The Effect of Potential-based Land Tax on Land Utilization

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Introduction (1)

Property tax has a long tradition

**Advantage:** Land cannot be transferred to other countries → stable source of income

Importance reduced with industrial revolution

More tax revenues on buildings than on land
Introduction (2)

Land tax in Austria based on unit value
Developed in the 19th century for agricultural land
Unit values not adapted to market changes →
Austrian Highest Court required adaptation (VfGH, 2012)

Chance for change of approach?
Potential-based land tax?
What would be the effect?
Land Administration

Basic processes that provide information on available resources

Information used in management processes

(Horisberger, 2011, as cited in Muggenhuber et al. 2011)
Property Tax (1)

“The property tax is, economically speaking, a combination of one of the worst taxes - the part that is assessed on real estate improvements ... - and one of the best taxes - the tax on land or site value”  (Vickrey 1999: 17)

Land tax shall relate to the location value of land instead of the value of improvements  (George & Drake, 1879)
Property Tax (2): Policy

Several goals (Muggenhuber & Twaroch, 1998)

• **Guidance**: High land tax may motivate land owners to sell land, which they do not need.

• **Distribution**: reallocate wealth

• **Income**

Tax assessment should be

• **Objective**

• **Fair**
Property Tax (3): Austria

Land tax based on unit-value (last complete survey done in 1973)

Unit-value determined by
  – soil quality
  – availability of water, and
  – climate

Improvement of land does not influence land tax

Does not work properly in complex situations like built environments
Property Tax (4): Reform Idea

Value of land is an objective criterion
Reflects the wealth of the land owner ➔ it is also fair
Market value is based on different factors including general economic situation, location, and potential use
Mass appraisal can provide good estimates of market value
Potential-Based Land Value (1)

“Fair market value”: Definition by International Accounting Standards Board (IASB) – included “highest and best use” as an element for determining the market value in 2013

Parameters applied to the definition of “highest and best use” are:

• The potential use is legal.
• The potential use is physically, economically and financially feasible.

Value: potential use fully exploit, regardless to the current use.
Potential-Based Land Value (2)

Austria has data sources suitable to determine land value (Muggenhuber et al., 2013), e.g.,

– physical and geometrical properties
– private law or public law restrictions

No new data needs to be collected!
Effects of Potential-Based Land Tax: Economic considerations

- Land is wasted, if the potential is not used
- Investors may hope for increasing value – no intention to use of improve the land

- Land tax based on market value will be fair
- Decreasing land value automatically reduces tax burden
- No data acquisition – setup is cheap (re-use)
Effects of Potential-Based Land Tax: Ecological considerations

• Better use of ressource land – contribution to sustainability of our eco-system

• Avoidance of unnecessary infrastructure for not utilized properties
Effects of Potential-Based Land Tax: Political and social considerations

Transparency is one of the key aspects of good governance (UN 1996):

- Effects of decisions in spatial planning become evident (= change in value)
- Costs of public law restrictions like national parks assessable

Is it fair that land owners pay higher tax if the value increases?

- NO, if increase based on improvement by land owner
- YES, if increase based on public investment
Conclusions

• Land tax in Austria currently not fair!

• Potential-based land tax
  – “punishes” land owners, who do not exploit the full potential
  – provides automatic compensation for loss in value

• Mass appraisal systems document the financial effects of political / spatial planning decisions