Property Tax Review

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1. Executive summary

1.1 Background and scope

PricewaterhouseCoopers LLP (PwC) has been commissioned by Treasury and Resources to undertake this broadly-based review of the taxation of land and property and to provide an independent analysis of the issues, informed by international best practice. The overall objective of this report is to provide a summary of current academic and institutional thinking and practice on the taxation of immovable property and options for the reform of the taxation of Jersey land and property. This report does not constitute a policy proposal or recommendation. It is intended to serve as an input to the development of tax policy in Jersey and to support the forthcoming Green Paper due for release in July 2014.

Taxes on land and property have historically been an important component of broad-based tax systems. Governments today typically levy taxes on the ownership of land and property or the transfer of ownership interests in property assets. In many countries, taxes are levied on both. The revenues from such taxes are often modest in comparison with those from other sources but in recent years the difficulties involved in taxing the profits of internationally mobile businesses have led to a resurgence of interest in the role that the taxation of immovable property can play.

In Jersey, consideration has been given to reforming the taxation of immovable property on a number of recent occasions. For example, the States' 2010 Fiscal Strategy Review outlined possible changes to domestic property rates and stamp duty, and the Land Transaction Tax was introduced that year. The use of economic modelling techniques to quantify the effects of the proposed options for the taxation of immovable property in Jersey is specifically beyond the scope of the report due to data limitations. As such, the design features of options presented in this report are purely conceptual and are not founded on detailed quantitative analysis.

1.2 Issues from the literature

An examination of the academic literature and international practice yields a number of relevant considerations for the development of policy in Jersey:

- **Historical and contemporary significance:** the taxation of immovable property has been, and will continue to be, a key component of the tax systems of national governments. Indeed, given the rapidly evolving nature of the international tax landscape, national governments must turn their attention to property tax modernisation to ensure that longstanding property tax policy remains tenable and fit for purpose.

- **Recurrent taxes on residential real estate are amongst the most efficient:** Property taxes are widely regarded as being an economically efficient form of taxation. However, as the literature describes, property taxation is far from a homogeneous concept and as such, the relative economic efficiency of different forms of property taxes is not uniform. The literature indicates that recurrent taxes on residential property are the most efficient, whereas taxes on capital improvements to land and inputs to the production process are among the most distortive.

- **The equity of property taxes is not uniform:** The equity embodied in the taxation of immovable property is a malleable concept and, in a similar way to their relative economic efficiency, is dependent on the design features of the tax. In the absence of a definitive answer to the question of equity, those leading the process of property tax reform should ensure that proposals are balanced and that the incidence of the tax as well as the parties responsible for paying it are properly understood.

- **Property tax policy is as much a political issue as it is an economic one:** The taxation of immovable property is rarely popular among taxpayers or politicians. Numerous property tax reforms have failed because they were unable to gain political and social buy-in. As a result of this, careful attention should be given to the extent and nature of provisions designed to promote taxpayer acceptance. Changes in property tax policy should be founded on a coherent policy rationale communicated in a clear and timely dialogue with the taxpayer community and there should be wide and transparent consultation in advance of any decisions being made. Additionally, any tax reliefs should be carefully designed to offer appropriate and sustainable concessions, while avoiding adverse impacts to macroeconomic and fiscal stability, and should maintain the integrity of the tax base.

1.3 Principles of Jersey property taxation

Drawing on the literature, international best practice and the Principles of Jersey Taxation, we set out below six principles that we believe should guide the thinking of policy-makers in relation to the reform of property taxation.

1. **Consultation: Property tax reform proposals should be the subject of wide consultation.** There is always strong public interest in property tax proposals. Every household will potentially be affected. Policy measures should be based on informed consent. Transparent consultation should therefore be undertaken to inform and test public opinion and to enhance public confidence in the process of reform as well its direction. Communication should be detailed enough to allow individuals to see the impact on their own situation.

2. **Coherence and certainty: Reform should build on the current framework of taxation of land and property, providing greater coherence, clarity and certainty to owners, occupiers and financiers, using up-to-date valuations as a base.** Property tax reforms should, as far as possible, fit with the existing principles and practice of taxation in Jersey. Proposals should be consistent with current legal and fiscal frameworks. New laws should be based on familiar concepts such as ownership and occupation and be certain in their application. Liabilities should be easy to calculate and framed around transparent and up-to-date valuations. The political economy of property taxation makes certainty a key consideration.

3. **Efficiency and growth: The choice of property tax instruments should favour economically efficient taxes such as recurrent taxes on land and residential property over taxes that distort behaviour such as stamp duties.** Property taxes should be designed to be economically efficient and supportive of economic growth. Wherever possible, within a balanced framework of taxation in Jersey, they should replace taxes that are less efficient. However, the economic efficiency of property taxation is not homogenous so more efficient property tax instruments, such as recurrent taxes on land, should normally be considered in preference to taxes that distort behaviour, for example transaction taxes. New property taxes should support the achievement of the priorities of the States' Island Plan 2011, including the efficient use of scarce resources such as land to protect and enhance the natural and built environment and the bringing into prompt use of land zoned for development to provide adequate housing for the population.

4. **Support for the competitive environment: The design of property taxes, including recurrent taxes on ownership and taxes on realisations, should continue to support and encourage inbound investment.** Jersey's prosperity today is, to a large extent, a reflection of its ability to attract capital and investment from the international business community. Property tax reform should recognise and take account of the competitive pressures that businesses face and the choices of location that are available to international investors. The selection of property tax instruments, the way in which they are used and their place within the overall framework of tax in Jersey should be factored into decisions about property tax reform so that Jersey remains an attractive and competitive destination for investment.

5. **Fairness: The benefits of occupancy and the rewards of ownership should be taxed in a balanced way that deals fairly with windfall profits and also recognises ability to pay. Where appropriate, the incidence of property taxation should be designed to enhance the fairness of the tax system as a whole.** The equity and incidence of property taxation is highly contested in many countries. Care should therefore be given to ensuring that property taxes are balanced in their incidence, based on up-to-date information (including valuations), reflect the ability of taxpayers to pay and are readily collectable. In principle, taking property taxes as a whole, everyone should take some part of the burden, their share depending on legal, financial and economic factors.

This does not mean that each instrument should treat all economic agents in the same way but that the system as a whole should deal fairly and even-handedly with the interests of tenants, home owners and investors. Where necessary, measures should be taken to protect the system from abuse.

6. **Fiscal stability and sustainability: Well-designed property taxes, particularly recurrent taxes, and the related system of reliefs should be used to improve macro-fiscal management, including the level of debt in the economy, and to dampen the volatility of tax receipts.** Property taxes should be designed to generate revenues that are stable and sustainable in order to contribute to the effectiveness of macro-fiscal management in Jersey. Attention should be given to the volatility associated with particular property tax instruments, to the potential buoyancy of revenues and to ensuring that allowable reliefs are rational and not over-generous, do not encourage undesirable outcomes such as the excessive use of debt finance and do not undermine the integrity of the tax base. Sustainability includes the concept of using taxation instruments that are readily understood and enjoy broad public support.

1.4 Policy options

The Report sets out high-level groups of policy options that could be implemented either individually or in combination to reform the taxation of immovable property in Jersey. The aim of these options is to show how it might be possible to create a modern and coherent framework for the taxation of immovable property through which to strengthen the public finances of Jersey, should the Jersey Government decide to proceed with reform of its property tax system.

Using the recommendations of the Mirrlees Review as a theoretical framework through which to conceptualise potential areas for reform in Jersey's property tax system, three thematic groupings of possible reforms have been identified.

1.4.1 Group 1: Occupation

This group of measures could comprise two main elements, the effect of which could be to tax more fully the occupation of both domestic and non-domestic property in Jersey:

1. The development of domestic rates into a levy on the consumption value of domestic property, following the Mirrlees concept of a Housing Services Tax. It could be levied solely on the occupier, whether or not the owner was the occupier; and,

2. In respect of the non-domestic sector, a choice between:

    a) The transformation of non-domestic rates into a land value tax, payable by reference to the value of land zoned for commercial purposes.

    b) The introduction of a system that could parallel the proposal for domestic rates, with a charge levied only on occupation, using an up-to-date valuation base.

These measures could be combined with Group 2 and/or Group 3 below.

The overarching intent of this group of measures is to reform and modernise the way in which ownership and occupation of property are currently taxed in Jersey. At present, the rates system taxes ownership and occupation separately using adjusted 2003 rental values as the tax base for both activities. Intuitively, this could be considered anomalous to a modern property tax system as two distinct taxable activities are taxed on the same bases and the current rates system provides for a double taxation of owner-occupiers. An additional layer of double taxation for owners of rental properties is also created as both imputed and actual rental income is currently taxed under the rates system and Schedule A of the income tax regime respectively.

As such, the objective of introducing these measures on a stand-alone basis would be to modernise the rates system, based on clearly articulated principles, using instruments that would:

- Create a new framework for an annual charge on all land and property in the domestic sector and all land zoned for commercial use;
- Underpin the Jersey tax system with a stable and sustainable revenue stream and a mechanism through which tax revenues could be increased over time, if necessary, without creating new distortions. At certain levels, it could potentially allow less economically efficient and more distortive taxes to be reduced; and

In principle the incidence of these measures could be as follows:

- Owner-occupiers and tenants in the domestic sector could potentially see an increase in their level of taxation.
- Owners of rental properties in the domestic sector could have a reduced level of taxation.
- The incidence borne by the commercial sector could be such that either:
    - The level of taxation on owners could increase because property owners would become solely liable for a charge based on unimproved land values; or
    - The level of taxation on tenants and occupiers could increase as they would become solely liable for an uprated tax on land and improvements.

The precise sharing of the tax burden of this group of measures will be dependent on the supply and demand dynamics of the rented housing market in Jersey.

From a revenue perspective it should be noted that the implementation of these measures on a stand-alone basis would not necessarily lead to private landlords being better off. Schedule A income would still be taxable and, depending on the efficiency of the Jersey property market, the heavier taxation of tenants could lead to a downwards adjustment in rental prices. Therefore, although the form of these measures suggests that landlords could benefit through a reduced burden on ownership the substance is that there could be a rebalancing between owners and occupiers and an implicit transfer between them.

Any proposals for change in this area should be the subject of wide consultation and are likely to be most successful if they are introduced over an extended period of time.

1.4.2 Group 2: Investment returns

This group of measures contains a number of elements, the effect of which would be to extend the range of circumstances in which returns to real estate investment could be taxed. The principal elements would be:

1. The broadening of the current scheme for taxing disposals of land and property as part of a trade so that a wider range of realisations could potentially give rise to tax;
2. The introduction of a concept of a normal return to investment which could reduce the profits that could otherwise be taxable on a realisation of an interest in land and property; and
3. The taxation of accrued development returns where land is rezoned and its potential use is changed.

Some or all of these measures could also be combined with the measures in Group 1 and/or Group 3.

There are currently only limited circumstances in which profits arising on the sale or other realisation of land or property are taxed in Jersey. Disposals in the course of a trade are taxable but there is no capital gains tax that captures the profits earned by businesses or individuals outside that framework. These measures do not contemplate the introduction of such a broad-based tax. The objective of introducing them on a stand-alone basis would be:

- To recognise that windfall gains may sometimes arise to owners of land and property as a result of factors that they do not control. This is especially important because of the fixed supply of land which is compounded by the island context and land use planning;

- To seek, where such circumstances arise, a contribution from those owners to the social costs of the Island; and

- To build economic efficiency into that framework.

In principle these measures could increase the level of taxation that owners of rental property would face in the future. They would also tax earlier and more fully, gains arising from the rezoning of land.

As with the measures in Group 1, any proposals for change in this area should be the subject of wide public consultation.

1.4.3 Group 3: Finance

This group of measures comprises two main elements, the effect of which would be to modernise the treatment of debt finance in the Jersey market for land and property.

The adoption of these measures would:

1. Phase out relief for mortgage interest on domestic properties that are owner-occupied; and

2. Impose a minimum level of taxation on rental income, where the use of debt finance would otherwise reduce it below a pre-set benchmark.

Some or all of these measures could be combined with the measures in Group 1 and/or Group 2.

The objective of such changes would be:

- To remove a distortion in the housing market caused by the rules for the treatment of financing costs for tax purposes;

- To reduce the current bias in favour of owner occupation of the housing stock in a progressive way; and

- To ensure that the existing rules that seek to limit the artificial use of debt finance for the purchase of land and property operate in a transparent manner.

In principle the incidence of these measures could be as follows:

- The level of taxation on some owner-occupiers of domestic property with mortgage finance could increase due to the phased removal of mortgage interest tax relief.

- The tax yield from properties held for rental, especially by international investors, could be protected.

As with the measures in Groups 1 and 2, any proposals in this area should be the subject of wide public consultation.

1.4.4 Stamp duty

None of the groups of measures outlined above includes an explicit proposal for the abolition of stamp duty. Nevertheless, the literature has little positive to say about this form of transaction tax. It is economically inefficient and creates distortions in the property market. It discourages investment in property and can, albeit to a modest degree in Jersey, adversely affect the mobility of labour.

The strongest points in favour of the retention of stamp duty are that:

- It is an established and accepted tax.
- It is easy to collect and, especially since the introduction of the Land Transaction Tax, compliance rates are high.
- It has a yield of around £14 million from real estate transactions which would otherwise have to be raised in a different way, if current levels of government spending were to be maintained.

However, these points alone do not justify its retention in a broad reform of the taxation of land and property.

