property purchases. Tanzi (2001) has recently made a proposal along similar lines, that people should assess their own properties and then make the self-assessed values public. Anyone who wanted to buy their property at a price that exceeded the declared price, by some margin such as 40 percent, could make an offer. If the owner refused the offer, the bid plus a penalty would become the new assessment. Although appealing to economists, and frequently recommended in the past, such ideas on closer examination seem much less attractive on a number of grounds (Holland and Vaughan 1970) and have not proven acceptable in practice anywhere.[6]

Nonetheless, self-assessment is an appealing procedure to poor countries with little administrative capacity. It does not appear to require expert assessment staff, and it seems to be easy to implement. Indeed, in some cases, such as Bogotá, Colombia, self-assessment has at times appeared to be relatively successful in terms of increasing revenues from property taxes, albeit at a time of rapidly rising property prices. In general, however, self-assessment seems likely to lead to inaccurate estimates of property values, with a tendency toward under-estimation. It violates the principle of fairness on the basis of ability to pay because people with comparable properties will not necessarily pay comparable taxes. Generally, lower-valued properties have a lower rate of under-estimation than do higher-valued properties, making this assessment approach regressive (i.e. taxes are relatively higher on low-valued properties). Under-estimation 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 under-statement 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.

At what rate is it taxed?

Tax liability is determined by multiplying the assessed value times the tax rate. Given the size of the tax base, the tax rate determines how much revenue the property tax will generate. Three major issues arise with respect to tax rates. Who sets them? Are they differentiated, and, if so, how? And, finally, how high are they?

Who determines the tax rate?

Tax rates are sometimes determined locally and sometimes by the central government. As shown in Table 3, there are very considerable differences between countries with respect to the extent to which local governments are free to determine tax rates. Sometimes rates are essentially set by the central government. Sometimes there is some local discretion, within centrally-set limits. Sometimes there is complete local discretion.

Where rates are determined locally, local governments first determine their expenditure requirements. They then subtract non-property tax revenues available (for example, intergovernmental transfers, user fees, and other revenues) from their expenditure requirements to determine how much they need to raise from property taxes. The resulting property tax requirements are divided by the taxable assessment to determine the property tax rate. Even where rates are locally determined, there are often limits placed on them by the central government. In Ontario, Canada, for example, tax rates imposed on non-residential property are effectively "capped" at present in many localities.

If a local government is to make efficient fiscal decisions, it needs to weigh the benefits of the proposed services against the costs of providing them. If local governments do not finance these services themselves, then the link between expenditures and revenues is lost and the choice of services will not be based on an accurate perception of their cost. Setting tax rates at the local level places accountability for tax decisions at the local level. Local determination of tax rates is particularly important in the many countries in which a senior level of government determines the tax base. Local tax rates may have to be set within limits, however, to avoid distortions. A minimum tax rate may be needed to avoid distorting tax competition. Richer local governments may choose to lower tax rates to attract business. With their larger tax bases, they can provide equivalent services at lower rates than poorer competing regions. The resulting location shifts are not always allocatively distorting, but they are generally politically unwelcome. In addition, a maximum rate may be

[6] For a brief review of the past history of this idea, and the problems with it, see Bird (1984).

needed to prevent distorting tax exporting, whereby local governments levy higher tax rates on industries in the belief that the ultimate tax burden will be borne by non-residents (Boadway and Kitchen 1999). Such tax exporting severs the connection between payers and beneficiaries and renders decentralized decision-making about taxing and spending inefficient.

Differentiated tax rates

Many local governments levy rates that differ by property class.[7] Different tax rates may be imposed for different classes of property (residential, commercial and industrial, for example). This system gives local governments the power to manage the distribution of the tax burden across various property classes within their jurisdiction in addition to determining the size of the overall tax burden on taxpayers.

Generally, where such variable tax rates are applied, properties are assessed at a uniform ratio (100 percent or some lesser percentage) of market value. Another and probably more common way to differentiate among property classes is through a classified assessment system, as in the Philippines. Under this system, classifications or types of property are differentiated according to ratios of assessed value, but a uniform tax rate is applied. In terms of accountability, variable tax rates would be more visible and easier to understand for taxpayers than a classified assessment system, which may, unfortunately, be one reason that differentiated rates are less commonly employed than differentiated assessment ratios. Indeed, even when assessment ratios differ substantially among classes of property, the differentiation is more often a matter of practice than of law and can only be determined by special study.

[7] Property tax rates can also vary according to the services received. In some jurisdictions, there is a general tax rate across the city and a special area rate or additional surcharge in those parts of the city that receive services only provided to them , for example, garbage collection, street lighting, transit etc.