The measures set out in Groups 1-3 could create a new framework of taxation that is more principles-based, more balanced and more equitable than the current system and which could allow similar levels of taxation to be raised with less distortion and greater economic efficiency. They could also potentially allow a higher yield to be achieved over a period of years, creating room to phase out over a similar period, less efficient and more distorting taxes. The gradual removal of stamp duty on real estate transactions would reduce the level of taxation on property owners and could generate positive impacts for occupiers of property dependent on the extent to which the incidence of stamp duty is passed through in rents. The positive impacts of the removal of stamp duty could help to offset the anticipated impact of the groups of measures presented above. However, the precise net effect would be dependent on the rates of tax applied. The dynamic interaction of the adopted tax measures would also have to be considered and should be investigated more thoroughly.

The phasing out of stamp duty levied on real estate transactions could be the subject of consultation alongside the other issues. Stamp duty could be phased out over a number of years to coincide with the phased implementation of any of the groups of measures presented above. This could be achieved by either reducing the rates at which stamp duty is levied, by gradually removing bands from the rate structure or by a combination of the two. The measures taken to remove stamp duty could be made broadly progressive if they initially target transactions falling within the lower bands of the rate structure. Additionally, stamp duty on the creation of security interests over Jersey property could be abolished.

2. Introduction

2.1 Background

Taxes on land and property have historically been an important component of broad-based tax systems. Governments today, at both national and sub-national level, typically levy taxes on the ownership of land and property or the transfer of ownership interests in property assets. In many countries, taxes are levied on both. The revenues from such taxes are often modest in comparison with those from other sources but in recent years the difficulties involved in taxing the profits of internationally mobile businesses have led to a resurgence of interest in the role that the taxation of immovable property can play in the tax systems of both developed and developing countries.

Against the backdrop of the challenging fiscal landscape and intense levels of tax competition facing most states, international institutions, including the International Monetary Fund (IMF) and Organisation for Economic Cooperation and Development (OECD), have identified the reform and development of immovable property taxation regimes as highly desirable for many jurisdictions (IMF, 2013a). Interest in the taxation of land and property has also become strong among national governments due to the possibility of achieving economically efficient and equitable taxation with instruments of this kind.

In Jersey, consideration has been given to reforming the taxation of immovable property on a number of recent occasions. For example in 2010 the States' Fiscal Strategy Review outlined possible changes to domestic property rates and stamp duty levied in the Island and the Land Transaction Tax was introduced that year. Given the nature of the tax base of the Island, it is clear that the issue of how best to tax land and property held by businesses and individuals in Jersey is an important issue for Treasury and Resources.

As many national governments have discovered, the best way to achieve widespread support and the successful implementation of tax reform is to ensure that there is a full and transparent process of consultation with those affected well in advance of implementation decisions. This should ideally be supported by an independent analysis of the issues and considerations, informed by international best practice. To this end, PricewaterhouseCoopers LLP (PwC) have been commissioned by the Treasury and Resources to undertake this broadly-based review of the taxation of land and property. This report does not constitute a set of policy proposals or recommendations. It is intended to serve as an input to the development of tax policy in Jersey and to support the forthcoming Green Paper due for release in July 2014.

2.2 Objectives and scope

The overall objective of this report is to provide Treasury and Resources with a summary of the current academic and institutional thinking and practice on the taxation of immovable property and options for the reform of the taxation of Jersey land and property. This report is intended to support the intention to reform the taxation of land and property.

Within the framework of this overall objective, this report will consist of the following:

- A review of the most recent academic and institutional literature published on the taxation of immovable property, focusing on the theoretical economic underpinnings of this area of tax policy and the development of a set of guiding principles for the taxation of immovable property.

- The identification and analysis of relevant regimes for taxing land and property considered and/or implemented in different parts of the world, commenting on the experiences of implementation and synthesising lessons that would be applicable to Jersey.

- The development of options for the taxation of immovable property in Jersey, taking account of the economic efficiency of such options, how best to tax gains on land for development and the place of interest deductibility within the options.

The use of economic modelling techniques to quantify the effects of the proposed options for the taxation of immovable property in Jersey is specifically beyond the scope of this report due to data limitations. As such, the design features of options presented in this report are purely conceptual and are not founded on detailed quantitative analysis. In any tax reform process it is advisable to conduct robust and detailed economic analysis of the nature and extent of the impacts generated by the proposed measures prior to implementation.

2.3 Structure of this report

This report has been structured to provide the reader with a clear and reasoned analysis of the issues relating to the taxation of immovable property as presented in the literature and in the context of Jersey, culminating in the synthesis of policy implications and three groups of policy measures for consideration by Treasury and Resources.

The remainder of this report is structured as follows:

- **Section 3** will review and distil the most relevant points from the large body of academic and institutional literature generated to date on the theoretical underpinnings and practice of the taxation of immovable property. In support of this review of the literature, several case studies of historical and contemporary immovable property taxes will be presented to highlight salient points.

- **Section 4** will present the policy implications of the literature and experience of the taxation of immovable property for Jersey, using the discussion presented in the preceding section as a base. This will result in the development of a proposed set of guiding principles to support the development of tax policy in this area.

- **Section 5** will briefly explore the key international trends in the taxation of immovable property and the macroeconomic environment in Jersey to provide context and a point of reference for the rationale of the policy options to be developed in the proceeding section.

- **Section 6** will, based on the discussion presented in previous sections, set out three groups of measures for the reform of the taxation of immovable property in Jersey.

- **Section 7** will draw together the key points presented in previous sections to synthesise a set of conclusions and considerations relating to the taxation of immovable property that are pertinent to Jersey.

The appendices should be read in conjunction with the main report.

- **Appendix 1** sets out, as a reference point, the current taxation system for property in Jersey.

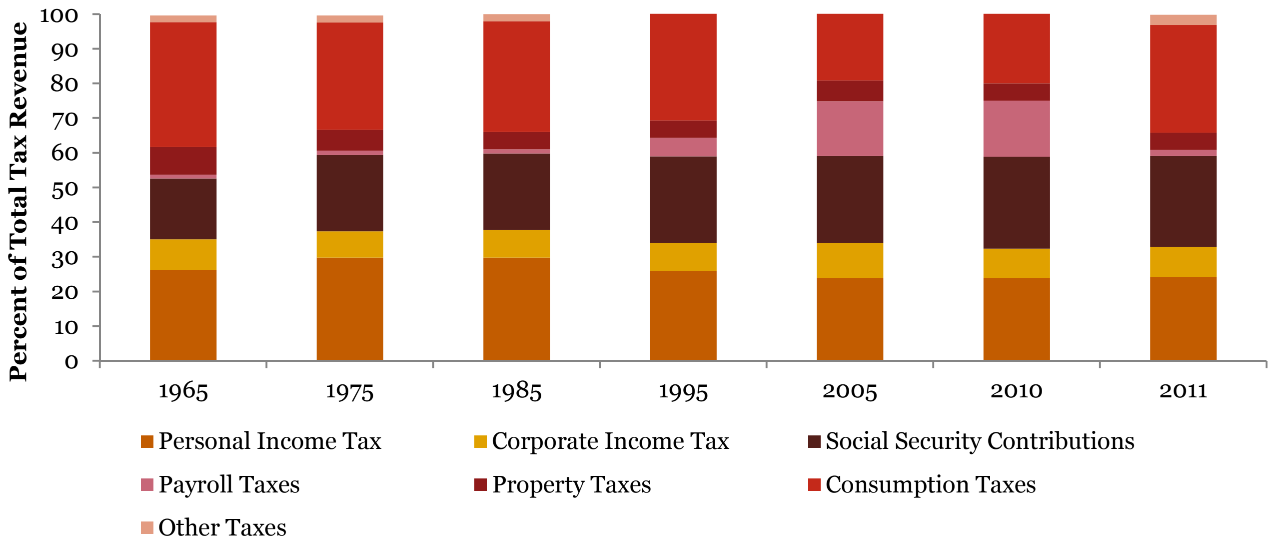
- **Appendix 2** provides some detail on a number of examples of systems for taxing land and property in other countries.

3. Theory and practice

3.1 Introduction

The taxation of immovable property has historically been a common feature of the tax systems of nation states. As Figure 1 illustrates with the example of OECD countries, even though property taxes have not typically generated large amounts of revenue compared to other taxes, they are a stable source of revenue and as such, contribute to fiscal sustainability.

Figure 1: OECD Average Tax Structure 1965-2011



Source: OECD Statistics, 2014

Although historically modest in scale, property taxes have recently become the subject of renewed interest, particularly within the fiscal advice provided to countries by International Finance Institutions (IFIs) such as the IMF. The long history of property taxes and the recent resurgence of interest in them means that there is a substantial body of academic and institutional literature on this subject.

The objective of this section of the report will be to develop a sound and robust knowledge base to underpin both the discussion presented elsewhere in this report and Treasury and Resources' ongoing engagement with the taxpayer community on the extent and nature of property taxation in Jersey.

In furtherance of this objective, this section will first provide context to the development of current thinking on property taxes. It will then briefly discuss what constitutes 'property' by way of a foundation for later sections. Following this it will discuss the arguments for and against property taxes, the various tax bases that can be used and the administrative issues that can impact on their efficacy. Finally, this section will present a consideration of the issues of political economy that have a bearing on property tax reform. Throughout this section, several case studies of historical and contemporary immovable property taxes will be presented to illustrate salient points highlighted in the literature.

3.2 Historical and contemporary perspectives

Taxes levied on immovable property have been imposed for centuries and in many jurisdictions their imposition predates that of income tax (Mirrlees *et al.*, 2011). As a result of their longstanding implementation, policymakers are able to draw on a substantial body of literature, dating back several centuries, on the theoretical constructs and experiences of implementation. Amid the challenging fiscal landscapes created by the financial crisis and the unprecedented mobility of capital, national governments and international institutions are beginning to reassess the importance of property taxation.

3.2.1 Classical arguments

The body of literature on the taxation of immovable property can be traced back to the scientific enlightenment of the 18th Century, and in particular, to the French 'Physiocrat' school of thought founded by Francois Quensay in the 1750s. Physiocrats regarded land as the source of all wealth, and as such, the only appropriate base for taxation (McLean, 2005). Although initially endorsed by Adam Smith (1776), the Physiocrat school of thought fell out of fashion due to the inherent fiscal weaknesses of single taxation and was later overtaken by other competing views.

One such competing view was that put forward by Thomas Paine in his work titled *Agrarian Justice* (1797) which expanded upon Locke's idea that the concept of privately held property is a social construct. Using this as a foundation, Paine states that *"it is the value of the improvement only, and not the earth itself, that is individual property"* (Paine, 1797). Therefore, as the concept of personal property is a social construct governed by the laws and norms, it is only right that *"the society which makes them possible has a right to tax them"* (McLean, 2005).

Following Paine's exposition of the fundamental rights of a society to tax immovable property, David Ricardo was next in developing the thought on immovable property. In Ricardo's Law of Rents (1817), it was argued that the rental value of unimproved land is beyond the control of landowners, instead resting on its intrinsic features such as location and fertility. Building on this, he states that it is the use of capital in *"ameliorating the quality of land"* (Ricardo, 1817) that allowed landowners to realise higher rents. Although the tax implications of Ricardo's Law of Rents were not fully expounded at the time, they would prove seminal in formulating the Georgite views of the taxation of immovable property that characterised the debate in the mid-19th and early 20th Centuries.

3.2.2 Georgite arguments

Building on Ricardo's Law of Rents, Henry George, the political economist, in his work titled *Progress and Poverty* (1879) argued for a system of land taxation to encourage the most productive use of land by imposing a tax cost on ownership and that such a system of taxation would be equitable *"because the value of land is determined by community effort, not individual effort"* (Mirrlees *et al.* 2011).

Henry George's arguments were eventually acted upon by Lloyd George, Chancellor of the Exchequer, in his budgets of 1909 and 1914 (McLean, 2005) which made provisions for a land value tax to be introduced in the United Kingdom. In defence of this, Lloyd George and his supporter, Winston Churchill, drew on elements from the classical arguments of Paine, Ricardo and those of Henry George to argue that a land value tax was equitable on the grounds that a landowner, as a landowner, does not contribute to welfare enhancing capital improvements to land yet benefits through increased rents regardless. In other words, *"To not one of those improvements does the land monopolist, as a land monopolist, contribute, and yet by every one of them the value of his land is enhanced"* (Winston Churchill, 1909, quoted by Mirrlees *et al.* 2011). However, despite the weight of his arguments George's proposed land value tax was never realised due to strong resistance from landowning elites and the outbreak of World War I.

3.2.3 Recent resurgence

Although the implementation and study of property taxation has by no means waned there has been a renewed focus on the role that they can fulfill in a nation's tax system in recent years, driven by concerted efforts at the multilateral level to address the problems of taxing highly mobile corporate profits.

Following the publication of the Organisation for Economic Cooperation and Development's (OECD) report titled *"Addressing Base Erosion and Profit Shifting"* in 2013, which highlighted threats to tax revenues, tax sovereignty and tax fairness from the tax practices of multi-national enterprises (OECD, 2013), policymakers have begun to focus on *"the revenue losses and efficiency costs stemming from levying taxes on highly mobile tax bases in a globalized setting"* (Norregaard, 2013).

Within this shift of policymakers' attention has been a focus on the *"alternative policy route of meeting revenue objectives by strengthening 'immobile' tax sources such as in particular immovable property taxes"* (Norregaard, 2013). Indeed, international institutions, including the International Monetary Fund (IMF) and the OECD, have identified the reform and development of immovable property taxation regimes as highly desirable in many jurisdictions for these reasons (IMF, 2013a).