Table 3

Characteristics of tax rate setting

	Different tax by property class	Local discretion over tax rates
OECD:		
Australia	Yes	Yes for local tax; limits on annual increase in revenues.
Canada	Yes	Yes (restrictions apply in some provinces)
Germany	Yes	Central base rates; locally determined leverage factors
Japan	No; assessment differentiation	Nationally set standard and maximum rates
United Kingdom	Two separate taxes	Residential tax only; tax ratios for bands set centrally
Central & Eastern Europe:		
Hungary	Yes	Yes, within legal limits
Latvia	No	No, but local governments can grant relief
Poland	Yes	Yes, subject to prescribed minimum and maximum rates
Russia	Yes	Yes, within narrow range set by senior governments
Ukraine	No	No
Latin America:		
Argentina	Yes	Yes
Chile	No	No
Colombia	Yes	Yes, subject to central government limits
Mexico	Yes	Yes
Nicaragua	No	No
Asia:		
China	No	No
India	Yes	Yes, subject to state restrictions
Indonesia	No	No, but can change valuation deduction
Philippines	No, assessment differentiation	Yes, subject to minimum and maximum rates
Thailand	Yes	No
Africa:		
Guinea	Yes	No
Kenya	Yes, but rarely differentiated	Yes
South Africa	No; relief mechanisms used	Yes
Tanzania	Yes	Yes
Tunisia	No	No

Source; Bird and Slack (2004).

Table 3 shows that in many countries tax rates are differentiated by property class, or there is assessment differentiation or tax relief for some classes of property. Variable tax rates (or other differentiation of property taxes among property classes) may be justified on a number of grounds:

- On the basis of fairness with respect to benefits-received, it can be argued that the benefits from local public services are different for different property classes. In particular, a case can be made on benefit grounds for taxing non-residential properties at a lower rate than residential properties (Kitchen and Slack 1993). Few examples of differentiation in this direction appear to exist, however.
- On efficiency grounds, it has been argued that property taxes should be heavier on those components of the tax base that are least elastic in supply. Since business capital tends to be more mobile than residential capital, efficiency arguments again lead to the conclusion that business property should be taxed more lightly than residential property. In reality, however, lower rates are generally applied to residential properties.
- Variable tax rates can also be used to achieve certain land use objectives. Since higher property taxes on buildings tend to slow development and lower taxes speed up development, a municipal policy to develop some neighbourhoods instead of others might support differential taxes in different locations as well as for different property classes.

An additional question about property tax rates is whether the tax is levied at a flat or graduated rate. In many countries, some graduation is in effect introduced by exempting low-value properties. In a few instances (for example, some provinces in Argentina) the tax rate increases with the value of the taxed property. In Thailand, the tax rate also increases, although in a way that results in rates being regressive. Many countries impose higher taxes on "idle lands" – though seldom with much effect (Bird and Slack 2004). Particularly in rural areas, some countries have occasionally attempted to use progressive land taxes as, in effect, proxy income taxes by attempting first to aggregate all land owned by a single person and then to impose a graduated tax. Such schemes have generally failed, however, owing both to the administrative difficulty of assembling the information – particularly when properties are located in different jurisdictions – as well as the political unreality of attempting to accomplish "land reform by stealth" in this way (Bird 1974).

The level of tax rates

One of the more striking features of land and property taxation in many developing countries is how low the tax rates are. Even in countries such as Argentina in which progressive rates are imposed, the top rate (on assessed value) seldom exceeds much more than 1 percent, and it is often lower. In Indonesia, for example, the centrally-set land tax rate is only 0.5 percent. Moreover, as a rule, the effective rate of property taxes is, owing to low assessment ratios and poor enforcement, much lower than the nominal or statutory rate. Other factors resulting in low effective tax rates in many countries are lags in reassessment and the inadequacy of adjustment for value changes. In the Philippines, for example, where the nominal rate is as high as 2 percent, the effective rate has been estimated at only 0.07 percent (Guevara, Gracia and Espano 1994).

Some special cases

Residential and non-residential property

In many countries, single-family residential properties are favored by deliberately under-assessing them compared to apartments or commercial and industrial property of comparable value; by legislating lower tax rates on these properties; or by granting special property tax relief measures in the form of tax credits, homeowner grants, or tax deferrals. The differential treatment of residences does not reflect the differential use of services by different property types. In many countries, single-family owner-occupied residential properties are presumably favored largely on political grounds: residential homeowners are much more likely to vote in local elections than are tenants.

There is little economic rationale for the usual higher taxation of non-residential property. Differentially higher taxation distorts land use decisions favouring residential use over commercial and industrial use. A similar rate on both uses would ensure that the choice is based on the highest and best use (Maurer and Paugam 2000). Special taxation of one factor of production (real property) may also distort productive efficiency by inducing a different choice of factor mix in producing goods and services.[8]

[8] As noted above, the central governments may need to establish minimum tax rates on non-residential properties to avoid distorting tax competition and maximum rates to avoid tax exporting.

Agricultural property

Finally, in most countries agricultural properties tend to be treated on explicitly favourable terms under most property tax systems.[9] In some countries, much agricultural land is simply not taxed. In others, rather than assessing farms at their market value (which reflects the highest and best use), farms are often assessed at their value in current use. The value of a farm for tax purposes is thus determined by its selling price if it were to continue to be used as a farm. Alternative uses of the farm (e.g. as a housing subdivision), or its speculative value, are not considered in the determination of value. Such favourable treatment of agricultural land is usually designed to preserve it from conversion to urban use. Basing the property tax on value in current use, however, is probably not sufficient to preserve farmland because the resulting tax differential is unlikely to be large enough to compensate for the much higher prices that would be paid if the land were converted to urban use (Maurer and Paugam 2000). Furthermore, favourable treatment of rural land can increase speculation at the urban fringe and hence end up increasing urban land prices.

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[9] An interesting exception is the Philippines where, unusually, farm properties are taxed on a higher percentage of market value than residential properties.