Against a backdrop of strong multilateral interest, challenging fiscal landscape and intense levels of tax competition facing most nations, the taxation of immovable property has become a key point of discussion in tax policy circles due to the potential ability to achieve economically efficient and equitable taxation with instruments of this kind, as will be discussed below.

3.3 What is 'property'?

Following the historical and contemporary perspectives of the taxation of immovable property presented in the previous section, a salient point of departure would be a consideration of what constitutes 'property' before moving into a review of the literature and practice.

To the uninitiated, the terminology used with reference to the taxation of property can appear quite intractable at times, with a number of terms used interchangeably. As Youngman (1996) states, *"references to taxes on immovable property as "property taxes" require some clarification"*.

The first key clarification that must be made is in what constitutes 'property'. Despite the commonly held view that property refers to physical and intangible assets held by individuals and businesses, it is useful, when discussing property in the context of taxation, to delineate between ownership and use. As Youngman (1996) states, *"in a technical sense, 'property' consists of a set of legal rights pertaining to a specific object"*. Therefore, using Youngman's definition, a property tax is imposed on the nature and extent of an individual or business' legal rights to property, rather than the physical asset itself. As will be discussed later in this section of the report, the ability to target ownership and occupation of immovable property separately or in combination has proved to be an important design feature of property taxes.

A second key clarification is in the distinction between 'movable' property and 'immovable' property. Movable property refers to assets held by businesses and individuals that can generally be moved, whereas immovable property generally cannot. Although, this is a seemingly obvious distinction, it is a necessary one because, as will be discussed later, the immovability of property is a key feature and source of economic efficiency of property taxes.

The final, and perhaps most important, clarification that must be made is what immovable property refers to. As Almy (2014) describes, *"immovable property comprises land and improvements to land"*, with land being defined as a *"demarcated piece of the Earth's surface"* and improvements to land referring to buildings, structures and constructions. This is an important clarification as the conceptual ability to view land and improvements to land as separable components of immovable property allows the design of property taxes to be targeted towards specific activities and sectors of an economy.

For the purposes of this report, the terms 'property' and 'immovable property' will be used interchangeably but will be accompanied with clarifications as to which component of immovable property is being referred to.

3.4 Why is property taxed?

Based on the understanding of the historical and contemporary perspectives of immovable property taxation and the discussion of the concept of immovable property presented above, a salient question to ask would be why it is that property taxes are so prevalent. To answer this question we must look to the qualities embodied in taxes levied on immovable property. In doing so, this section will first explore the underlying equity and efficiency arguments that characterise much of the discussion on the merits of property taxation before discussing how property taxes can be used to achieve wider policy objectives.

3.4.1 Efficiency arguments

A core argument that is frequently used to support the imposition of taxes on immovable property has been that it is an economically efficient form of taxation. As will be discussed, with reference to the distinctions between the components of immovable property drawn above, this argument requires significant qualification as the efficiency of property taxation is not uniform and is dependent on the tax base and the basis on which it is levied.

The stylised economic rationale in support of property taxation claims that its economic efficiency is derived mainly from the immobility of the tax base as property cannot move location or be hidden in response to the imposition of a tax. These qualities would indicate that property taxes are difficult to avoid, and as such do not affect resource allocation or the decisions to supply labour or invest. However, as was discussed above, immovable property can be conceptually separated into land and capital improvements to land, which when viewed as separate tax bases have distinctly different economic qualities. As Norregaard (2013) states "*only land is truly immobile, while capital invested in structures,… [a]nd particularly non-residential structures, is indeed mobile*". Therefore, when considering the relative economic efficiency of property taxes one must distinguish between taxes on land and taxes on buildings and within this, taxes on residential and non-residential property (Slack, 2011).

Revisiting Ricardo's Law of Rents and the Georgite arguments presented above, taxes levied on land are considered to be economically efficient as they are in effect a tax on an economic rent. As Johannesson-Linden & Gayer (2012) discuss, "*as the supply of land is relatively fixed and inelastic*" a tax on land would not adversely distort economic activity, rather it would promote the productive utilisation of land by imposing a tax cost on ownership. Although in practice, the supply of land can be influenced by a jurisdiction's land planning system (Mirrlees *et al.*, 2011; Barker, 2003), these effects hold true for both commercial and residential land.

However, the main point of divergence in the efficiency arguments of immovable property taxation comes when the taxation of commercial and residential buildings is considered. As Diamond and Mirrlees (1971) illustrate in their paper on optimal taxation, taxes on business inputs, such as commercial buildings, are a particularly distortive type of tax as they are in effect a tax on a factor of production that will influence choices taken in both the production and consumption decision. Furthermore, despite limited empirical evidence, taxes on commercial buildings are perceived in the literature to be economically inefficient due to the effects of their incidence. Depending on the dynamics of a commercial property market, taxes on owners are expected to be capitalised into lower returns to real estate investment and taxes on occupiers are expected to be passed through into prices, generating a cascade effect. Whereas taxes on residential buildings are considered to be more efficient as residential buildings do not serve as an input to the production process and as such "*have relatively little influence on labour supply, investment in human capital, production and innovation compared to other taxes*" (Johannesson-Linden & Gayer, 2012).

Another key qualification and determinant of the efficiency of property taxes is the basis on which they are levied. In this respect the literature distinguishes between the economic efficiency embodied in recurrent taxes and transaction taxes.

Recurrent taxes levied on immovable property are widely thought to be more efficient than transaction taxes in that their impact on resource allocation is less adverse (Norregaard, 2013; Arnold, 2008; Johannesson-Linden & Gayer, 2012). Indeed, Johansson *et al.* (2008) establish a 'growth ranking' of different tax measures, supported by empirical research, which presents recurrent property taxation as the least detrimental form of taxation to long-run economic growth. The case of New Zealand's Local Government Rates is presented in **Box 1** as an example of recurrent immovable property taxation.

Box 1: New Zealand's Local Government Rates

Since European colonisation, the taxation of immovable property has formed the basis of local government finance (McCluskey *et al.*, 2002). Presently local authorities tax property through a system of rates based on land or property values (Victoria University of Wellington Tax Working Group, 2010), which currently raises over half of all local government revenue, as illustrated by the chart below.

The Local Government (Rating) Act 2002 provides local government with flexible powers to set, assess and collect rates from landowners (Department of Internal Affairs, 2011). Specifically, the Act provides local government with a choice of three methods for calculating the annual rateable value of land:

- **Annual value:** The annual rental value of the property at the date of revaluation.
- **Capital value:** The probable selling price of the property at the date of revaluation.
- **Land value:** The value of unimproved land at the date of revaluation.

Source: New Zealand Statistics, 2014

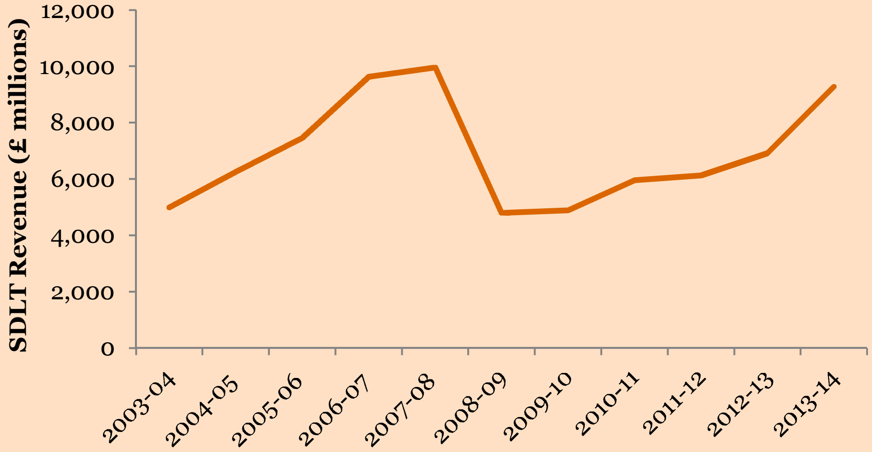
In contrast to recurrent taxes, transaction taxes levied on immovable property are widely criticised as being an inefficient form of property taxation due to their distortionary nature (Mirrlees *et al.*, 2011; Johansson *et al.*, 2008). As transaction taxes are generally borne by the purchaser, as Slemrod *et al.* (2012) state, transaction taxes create disincentives to invest and *"arguably induces asset owners to hold on to assets that they would otherwise want to sell"*. When this effect is considered in terms of the residential housing market, it becomes apparent that property transaction taxes have the ability to adversely affect labour mobility creating inflexibilities in the labour market. **Box 2** presents the case of the United Kingdom's Stamp Duty Land Tax as an example of a property transaction tax.

Box 2: The United Kingdom's Stamp Duty Land Tax

The United Kingdom (UK) currently levies a property transfer tax known as Stamp Duty Land Tax (SDLT) on freehold and leasehold transfer of residential, non-residential or mixed-use land and buildings. SDLT was introduced in the Finance Act 2003, replacing Stamp Duty that was previously charged on transfers of property, in order to address avoidance behaviour. The statutory incidence of the tax is borne by the purchaser who is required to file a return shortly after completion of the transaction.

The main rates of tax are shown in **Table A13** and **Table A14**. Purchases of residential property by corporate bodies attract a higher rate of tax, whereas transactions in new freehold and leasehold property attract a lower rate (HMRC, 2014). SDLT relief for transactions in property located in disadvantaged areas was available prior to 6th April 2013.

In recent years, SDLT receipts have been approximately 0.6% of GDP but the relatively consistent relationship with the performance of the economy tends to mask the underlying volatility of cash receipts, as the chart below demonstrates. These can be significantly affected by changes in prices and the manner of transactions. In general, SDLT has been characterised by high levels of compliance although changes were needed to tackle avoidance in relation to some high value properties.



Source: HMRC Statistics, 2014

SDLT, like other forms of transaction taxes, has been widely criticised by industry groups and has been labelled as economically distortionary. A critical aspect of SDLT in this regard is its 'slab' rate structure (Mirrlees *et al.*, 2011) which creates 'notches' – "*discontinuous jumps in tax liability*" (Slemrod *et al.* 2012) – as a result of the SDLT rate applying to the entire transacted price. As suggested in the literature, notches in the rate structure of property transfer taxes distort price distribution causing 'bunching' of property values just under the notches (Best & Kleven, 2013; Kopczuk & Munroe, 2013; Slemrod *et al.*, 2012). Furthermore, the SDLT rate structure is not "*indexed for inflation, which creates 'bracket creep' as property price inflation pushes houses into higher stamp duty brackets*" (Best & Kleven, 2013).

Despite limited analysis on the effects of property transfer taxes in the literature, recent analysis on SDLT has shown that a decrease in rate stimulates market activity. Best & Kleven (2013) investigated the effect of an unanticipated residential SDLT holiday between September 2008 and December 2009 which *"moved the first notch point from £125,000 to £175,000 and thereby eliminated stamp duty in a £50,000 range"* (Best & Kleven, 2013). They found that during the course of the SDLT holiday, trading volumes in the residential housing market increased by 20%, stimulating consumer spending and enhancing the positive economic impact.

Those in favour of property transaction taxes often look to the underpinning arguments of such tax measures, notably that they discourage inefficient and socially undesirable transactions from taking place. This argument has been drawn from the long running debate on the merits of financial transaction tax (FTT), as presented by Tobin (1978). However, as Mirrlees *et al.* (2011) describe, these arguments do not bear application to property transaction taxes as a liquid property market promotes the efficient utilisation of land and property, therefore leaving little support for property transaction taxes.

Indeed, recent empirical evidence presented in the literature validates the distortionary nature of property transaction taxes. Dachis *et al.* (2012) studied the impact of the imposition of a 1.1% transfer tax in Toronto, Canada in 2008 and found that it resulted in a 15% reduction in the number of transactions and a decline in house prices equivalent to the tax increase. Additionally, Slemrod *et al.*'s (2012) study of the impacts of changes to the rate structure of a residential real estate transfer tax in Washington D. C. find that a 1% increase in the rate of tax reduces the rate of sales by 0.2%.

In practice, however, the arguments for and against recurrent and transaction taxes are not quite as stark as a consideration of their relative economic efficiency would suggest. In fact, as Box 3 highlights with the example of the Australian property tax system, many national governments have chosen to implement a property tax mix featuring both recurrent and transaction taxes.

Box 3: Australia's Property Tax Regime

Australia currently implements a property tax system that is composed of both recurrent and transaction taxes implemented at the state and local levels (Slack, 2004). While the practice of utilising both inefficient transaction taxes in conjunction with efficient recurrent taxes is widespread, Australia presents an interesting example.

Stamp duty is levied by all states on the transfer of freehold property, with some also taxing transfers of leaseholds (Australian Taxation Office, 2014) and most offering relief for first-time buyers (Wood *et al.,* 2012). Land tax is levied on land ownership utilising the unimproved land value of a property exceeding a predetermined threshold as the tax base (Australian Taxation Office, 2014). Table 16 sets out the states currently implementing these taxes and lists any differences in allowed concessions and exemptions.

At the local level, municipal rates are levied on a recurrent basis, with local authorities utilising a number of different tax bases listed below and rates being set in line with budgetary requirements (Commonwealth of Australia, 2011):

- Unimproved value
- Unimproved capital value
- Land/site value
- Capital value
- Annual value

3.4.2 Equity arguments

In a similar way to other areas of tax policy, the perceived 'fairness' or equity of the taxation of immovable property has been implicated as a critical issue by both advocates and proponents for over a century (Mandell, 2002). In this respect, the key question at the centre of this debate is that of the incidence of property taxes. In other words, who pays the tax?

The study of the incidence of taxes is a highly contested area of research, however, the incidence of immovable property taxation certainly numbers amongst the most contested, with three distinct schools of thought being presented in the literature. The three views on the incidence of property taxation are as follows:

- **The 'Traditional' View:** This view of property taxes draws on Ricardo's Law of Rents (1817), arguing that the nature of incidence is influenced by the distinction between the constituents of immovable property. Taxes imposed on land are viewed as inherently equitable (Almy, 2014) as they are serviced by the economic rent land owners obtain from the very virtue of being land owners (Bird & Slack, 2002). Whereas taxes imposed on buildings are borne fully by those who make use of such capital rather than the owners (Norregaard, 2013). It is from this view that Vickery's comment that "*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*" (Vickery, 1999) stems from.

- **The 'New' View:** In his influential work, Mieszkowski (1972) develops the view that property taxes are in effect a tax on capital and are therefore not regressive as income derived from land and capital "*constitutes a relatively higher share of income for richer people*" (Bird & Slack, 2002). Indeed, recent research by Sennoga *et al.* (2008) confirms that the incidence of property taxes levied on capital and land is borne predominantly by the owners, indicating that when viewed in this way, property taxes are progressive.

- **The 'Benefit' View:** As put forth by Hamilton (1975), this view of property taxation utilises Tiebout's (1956) theory of local public goods by viewing property taxes as a benefit tax for the provision of local public services specific to the area in which an individual or entity has chosen to locate (Wilson, 2003). "*By being in essence a user charge for local public services, there is an inherent fairness to the property tax based on the benefit principle*" (Norregaard, 2013).

The debate on the equity of property taxation is far from resolved, and as such, immovable property taxes can either be regarded as progressive or regressive depending on the theoretical lens used to view them. Indeed, Bird & Slack (2002) sum up the debate on the equity of property taxation well when they say, "*In the end, it seems, what one beholds in the property tax in terms of equity appears to depend to a large extent on what one thinks of the property tax in the first place*".

3.4.3 Broader policy objectives

Governments are increasingly using tax policy as a means by which to effect a behaviour change in the population, perhaps best typified by Denmark's short-lived 'health' tax on saturated fats that hoped to promote healthy eating by making food with high saturated fat content comparatively more expensive. In this regard policymakers have sought to draw on the Georgite arguments to influence the way in which land and buildings are utilised with proposals for introduction of property taxes.

Policymakers have long sought to influence the development of land to meet societal needs through the imposition of property taxes (UN-HABITAT, 2011). A notable example of this is contained within the Barker Review (Barker, 2004) which reviewed the current provision of housing in the United Kingdom and presented policy recommendations aimed at meeting future demand. The Review put forward arguments for a number of property-related tax measures that were designed to increase both the supply and efficient utilisation of housing in the United Kingdom. For instance, it was argued local governments should be allowed to charge higher rates of property tax on second homes to incentivise their efficient utilisation. The Review also recommended taxing the windfall gains that accrue to land owners as a result of rezoning of land use in order to deliver the benefits of development to society through the provision of public services. However, to each of these tax measures, the Review recommended a holistic approach, suggesting that the introduction of property taxes should be viewed within the broader context of the property market and land use planning system in order to achieve the desired policy objectives.

More recently, several academics have put forward suggestions that property taxes could be used as a means of addressing the environmental externalities associated with urban sprawl by creating incentives for the efficient utilisation of land. As Brandt (2014) describes, the phenomenon of urban sprawl can cause underutilisation of urban infrastructure and excessive loss of open space which generates intrinsic and extrinsic costs for society.

Drawing on Georgite arguments, proponents of this approach utilise the argument that a land value tax generates incentives to encourage the productive use of land by imposing a tax cost on ownership (Brandt, 2014; Norregaard, 2013; Mirrlees *et al.*, 2011; Johansson *et al.*, 2008; Muellbauer, 2005). For areas in which land values are higher, such as around existing urban infrastructure, a land value tax would generate stronger incentive effects for the efficient utilisation of urban as opposed to rural land, thereby potentially limiting the extent to which urban sprawl occurs.

Indeed, recent empirical evidence would suggest that land value taxes could be used to achieve environmental objectives, such as limiting urban sprawl. For instance, research by Banzhaf and Lavery (2010) on the density effect of property taxes in Pennsylvania found that two-tier property tax structures, with higher rates levied on land serve to increase the density of urban areas. However, the weight of evidence indicates that property taxes only exert limited influence on the density of urban areas (Meng & Zhang, 2011; Song & Zenou, 2006). It must also be noted that in order for a land value tax to achieve the desired environmental objectives, the tax must be coupled with a robust land zoning system to sufficiently depress the incentives to develop rural land (Brandt, 2014).

Although not overtly used as such, it is evident that property taxes can be used to achieve policy objectives that are broader than pure fiscal objectives. However, building into the wider debate on tax versus regulation, the literature suggests that on its own, tax may be too blunt an instrument to achieve broader policy objectives. Rather, as Barker (2004) would suggest, property taxes should be considered within the broader context of the land planning system and real estate market to ensure that the appropriate incentives are generated to promote the behaviour desired by policymakers and society.

3.5 Design considerations

Building on the supporting economic and policy rationale presented in the previous section, we now turn to explore the depth of nuances that become apparent when one considers the various design features of a property tax. To examine these issues in a systematic and tractable manner, this section of the report will group the considerations into three broad categories and will present the case of Denmark's Property Value Tax in **Box 4** by way of illustration.

3.5.1 Tax base

A salient point of departure for the examination of the design issues inherent in immovable property taxation is to consider what should be taxed. Property taxes are unique amongst most tax measures in that policymakers have a number of tax bases to choose from. However, as will be discussed below, there are a number of factors, not least of all the overall policy objective, which must be considered in selecting an appropriate tax base.

The intended nature of how a property tax is to be levied is the key consideration in determining the tax base. Transaction taxes typically use the monetary value of the consideration transferred as the tax base, and in this regard do not present policymakers with a choice of tax bases. Property taxes wishing to tax property as an asset would simply tax the profit accruing to the vendor on disposal (Mirrlees *et al.* 2011). Similarly, those taxes wishing to tax the consumption value of property would tax an approximation of the annual value of that consumption (Cnossen, 1996). Recurrent property taxes by contrast, present policymakers with a number of possible tax bases. These tax bases are aligned on a spectrum ranging from market value to physical attribute approaches (UN-HABITAT, 2011) and allow the distinction between land and buildings to be drawn (Almy, 2014).

As **Figure 2** shows, there are a number of alternative tax bases, drawn from the literature and international practice, which are available to policymakers.

Figure 2: Recurrent Property Tax Base Spectrum

Physical attribute approaches seek to tax immovable property on predetermined physical attributes that are aligned to the desired policy and fiscal objectives (UN-HABITAT, 2011). One of the most common tax bases used under the physical attribute approach is the area of a piece of immovable property, to which a rate of tax per unit of area is applied (Almy, 2014; Norregaard, 2013). To this, multipliers can be incorporated into the computation to reflect additional physical attributes in order to produce a taxable value that is a better proxy of those yielded under market value approaches.

According to the work of Connolly and Bell (2009), there were 38 jurisdictions implementing a form of area-based property taxation in 2009, indicating that it has been considered to have merit as a tax base despite its rudimentary nature. Indeed, the main strength of area-based systems can be found in their administrative simplicity as the data it requires is relatively easy to establish even in jurisdictions with thinly traded formal property markets (UN-HABITAT, 2011). Additionally, area-based systems avoid the subjective element involved in property valuation which makes the basis of assessment less arbitrary and therefore less contestable in jurisdictions with low levels of trust in government (Almy, 2014). Greece provides a very recent example of such a tax but it proved to be unconstitutional and was replaced in 2014.

The administrative simplicity of physical attribute approaches gives way to two key weaknesses that often limit the extent of their application. Firstly, these approaches are widely considered to be inequitable because, assuming a uniform tax base, they place the same rate of tax on desirable property as undesirable property, which has the effect of generating large disparities in effective tax rates (Norregaard, 2013; UN-HABITAT, 2011; Youngman, 1996). Secondly, and in particular for area-based taxes, this approach lacks revenue buoyancy due to the largely static nature of the tax base (Almy, 2014).

Market value approaches by contrast seek to tax immovable property through a tax base that is inferred from the market value of property. Policymakers wishing to employ a market value approach have at least three different tax bases to choose from, each with different qualities that align them to the achievement of different policy objectives.

Perhaps the most widely utilised and straightforward of these tax bases is capital value, which seeks to tax property based on the monetary value of consideration that would be received in return for the property in a transaction between a willing purchasor and a willing unrelated vendor. The key advantage to using capital value as a tax base is that it closely approximates a capital tax, which when viewed through Mieszkowski's (1972) New View of property taxes results in a progressive form of property taxation. Furthermore, capital value also provides revenue buoyancy in that tax revenues potentially grow as property values grow (UN-HABITAT, 2011). Despite these advantages, to be an effective tax base capital value is reliant on data generated by an active property market and a well-functioning land registry, which may not be present in some jurisdictions. Additionally, the use of capital value as a tax base has been criticised for taxing unrealised gains that accrue to property owners, which can generate liquidity constraints for asset rich but cash poor taxpayers (Youngman, 1996).

Related to capital value, annual rental value is another widely utilised property tax base "*which defines the tax base as the rent that can reasonably be expected in a fair market transaction*" (Norregaard, 2013). Annual rental values attempt to overcome the potential liquidity constraints created by capital values by taxing the current use of property, rather than how the property might be used if sold on an open market (UN-HABITAT, 2011). In this respect, annual rental value can be used as a close approximation for the consumption value of property, and as such, lends itself as a tax base to housing services taxes (Mirrlees *et al.*, 2011; Cnossen, 1996). However, as with capital value, the efficacy of annual rental value as a tax base is reliant on data from an active rental market, or, if this is not available, the skill of tax administrators in inferring such values (Almy, 2014).

The final of the three widely used market value approaches is land or site value, which uses the unimproved land value as the tax base. Unlike capital or annual rental value, the use of land value seeks to make a distinction between land and buildings by only taxing the market value of land. Due to this distinction, land value lends itself as a tax base to Georgite land taxes by creating the strongest incentives for the productive utilisation of land (Norregaard, 2013). However, as with the other tax bases discussed, the use of land value as a tax base ideally requires data generated from an active market, which given the thinly traded nature of land, could create administrative difficulties.

3.5.2 Valuation and assessment

Once the basis of assessment has been defined, the next design issue that is generally considered is how best to assign taxable values in a uniform and fair manner. To resolve this issue the literature and international practice point to two distinct valuation models.

The first of these models is to conduct periodic mass valuation exercises based on standardised techniques to establish a comprehensive data set, known as a fiscal cadastre, of the taxable value of each property in a jurisdiction (Almy, 2014). Whereas, the second of these models utilises 'spot' data from recent property transactions to update the database of taxable property values on an ad hoc basis. However, 'spot' data is rarely used as it is not regarded as an equitable valuation model because, for example, in times of rising property prices, thinly traded property would be subject to a lower tax liability than more frequently traded property (Youngman, 1996).

Given the weakness of spot valuation models, mass valuation models are employed for the majority of recurrent property taxes, despite it being a costly exercise to maintain and update. Indeed, without regular revaluation, property taxes founded on a mass valuation system tend to lack revenue buoyancy as tax revenues are determined without accounting for recent movements in the tax base (Youngman, 1996). To balance the need to maintain revenue buoyancy and achieve economy of administration, many tax authorities have introduced multi-year assessment cycles, with some even including provisions for interim indexing to inflation or property price indices.

Additionally, apart from the expense and administrative complexities, mass valuation systems also have the inherent weakness of being conceptually difficult to communicate to the taxpayer, particularly when the valued basis of assessment differs significantly from how the taxpayer would value their property (Almy, 2014).

3.6.3 Reliefs and deferrals

Following the decisions on tax base and valuation method thought must be given to the tax reliefs allowed under a property tax. As Norregaard (2013) states, international experience has shown that "*the property tax base is often porous, corroded by multiple exemptions and reliefs*" the result of which often means that "*taxes are frequently paid on a base that bears little resemblance to the true level of property values*".

The decisions relating to allowable property tax reliefs are often made with reference to a mixture of political and economic factors. Common property tax reliefs include exemptions for government and charitable property and reliefs for asset rich and cash poor taxpayers, businesses and agricultural land (Norregaard, 2013; Youngman, 1996). **Box 4** presents the case of Denmark's Property Value Tax to illustrate the use of tax reliefs.

Box 4: Denmark's Property Value Tax

In response to a prolonged period of high house price inflation, the Danish government introduced a flat rate tax on property held in Denmark and abroad in 1998 (HMT, 2003). The property value tax (PVT) is levied on assessed property value at a rate of 1% up to DKK 3,040,000 (approximately £325,000) and 3% thereafter (SKAT, 2014). Property value is assessed annually and 2014 PVT liabilities are based on the lower of (SKAT, 2014):

- Assessed property value as at 1st October 2011 reduced by 2.5%.
- Assessed property value as at 1st January 2002.
- Assessed property value as at 1st January 2001 increased by 5%.

In 2012, the Danish government agreed to maintain a freeze on the PVT until 2020. According to the European Commission's Directorate General of Economic and Financial Affairs (2014), this has, in conjunction with a cap on land value tax, "*effectively decoupled housing taxes from house price developments, thereby removing countercyclical properties of housing taxes*".

Denmark's PVT has been widely cited in positive terms in the literature (Muellbauer, 2005) for the schedule of reliefs allowable under the tax, in particular for pensioners. The reliefs allowed are as follows (SKAT, 2014):

- **Relief for pensioners:** Taxpayers over the age of 65 automatically qualify for relief on PVT. Eligible taxpayers are entitled to a relief of 0.4% of PVT liabilities subject to a maximum amount of DKK 6,000 (approximately £600) for year-round homes and DKK 2,000 (approximately £200) for holiday homes. The relief is reduced by 5% for single and married pensioners with an income exceeding DKK 174,600 (approximately £19,000) and DKK 268,600 (approximately £29,000) respectively.

- **Relief for uninhabited property:** PVT relief is available for the length of time a property was uninhabited post-transaction settlement and for the length of time a property is uninhabitable as a result of actions unattributable to the taxpayer.

- **Relief for rented property:** Owners of rental properties are entitled to deduct the PVT liability attributable to the period of time which the property was unoccupied by tenants during the computation of their taxable income for income tax purposes.

- **Relief for foreign taxes:** Taxpayers are entitled to relief on PVT liabilities in respect of PVT paid on foreign property providing the basis of assessment was the property value.

- **Relief for property purchased on or before 1st July 1998:** PVT liabilities on properties purchased on or before 1st July 1998 will be reduced by 0.2% of the total tax liability. Year-round homes purchased on or before 1st July 1998 will be eligible for a further 0.4% reduction of total tax liability, limited to a total liability reduction of DKK 1,200 (approximately £130) per property.

Additionally, a number of jurisdictions offer tax relief to incentivise home ownership, typically through mortgage interest deductibility, based on the assumption that home ownership is welfare enhancing (Johannesson-Linden & Gayer, 2012). Indeed, as

Figure 3 demonstrates through an indicator[1] that compares the market interest rate and the after-tax debt financing cost on housing in OECD countries, a number of jurisdictions offer substantial tax subsidies to encourage investment in residential properties.

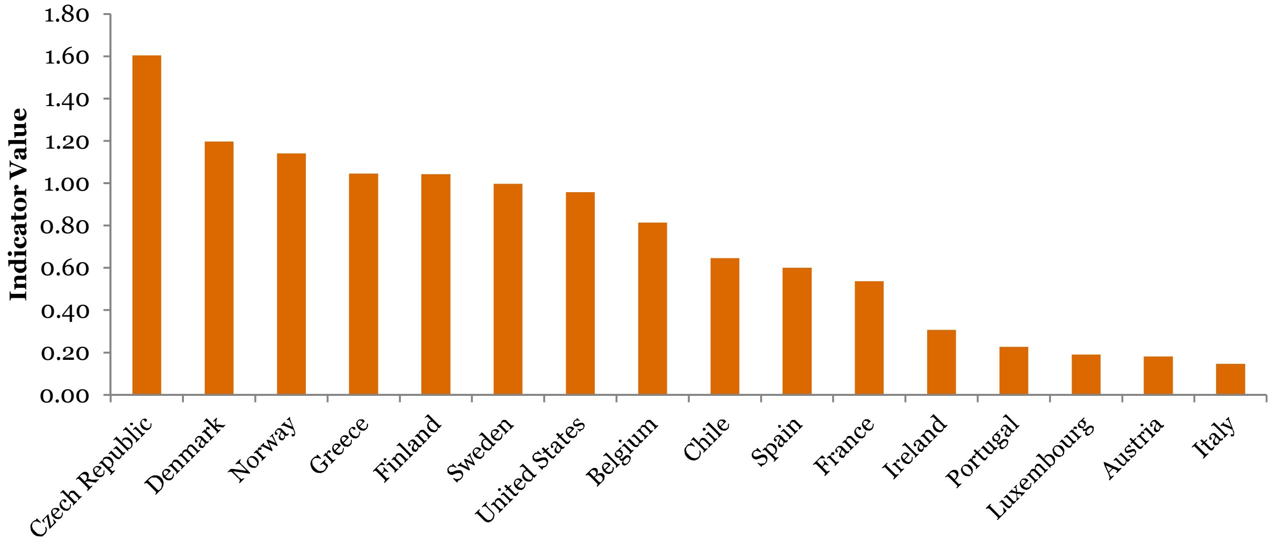
Although designed to support residential housing markets, mortgage interest relief has in fact been shown to be related to adverse property market outcomes. At a conceptual level, mortgage interest relief creates a debt bias, which, during times of rising house prices could encourage excessive household debt accumulation (Johannesson-Linden & Gayer, 2012). Furthermore, research (Van den Noord, 2005; Andrews, 2010) has also shown that mortgage interest relief is correlated with volatility in housing markets, with higher levels of relief being related to higher levels of house price volatility.

The prevalence of mortgage interest relief despite its adverse economic impacts is a clear indication that the design choices made about allowable reliefs are as much political as they are economic in nature.

1

This indicator takes into account whether interest payments on mortgage debt are deductible from taxable income, whether there are any limits on the allowed period of deduction or the deductible amount and whether tax credits for loans are available. For countries that have no tax relief on debt financing costs, this indicator takes the value of zero (Andrews et al., 2011).

Figure 3: Tax Relief on Debt Financing Costs of Homeownership 2009



Source: Andrews *et al.*, 2011

3.6 Political economy of property tax reform

Following on from the discussion presented in the previous sections, one could be forgiven for assuming that the taxation of immovable property was widely welcomed on the basis of its economic virtues (Slack & Bird, 2014). Instead, property taxes are have been described as the "*tax everyone loves to hate*" (Rosengard, 2013) and "*the most hated tax*" (Brunori, 2007).

Taxes on property are certainly no more popular than other taxes and the support they receive rises and falls on perceptions of their political, as well as their economic, rationale. It is the transition from the pages of academic papers to political reality that reveals a number of features of the taxation of immovable property that makes it a hard sell to both politicians and taxpayers. Indeed, as the Barker Review (Barker, 2004) discussed, numerous past attempts to introduce land transfer taxes in the United Kingdom were unsuccessful, in part due to the level of political resistance encountered.

It is therefore apparent that property taxation is as much a political issue as an economic one. As such, this section will outline the main sources of political 'friction' among politicians and taxpayers that property taxation generates. It will also present the case of Ireland's Land Value Tax in **Box 5** as an example of a property tax that has attempted to overcome some of the political economy issues associated with the taxation of immovable property.

3.6.1 Visibility

As Slack and Bird (2014) state, "*much of the popular resistance to the property tax appears to be based on its visibility*". Unlike many other forms of taxation, property taxes are very rarely deducted at source, instead the taxpayer settles liabilities directly with the tax authority making them unusually visible in a modern tax system. Additionally, property tax liabilities are usually of a material nature requiring taxpayers to give prior thought to their likely size in order to make provisions during budgeting processes. These qualities serve to reduce the 'fiscal illusion' effect outlined by Mill (1848), thereby making property taxes one of the most visible forms of taxation (Cabral & Hoxby, 2012). Ireland's recent introduction of a Land Value Tax, presented in **Box 5**, contains provisions to reduce its visibility by allowing the liability to be deducted at source.

The debate on the political economy impact of the visibility of property taxes is divided into two issues within the literature, which ultimately presents a somewhat uncertain view. On one hand, the visibility of property taxes makes them a particularly hard sell politically (Slack & Bird, 2014) and this is often compounded by a counterintuitive taxpayer preference for visible taxes when trust in government is low (Cabral & Hoxby, 2012). On the other hand, due to their visibility, property taxes are thought to have political accountability-enhancing properties, as, linking back to the benefit view, taxpayers are more able to link property tax liabilities to the provision of public services (Simonsen & Robins, 2003). However, when considered together these issues do not indicate a clear course of action for implementing governments, as it would appear that property tax visibility is both good and bad.

3.6.2 Liquidity constraints

A further key source of political economy friction to the taxation of immovable property is that, depending on the tax base used, it is often a tax levied on an imputed cash flow rather than a real one and as a result, the tax liability generated may not reflect the ability to pay of the taxpayer (Johannesson-Linden & Gayer, 2012). As the tax liability has been decoupled from real cash flows associated with immovable property, property taxes have the ability to create liquidity constraints for those taxpayers who are asset rich but cash/income poor, such as pensioners (Slack and Bird, 2014), thus contributing to perceptions of regressivity.

To overcome the liquidity constraints and associated equity concerns linked to property taxes many implementing national governments have instituted a system of reliefs and deferrals to address cash flow problems. Despite the economic rationale for such reliefs, such systems have proved politically unpopular due to the inter-generational welfare concerns attached to pensioners bequeathing deferred tax liabilities to their relatives (Youngman, 1996; Bird and Slack, 1978). Another way to address liquidity constraints created by property taxes presented in the literature would be to create an allowance with reference to the income, age or social circumstances of the taxpayer, which can be used to offset the total tax liability (Johannesson-Linden & Gayer, 2012; Haveman & Sexton, 2008; Bird & Slack, 1978). The examples of Denmark's Property Value Tax and Ireland's Local Property Tax presented in **Box 4** and **Box 5** respectively highlight the use of reliefs for those taxpayers who are asset rich but cash poor.

3.6.3 Volatility

Although property tax revenues generally exhibit high levels of stability due to the relative inelasticity of the tax base, the underlying tax liabilities, particularly for recurrent taxes, accruing to taxpayers can exhibit volatility as a result of fluctuations in property prices without attendant changes in the income of the taxpayer (Sheffrin, 2010; Boije and Lind, 2002). This can become a key source of political friction, especially in times of rising property prices and in a tax system that employs multi-year revaluations, and has often been the cause of 'tax revolts' (Haveman & Sexton, 2008).

As Slack & Bird (2014) discuss, annual revaluations would smooth out the increases in tax liability that often occur with multi-year revaluations in time of rising property prices, however the monetary and time costs involved in annual revaluations often precludes their use. Instead, as McCluskey & Franzsen (2013) describe, many national governments have sought to delay revaluations in order to maintain a static basis of assessment for property taxes. For instance, as Johannesson-Linden & Gayer (2012) illustrate, both Denmark and Sweden took measures to postpone revaluations during the latest house price boom. Although such a course of action does result in reduced volatility of tax liabilities in the short term, over time it erodes the tax base and creates political inertia with regard to conducting revaluations.

3.6.4 Arbitrariness

Property taxes, being based on a system of valuations as discussed in the previous section, have often been labelled as presumptive taxes. As a result of the inherent subjectivity in asset valuation, property valuations for tax purposes, particularly in tax systems that employ cadastral values, are a source of disagreement between the taxpayer and the tax authority (Bird *et al.*, 2012). In situations where trust in government is low, this disagreement may even turn to argument, adversely affecting property tax revenues and compliance rates.

To overcome such frictions related to valuation and assessment, some national governments, such as Ireland in **Box 5** have turned to a system of self-assessment, whereas others have employed transparent cadastral assessment systems. However, regardless of the robustness of the valuation methodology employed, property taxes are still commonly held to be unfair and arbitrary by the taxpayer (Slack & Bird, 2014).

Box 5: Ireland's Local Property Tax

Following the recommendations of the Commission on Taxation (2009) and the Inter-Departmental Group (2012), the Republic of Ireland has recently implemented a programme of reform to the taxation of immovable property that culminated in the introduction of the Local Property Tax (LPT) in July 2013.

LPT is a recurrent tax levied at a rate of 0.18% using the market value of residential property as the tax base and is borne by the property owner (Society of Chartered Surveyors Ireland & Irish Tax Institute, 2013). LPT liabilities are determined on a schedule of property value bands, with the tax rate being applied to the midpoint of the applicable band. The schedule of property value bands can be found in **Table A15**.

The LPT was introduced on 1st July 2013, with a half year tax liability being charged for the tax year 2013 and a full year for 2014 (Society of Chartered Surveyors Ireland & Irish Tax Institute, 2013). By 31st December 2013, the LPT had raised €318mn, of which €242mn related to 2013 liabilities and €76mn to 2014 liabilities, representing an overall compliance rate of 94% for 2013 (Revenue, 2014).

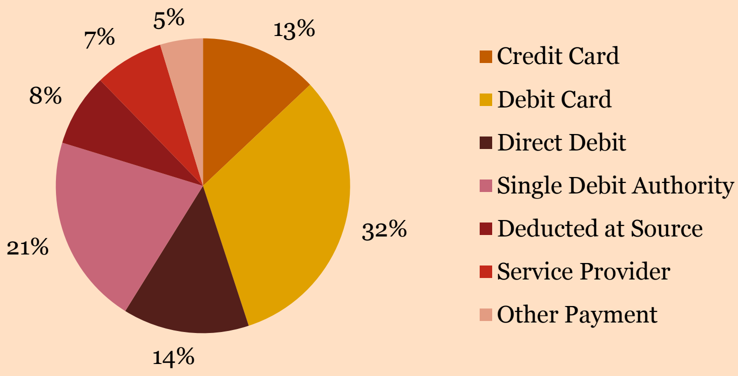
A number of the design features of the LPT are reflective of the need to acknowledge the political economy of property tax reform. Slack & Bird (2014) highlight the following design features of LPT:

- **Self-assessment of property values:** As outlined by the Commission on Taxation (2009), the last valuation of Irish residential real estate was conducted in 1845. In order to overcome the obstacle presented by maintaining up to date valuation records, an initial mass valuation exercise was conducted in 2013 for the purposes of setting rates and bands. From 2017 onwards the LPT will require homeowners to assess the market value of their property themselves. This provision has served to remove the need for a costly country-wide revaluation exercise, however its net effect is dependent on "*the extent to which the central government needs resources to verify assessments*" (Slack & Bird, 2014).

- **Local tax:** The LPT embodies a pragmatic mix of central and local government involvement, with the rate being set centrally with local discretion to vary the rate within a range of plus or minus 15% from 2015 which limits the extent of tax competition and revenues accruing to local government.

- **Liquidity constraints:** The LPT has acknowledged the perceived inequity of property taxes that can be created by liquidity constraints facing certain taxpayers by allowing four categories of full or partial deferral of tax liabilities. Deferrals are available for those with gross incomes unlikely to exceed a threshold set with reference to personal circumstances, in respect of the administration of a deceased person's estate for a maximum of three years, for individual insolvency and on hardship grounds for those suffering an unexpected or unavoidable financial loss. Interest is charged at a rate of 4% per annum on deferred LPT liabilities (Revenue, 2013).

- **Visibility:** Steps have been taken to reduce the visibility of the LPT by providing property owners with the option of having the liability deducted at source from salary or pensions. The chart below shows the 2013 use of payment options for the LPT. It is interesting to note that in 2013 only 8% of payments were deducted at source, which may suggest that the avoidance of visibility is not a key concern of the taxpayer.



Source: Revenue, 2014

4. Policy implications

4.1 Introduction

It is clear from the exploration of the rich literature on the taxation of immovable property that the design and implementation of sound and practicable property tax policy can be difficult to achieve given the number and complexity of design features to be considered. Similarly, the experiences of historic and contemporary property taxes provide numerous points of reference that are instructive for policy makers in the design and implementation of property taxes.

In order to assist the consideration of property tax reform in Jersey, the objective of this section of the report will be to synthesise the policy implications from the literature and contemporary and historic implementation of property taxes. To this end a set of guiding principles will developed and a number of policy implications will be presented with regard to the taxation of Jersey property.

4.2 Policy implications of international practice

An examination of the experience of international practice and the theoretical constructs of property taxation discussed in the previous section yields a number of pertinent policy implications to Jersey. These are as follows:

- **Historical and contemporary significance:** As is evident from the discussion on the historical and contemporary arguments, the taxation of immovable property has been, and will continue to be, a key component of the tax systems of national governments. Indeed, given the rapidly evolving nature of the international tax landscape, national governments must turn their attention to property tax modernisation to ensure that longstanding property tax policy remains tenable and fit for purpose.

- **Recurrent taxes on residential real estate are amongst the most efficient:** Property taxes are widely regarded as being an economically efficient form of taxation. However, as the literature describes, property taxation is far from a homogeneous concept and as such, the relative economic efficiency of different forms of property taxes is not uniform. The literature indicates that recurrent taxes on residential property are the most efficient, whereas taxes on capital improvements to land and inputs to the production process are among the most distortive.

- **The equity of property taxes is not uniform:** The equity embodied in the taxation of immovable property is a malleable concept and, in a similar way to their relative economic efficiency, is dependent on the design features of the tax. Property taxes structured as capital taxes and benefit taxes are regarded as equitable under the New and Benefit views respectively. The Traditional view regards taxes on land as inherently equitable but taxes on buildings as inequitable due to the ability for the incidence to be passed on. In the absence of a definitive answer to the question of equity, property tax reform should ensure, wherever possible, that those who pay the tax are those who bear its impacts by minimising the opportunities for the incidence to be passed on.

- **Property tax policy is as much a political issue as it is an economic one:** The taxation of immovable property is often a deeply unpopular form of taxation among both taxpayers and politicians. Numerous property tax reforms have failed because they were unable to gain political and social buy-in. As a result of this, careful attention needs to be given towards the extent and nature of provisions designed to promote taxpayer acceptance. Changes in property tax policy should be founded on a coherent policy rationale communicated in a clear and timely dialogue with the taxpayer community through consultation. Additionally, any tax reliefs should be carefully designed to offer appropriate and sustainable concessions, while avoiding adverse impacts to macroeconomic and fiscal stability, and maintain the integrity of the tax base.

4.3 Guiding principles of property taxation

As a result of the often highly challenging situations to which tax policy is applied and the complexity of design considerations there have been numerous attempts by academics and national governments to develop overarching sets of principles that can serve to guide tax policymakers in their task. These sets of principles generally seek to provide a conceptual framework to which policymakers can overlay local context and characteristics of the issue at hand in order to guide their decision making towards the generation of an optimal tax policy solution.

The generic nature of these sets of principles means that there have been few attempts to develop sets of guiding principles specifically related to a particular type of taxation, such as the taxation of immovable property. This section will explore several notable examples of generic sets of principles and one example specifically tailored to property taxation, drawn from academic literature and governmental practice, before developing a set of guiding principles tailored specifically to the taxation of Jersey property.

4.3.1 Guiding principles of taxation

One of the first and most widely cited attempts to set out guiding principles of taxation was laid out by Adam Smith in his influential *Wealth of Nations*, 1776. Smith's (1776) canons of taxation, as set out in Box 6 below, have since served as the classical underpinnings of numerous subsequent attempts to develop sets of guiding principles and have significantly shaped the study of taxation by highlighting the concepts of incidence and efficiency.

Box 6: Adam Smith's Canons of Taxation

As set out in his influential *Wealth of Nations*, 1776, Smith developed a set of four guiding principles that he believed embodied desirable properties that tax policy makers should aspire to. These were:

- **Equality:** Tax should be levied with reference to the means and ability of the taxpayer to contribute to public finances.
- **Certainty:** Tax should be levied in such a way as to be certain and not arbitrary.
- **Convenience of payment:** Tax should be administered in such a way as to promote convenience and ease of payment.
- **Economy of collection:** Tax should not be expensive to collect in terms of both administrative and taxpayer compliance costs.

Despite their timeless relevance, Smith's canons of taxation are of an era that is far removed from the contemporary realities of today's global economy and the current state of thinking on the theoretical underpinnings of taxation. As such, they have been the subject of much revision and refinement over time to apply them to the contemporary challenges facing tax policy.

A notable example of such an attempt can be found in the Mirrlees Review, which argues that Smith's canons of taxation *"do not help with the really difficult questions which arise when one objective is traded off against another"* (Mirrlees *et al.*, 2011). To overcome the 'static' nature of Smith's canons of taxation and provide a conceptual framework that can accommodate the trade-offs present in tax systems, the Mirrlees Review proposes that for a "*given distributional outcome"* (Mirrlees *et al.*, 2011), tax policy should attempt to:

- Minimise adverse effects on economic efficiency and welfare.
- Minimise costs of administration and compliance.

- Promote procedural fairness.
- Be transparent and promote understanding among taxpayers.

However, Mirrlees *et al.*(2011) set out three 'rules of thumb' to supplement the objectives of tax policy listed above, acknowledging that in order to achieve these objectives tax policy should be based on a set of fundamental principles set out in the **Box 7** below. They also state that in some instances it may not be appropriate to attempt to satisfy all of the rules of thumb in the design of tax policy, as for instance, taxes designed to effect a change in behaviour of taxpayers would need to sacrifice neutrality in order to achieve its objective.

Box 7: The Mirrlees Review's 'Rules of Thumb'

Mirrlees *et al.* (2011) set out the following 'rules of thumb' that are designed to support the achievement of the objectives of good tax policy.

- **Neutrality:** Tax policy should avoid the generation of distortions to behaviour by treating "*treating similar activities in the same way"* (Mirrlees *et al.*, 2011). Neutral tax policy is generally welfare-enhancing as it promotes efficient resource allocation by reducing the need to allocate resources to avoidance behaviour.
- **Simplicity:** Tax policy should be simple both for tax authorities to administer and for taxpayers to comply with. A lack of simplicity in tax policy creates opportunities for avoidance, which in turn triggers the introduction of complex rules to close loopholes by tax authorities, thus creating a vicious circle that compounds the problem of complexity.
- **Stability:** Tax policy should maintain stability through "*a clear and transparent method of making changes to the tax system, and a clear long-term strategy for change*" (Mirrlees *et al.*, 2011) so as not to generate excessive costs of compliance and administration and economic distortions that frequent revisions and reforms produce.

4.3.2 Application by national governments

Contrary to the discussion on the development of guiding principles of taxation presented above, this is not a purely academic exercise. Rather, many national governments, including Jersey, have found it useful to articulate a set of principles, rooted in theoretical underpinnings and local context, to guide the development of tax policy. **Box 8** sets out a number of examples of guiding principles of taxation developed by several national governments.

Box 8: Guiding Principles Applied by National Governments

- **United Kingdom- Principles of Tax Policy**
    - **Stability:** The stability of the political and tax environment is a crucial factor for businesses making long-term investment decisions.
    - **Certainty:** The legal clarity, simplicity and certainty of proposed taxes are key considerations in evaluating their merits.
    - **Practicability:** The administrative burden should be taken into account when contemplating new tax policies.
    - **Coherence:** The tax system should be coherent so that new provisions should complement, not conflict with it.

Source: Treasury Committee, 2011

- **Australia – Design Principles for the Tax and Transfer System**
    - **Equity:** The tax and transfer system should treat individuals with similar economic capacity in the same way, while those with greater capacity should bear a greater net burden, or benefit less in the case of net transfers.
    - **Efficiency:** The tax and transfer system should raise and redistribute revenue at the least possible cost to economic efficiency and with minimal administration and compliance costs.
    - **Simplicity:** The tax and transfer system should be easy to understand and simple to comply with
    - **Sustainability:** The tax system should have the capacity to meet the changing revenue needs of government on an ongoing basis without recourse to inefficient taxes.
    - **Policy consistency:** Tax and transfer policy should be internally consistent.

Source: Commonwealth of Australia, 2011

- **New Zealand – Principles of a Good Taxation System**
    - **Efficiency and growth:** Taxes should be efficient and minimise as far as possible impediments to economic growth.
    - **Equity and fairness:** the tax system should be fair.
    - **Revenue integrity:** The tax system should be sustainable over time, minimise opportunities for tax avoidance and arbitrage, and provide a sustainable revenue base for government.
    - **Fiscal cost:** Tax reforms should be affordable given fiscal constraints.
    - **Compliance and administration cost:** The tax system should be as simple and low cost as possible for taxpayers to comply with and for the Inland Revenue Department to administer.
    - **Coherence:** Individual reform options should make sense in the context of the entire tax system.

Source: Victoria University of Wellington Tax Working Group, 2010

- **Republic of Ireland – Principles of Taxation**
    - **Equity:** The tax system should achieve horizontal and vertical equity.
    - **Flexibility:** The tax system should be capable of responding to changes in society and budget volatility.
    - **Tax neutrality:** The tax system should not create biases that could affect decision-making.
    - **Simplicity:** The tax system should be comprehensible and rational.

Source: Commission on Taxation, 2009

As can be seen from the examples presented in **Box 8**, national governments have drawn heavily from the principles espoused in the literature, focusing mostly on the achievement of equity, economic efficiency and ease of compliance and administration. However, a crucial divergence between the guiding principles in the literature and those used by government is the inclusion of political economy factors such as policy consistency, coherence and certainty. The use of political considerations in these sets of guiding principles is a useful point to note as they are what bridges the gap between the literature and reality, recognising that tax policy is a political decision as much as an economic one.

For the most part, national governments have tended to develop generic sets of principles that can be applied to all areas of tax policy, rather than developing or tailoring sets of principles to the needs of specific areas of tax policy. Although this approach is less common, it has recently been used by the European Commission (EC) in a paper surveying the literature on the taxation of immovable property in the context of the case for property tax reform in the European Union. In their paper, Johannesson-Linden & Gayer (2012) develop six policy criteria, informed from the literature, for the successful reform of property taxation. These policy criteria are set out in **Box 9** below and represent one of the most advanced attempts to date to develop a set of guiding principles recognising the unique economic and political realities of property taxation.

Box 9: European Commission's Principles of Property Taxation

- **"Shift from personal and corporate income taxes to consumption and property taxes in order to increase GDP per capita in the long run":** Property tax reform should be part of a broader programme of reform away from economically distortive taxation.
- **"Shift away from (high) taxes on residential property transfers to recurrent tax on residential property":** Less distortive forms of property taxation, such as recurrent taxes on residential properties, should be promoted.
- **"Ensure that the residential property tax system does not favour debt":** The property tax system should not provide incentives for households to take on debt.
- **"The cadastral value (i.e. the tax base) should be regularly updated according to market values":** The assessed value of a property should reflect its market value as closely as possible.
- **"Distributional impacts and concerns need to be acknowledged and addressed in the design of residential property tax reform":** Due to the unpopularity of property tax reform, distributional impacts should be considered "*in order to facilitate implementation as well as to ensure the political acceptability of the tax reform*".
- **"Residential property tax reforms should take account of the local tax dimension":** Due to the common use of property taxes as local taxes, property tax reform should encompass a review of the intergovernmental fiscal transfer system.

Source: Johannesson-Linden & Gayer, 2012

4.3.3 Development of principles of Jersey property taxation

In the States' Medium Term Financial Plan 2013-2015 a set of principles for Jersey taxation was developed. The Principles of Jersey Taxation state that (States of Jersey, 2012):

- Taxation must be necessary, justifiable and sustainable.
- Taxes should be low, broad and simple.
- Everyone should make an appropriate contribution to the cost of providing services, while those on the lowest income are protected.
- Taxes must be internationally competitive.
- Taxation should support economic development and, where possible, social policy.

These guiding principles are fully reflective of the Jersey environment and create a conceptual framework that ensures that tax policy decisions are appropriate to the local context. Although the development of 'generic' principles is widely regarded as best practice and, as such, has been adopted by many national governments, the application of these to especially complex areas of tax policy, such as property taxation, may be suboptimal.

Property taxation, as evidenced by the discussion in the preceding sections, is a highly nuanced area of tax policy that implicates a wide range of political and economic issues. Therefore, in order to allow for the generation of options for the reform of the current tax treatment of Jersey property that are informed by the knowledge base presented in the literature and conform to the local context a proposal for a set of guiding principles of Jersey property taxation have been set out in the **Box 10** below.

Box 10: Principles of Jersey Property Taxation

Drawing on the literature, international best practice and the Principles of Jersey Taxation, we set out below six principles that we believe should guide the thinking of policy-makers in relation to the reform of property taxation.

1. **Consultation: Property tax reform proposals should be the subject of wide consultation.** There is always strong public interest in property tax proposals. Every household will potentially be affected. Policy measures should be based on informed consent. Transparent consultation should therefore be undertaken to inform and test public opinion and to enhance public confidence in the process of reform as well its direction. Communication should be detailed enough to allow individuals to see the impact on their own situation.

2. **Coherence and certainty: Reform should build on the current framework of taxation of land and property, providing greater coherence, clarity and certainty to owners, occupiers and financiers, using up-to-date valuations as a base.** Property tax reforms should, as far as possible, fit with the existing principles and practice of taxation in Jersey. Proposals should be consistent with current legal and fiscal frameworks. New laws should be based on familiar concepts such as ownership and occupation and be certain in their application. Liabilities should be easy to calculate and framed around transparent and up-to-date valuations. The political economy of property taxation makes certainty a key consideration.

3. **Efficiency and growth: The choice of property tax instruments should favour economically efficient taxes such as recurrent taxes on land and residential property over taxes that distort behaviour such as stamp duties.** Property taxes should be designed to be economically efficient and supportive of economic growth. Wherever possible, within a balanced framework of taxation in Jersey, they should replace taxes that are less efficient. However, the economic efficiency of property taxation is not homogenous so more efficient property tax instruments, such as recurrent taxes on land, should normally be considered in preference to taxes that distort behaviour, for example transaction taxes. New property taxes should support the achievement of the priorities of the States' Island Plan 2011, including the efficient use of scarce resources such as land to protect and enhance the natural and built environment and the bringing into prompt use of land zoned for development to provide adequate housing for the population.

4. **Support for the competitive environment: The design of property taxes, including recurrent taxes on ownership and taxes on realisations, should continue to support and encourage inbound investment.** Jersey's prosperity today is, to a large extent, a reflection of its ability to attract capital and investment from the international business community. Property tax reform should recognise and take account of the competitive pressures that businesses face and the choices of location that are available to international investors. The selection of property tax instruments, the way in which they are used and their place within the overall framework of tax in Jersey should be factored into decisions about property tax reform so that Jersey remains an attractive and competitive destination for investment.

5. **Fairness: The benefits of occupancy and the rewards of ownership should be taxed in a balanced way that deals fairly with windfall profits and also recognises ability to pay. Where appropriate, the incidence of property taxation should be designed to enhance the fairness of the tax system as a whole.** The equity and incidence of property taxation is highly contested in many countries. Care should therefore be given to ensuring that property taxes are balanced in their incidence, based on up-to-date information (including valuations), reflect the ability of taxpayers to pay and are readily collectable. In principle, taking property taxes as a whole, everyone should take some part of the burden, their share depending on legal, financial and economic factors. This does not mean that each instrument should treat all economic agents in the same way but that the system as a whole should deal fairly and even-handedly with the interests of tenants, home owners and investors. Where necessary, measures should be taken to protect the system from abuse.

6. **Fiscal stability and sustainability: Well-designed property taxes, particularly recurrent**

taxes, and the related system of reliefs should be used to improve macro-fiscal management, including the level of debt in the economy, and to dampen the volatility of tax receipts. Property taxes should be designed to generate revenues that are stable and sustainable in order to contribute to the effectiveness of macro-fiscal management in Jersey. Attention should be given to the volatility associated with particular property tax instruments, to the potential buoyancy of revenues and to ensuring that allowable reliefs are rational and not over-generous, do not encourage undesirable outcomes such as the excessive use of debt finance and do not undermine the integrity of the tax base. Sustainability includes the concept of using taxation instruments that are readily understood and enjoy broad public support.

In **Section 6** of this report, we test each of the groups of possible reform measures against these principles.

5. *International and domestic context*

5.1 *Introduction*

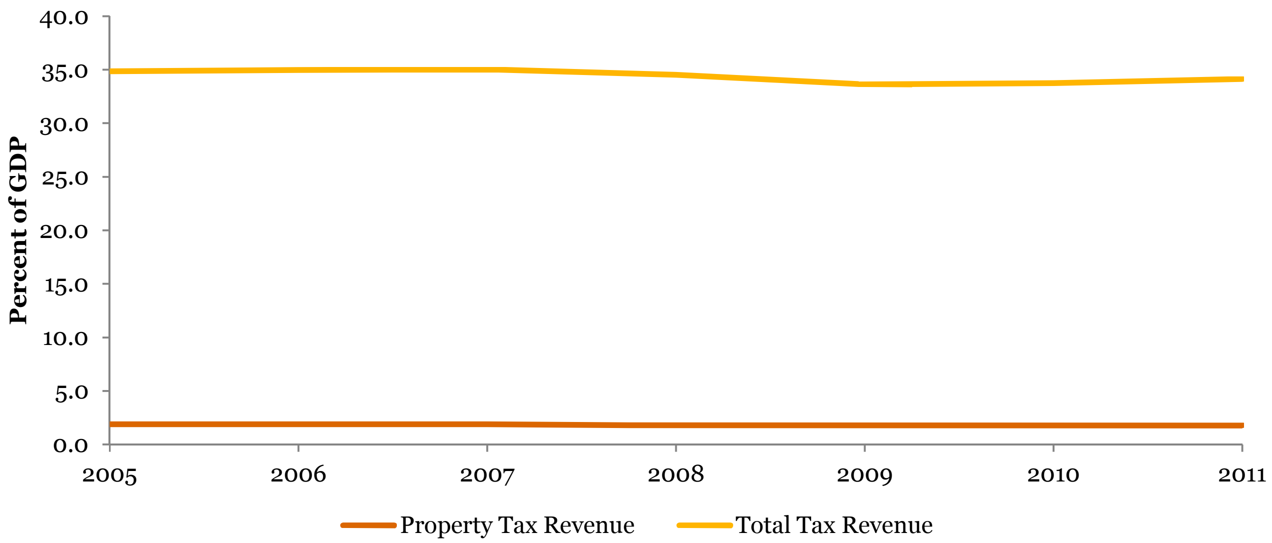
Before policy options for the reform of property taxation can be developed, the trends in the international tax environment and the situation and performance of the Jersey economy must first be understood. The reason for this is two-fold and centres on the dynamic interplay between domestic feasibility and international competition. Firstly, property taxes must be properly contextualised against what is happening in the international tax landscape so tax policy measures are not proposed that would adversely impact Jersey's international competitiveness. Secondly, the performance and nuances of the Jersey economy must be understood in order to design tax policy that is feasible and reflective of the local context.

5.2 *International trends in the taxation of property*

As mentioned in **Section 3**, the taxation of immovable property has historically been a component of the tax systems of national governments. Indeed this legacy can still be seen today, for instance 166 countries are known to have a form of recurrent immovable property taxation (Almy, 2014). Despite their wide spread implementation, property taxes do not typically generate large amounts of revenue. However, it must be noted that the revenue they do generate is relatively stable compared to other forms of taxation.

As **Figure 4** illustrates through the use of OECD tax revenue statistics, property taxes generate a relatively small amount of revenue compared to the total tax revenue generated by OECD countries. For the period 2005 to 2011 average property tax revenue in OECD countries was approximately 1.8% of GDP compared to 34.4% for total tax revenue. Additionally, the revenue generated from property taxes in OECD countries has been remarkably stable during the period 2005 to 2011, declining only 0.1% of GDP in 2008 due to the adverse effects of the financial crisis on property markets.

Figure 4: OECD Average Tax Revenue 2005-2011



Source: OECD Tax Statistics, 2014

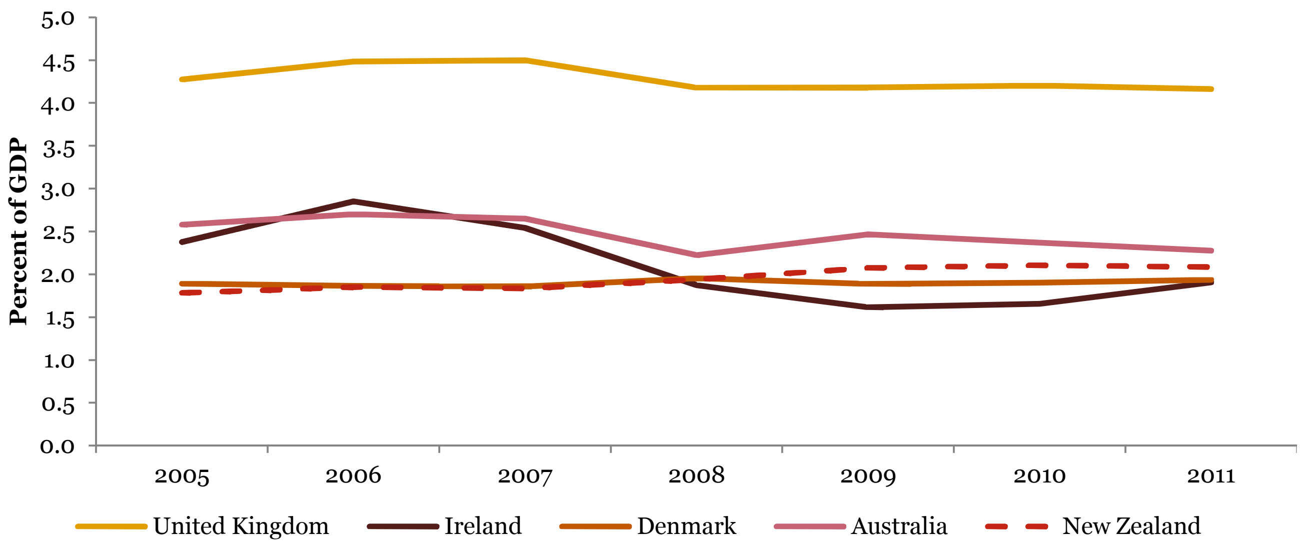
At the aggregate level property taxes appear to be an often small but reliable component of a country's tax system, and whilst this is true for the most part, the stability of property tax revenue is not homogenous.

Indeed, examining the revenue generated by the countries mentioned in **Section 3**, shown in **Figure 5**, reveals two important issues:

- **The absolute level of revenue generated by property taxes varies between countries:** For instance over the period 2005 to 2011 the United Kingdom has raised an average of 4.3% of GDP whereas Denmark has raised an average of 1.9% of GDP. This indicates that there is no 'rule of thumb' as to how much revenue should be raised from property taxes, suggesting that the level of revenue generation is dependent on country-specific variables such as budgetary needs, the wider tax mix or the preferences of the taxpayer community.

- **Property tax revenues are less stable at the country-level:** Comparing the trends in property tax revenue shown in **Figure 4** to those in **Figure 5** reveals that property tax revenues are less stable when analysed at the country-level. The increased level of volatility in national property tax revenues can be explained by the mix of taxes used in a property tax system. Examining the country level trends reveals that during the period 2005 to 2011, every country's property tax revenue, with the exception of Denmark and New Zealand, declined around the time of the financial crisis. This is indicative of the revenue volatility that can occur from exposure to property prices resulting from the dominance of property transaction taxes in a property tax system. For instance, New Zealand does not tax property transfers and Denmark relies heavily on recurrent property taxes, whereas the United Kingdom, Ireland and Greece rely heavily on revenue generated by property transaction taxes.

Figure 5: Property Tax Revenue 2005-2011



Source: OECD Tax Statistics, 2014

Furthermore, drawing on the definitions of immovable property and its separable elements presented in **Section 3**, it is interesting to note that there is a large degree of variation between jurisdictions in the extent to which land and buildings are taxed separately or in combination. Again, using the OECD members and partner countries as an example, **Table 1** below illustrates the different tax bases used in the property tax systems.

Although there is a certain degree in heterogeneity in the tax bases, it would appear that the majority of jurisdictions prefer to implement a single tax encompassing both land and buildings as the tax base, perhaps because of the administrative simplicity of a unified tax base. Additionally, it is evident that a number of jurisdictions prefer to implement multiple property taxes, with 14 countries utilising a combination of taxes on different tax bases.

Drawing on these high-level reflections on the trends in the international property tax landscape it is apparent that property taxes are a small, but potentially stability-enhancing contributor to public finances, especially when the reliance on property transaction taxes is low, and exhibit a certain degree of heterogeneity in the segregation of the tax base.

Table 1: Immovable Property Tax Bases

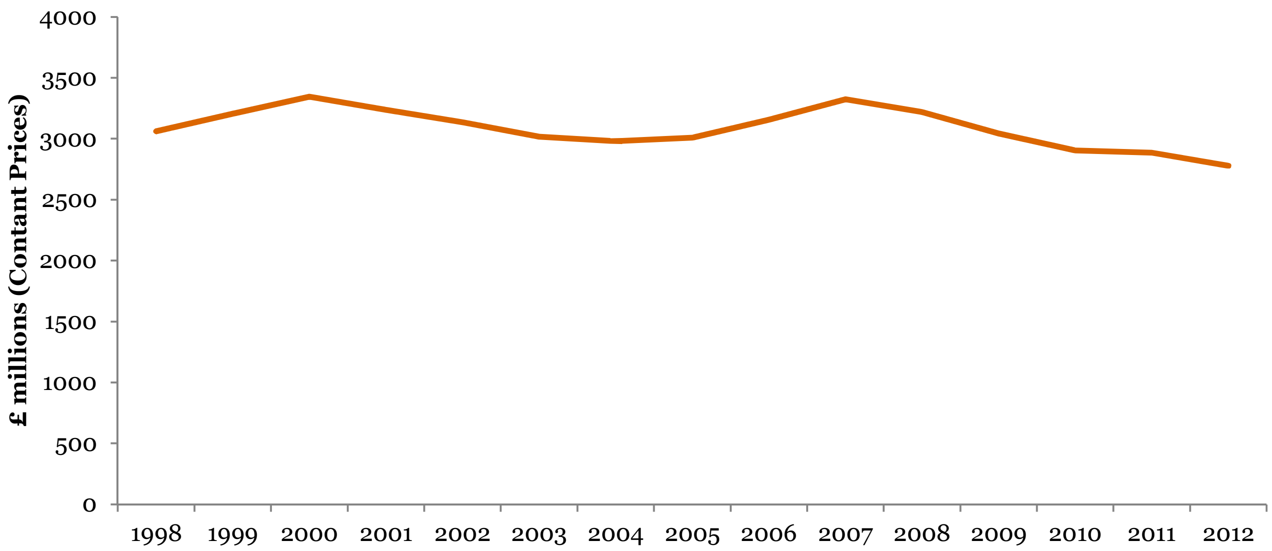
Type of Taxes	Number of OECD Countries
Land Tax	1
Single Immovable Property Tax	25
Land Tax and an Immovable Property Tax	5
Building Tax and an Immovable Property Tax	3
Land Tax, Building Tax and an Immovable Property Tax	5
Land Tax and Building Tax	1

Source: Almy, 2014

5.3 Jersey macroeconomic context

Following a period of economic growth in the mid-2000s, the Jersey economy has been exhibiting a downward trend in the levels of economic growth in recent years as a result of exposure to the financial crisis and subsequent crises in the Euro-zone as illustrated by Figure 4.

Figure 4: GVA 1998-2012



Source: Statistics Unit, 2014

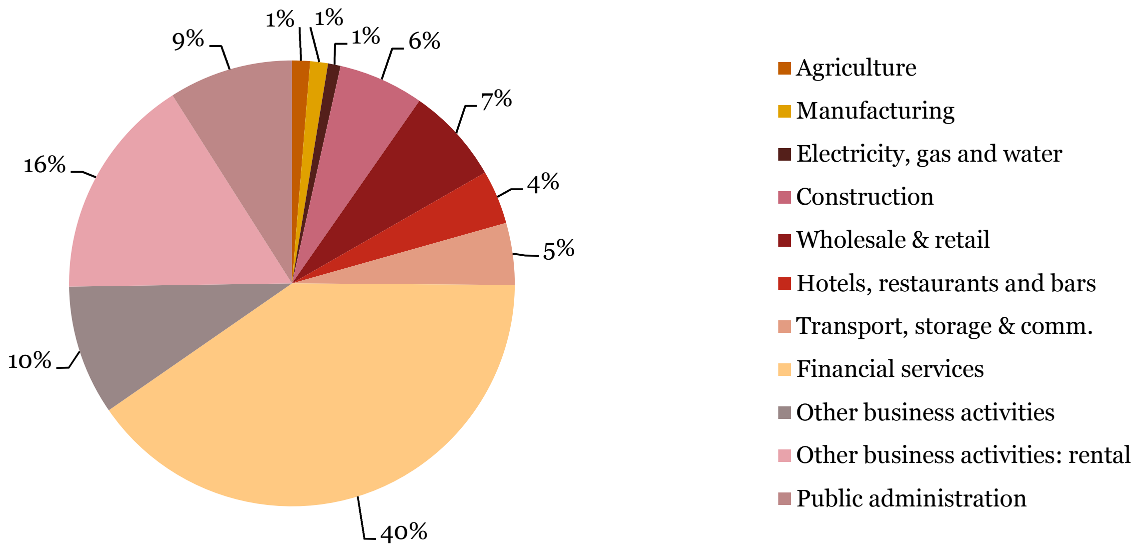
In 2012, economic activity, as measured by Gross Value Added (GVA), declined 4% in real terms, driven in part by a decline in the level of financial sector GVA by 5%. In its Annual report, published in November 2013, Jersey's Fiscal Policy Panel forecast GVA growth of between -2% and 2% for 2013 and between -2% and 3% for 2014.

As Figure 5 shows, in 2012 the Financial Services (FS) sector contributed the most to whole economy GVA, followed by rental activities and other business services. Despite a prolonged decline of 30% of GVA since 2008, Jersey's FS sector has historically been a key contributor to its economy, employing 22% of the workforce and accounting for the largest share of GVA by employee in 2012. Figure 5 also reveals that the

Jersey economy is oriented towards tertiary industries, with primary and secondary industries accounting for approximately 9% of whole economy GVA in 2012.

It must be noted that the dominance of the FS sector in Jersey's economy and the extent of its decline in economic activity have exerted significant influence over the aggregate trend of Jersey GVA. Considering the performance of non-finance sectors reveals a more gradual downward trend in GVA over the same period.

Figure 5: 2012 GVA by Sector

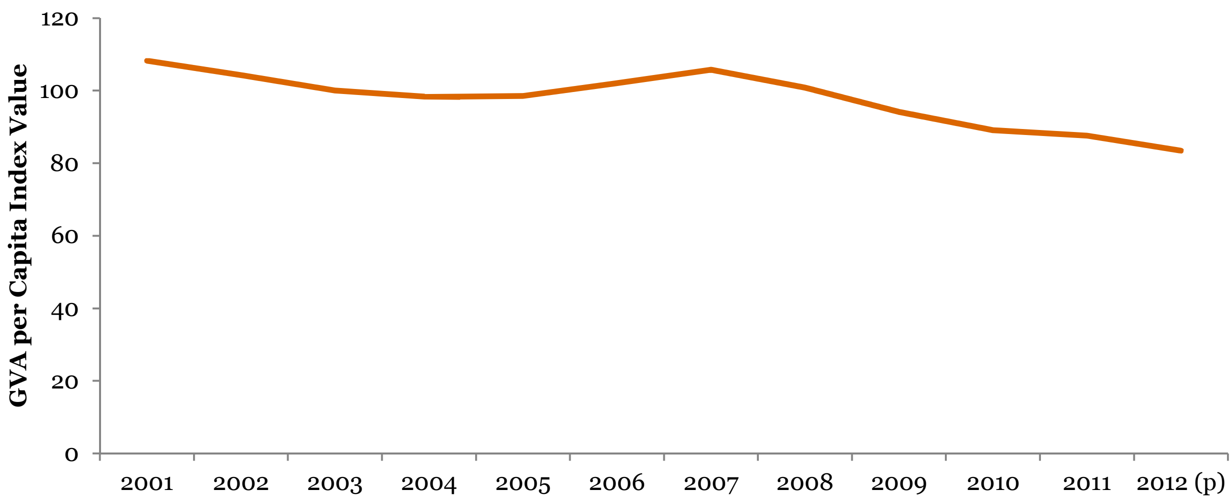


Source: Statistics Unit, 2014

The downward trend in GVA has equated to reductions in GVA per capita in Jersey of 21% in 2012 and as Figure 6 shows, this is the fifth consecutive year of decline. However, it is interesting to note that despite the downward trend, Jersey's GVA per capita is still 68% greater than that of the United Kingdom.

Average earnings have grown steadily in recent years and stand at £650 per week per full-time equivalent employee for the whole economy, with significant wage premia in certain sectors such as the FS sector. In 2012, earning grew 0.7% ahead of inflation. However, over the last three and five year periods inflation has outstripped growth in earnings.

Figure 6: GVA per Capita 2001-2012

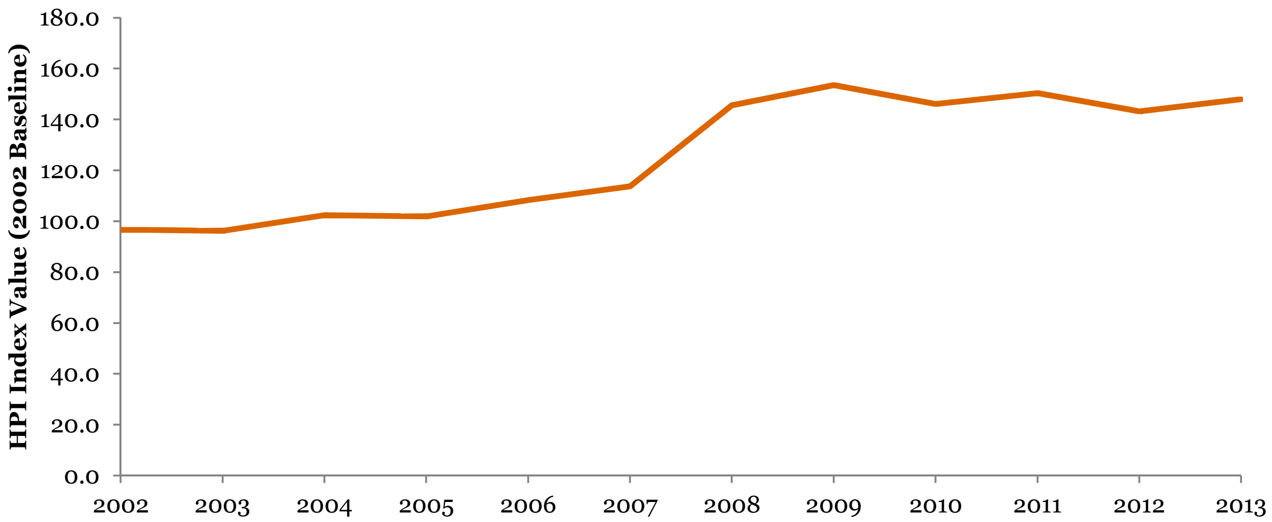


Source: Statistics Unit, 2014

In the context of Jersey property, the construction sector accounted for 6% of whole economy GVA and rental services is the third largest sector as measured by GVA. The construction sector, as with the FS sector, has been adversely affected by falling demand due to the financial crisis. Since 2008 construction sector GVA has fallen £20million and employment has fallen by 6%, suggesting excess capacity in the sector. It is anticipated that conditions in the construction sector will improve in the coming years as a result of the States recent commitment to increase public expenditure on building and infrastructure projects.

House prices in Jersey, as shown in **Figure 7**, have been on a broadly upwards trend over the period 2002 to 2013. However, in recent years house prices have remained largely flat with only minor fluctuations. Following a period of stability from 2008-2009, median house prices decreased in 2010 and 2011 and were subject to a slight increase in 2012. Median house prices for 2012 were £210,000 for a 1-bedroom flat, £300,000 for a 2-bedroom flat, £390,000 for a 2-bedroom house, £455,000 for a 3-bedroom house and £638,000 for a 4-bedroom house.

Figure 7: Jersey House Price Index 2002-2013



Source: Statistics Unit, 2014

6. Options for reform

6.1 Introduction

The intention of this section of the report is to consider three high-level groups of policy measures that could be implemented either individually or in combination to reform the taxation of immovable property in Jersey. The development of these options will be conditioned by an understanding of the Jersey context and the theoretical nuances of property taxation. The aim of these groups of measures would be to create a modern and coherent framework for the taxation of immovable property through which to strengthen the public finances of Jersey.

To do this, this section will first briefly review the current tax treatment of Jersey property to provide a basis for determining the nature and extent of the options for reform. A theoretical framework drawn from the literature will then be overlaid to highlight potential areas for reform. Finally, the options for reform will be developed and qualitatively assessed using the Principles of Jersey Property Taxation developed in **Section 4** of this report as criteria.

6.2 Current property tax regime

In order to present insightful and pertinent options for the reform of the taxation of Jersey property the way in which it is currently taxed must first be understood. To this end a summary of the current tax treatment of Jersey land and property has been included in **Appendix 1**. However, a brief review of this, as outlined in **Table 2**, reveals that Jersey taxes immovable property through a number of different taxes on commercial and residential property the incidence of which falls on both individuals and businesses.

Table 2: Current Tax Treatment of Jersey Property

Tax Regime	Taxable Activities	Key Features
Parish and Island-Wide Rates (IWR)	• Ownership and occupation of Jersey real estate	• Levied on a recurrent basis • IWR differentiated between commercial and residential property • Reliefs for certain government, Crown and religious property
Income Tax	• Rental income • Income from disposals carried on as a trade • Income from the exploitation of natural resources	• Mortgage interest relief • Interest deductibility in respect of taxable income arising from Jersey property, in cases of artificially high levels of debt, limited at the discretion of the Comptroller of Taxes
Stamp Duty	• Freehold purchase or transfer of Jersey property • Conveyance of Jersey property through a will • Creation of a security interest over Jersey property	• Banded rate structure • Reliefs for first-time buyers, charities, re-registration of property owned by married and cohabiting couples and changing mortgage providers
Land Transaction Tax	• Purchase or transfer of shares in a company that confer a right to the occupation of Jersey real estate • Creation of a security interest over shares as described above	• Levied at rates equivalent to the stamp duty liability that would have been due if the rights of occupation were obtained through direct means

Tax Regime	Taxable Activities	Key Features
Goods and Services Tax	• Supply of commercial and residential real estate	• Supplies of residential real estate are zero-rated • Supplies of commercial real estate are taxed at the main rate of 5% • GST incurred on the construction of a dwelling that does not constitute a trade is refundable

The review of the current property tax system has highlighted a number of features that will have a bearing on the nature and extent of the options presented in this section. These features are as follows:

- **Number of widely implemented taxes not utilised:** Jersey does not currently tax immovable property through capital gains taxes, inheritance tax or development gains taxes. With the exception of development gains taxes, these taxes have been, and continue to be, widely implemented to tax immovable property in a number of other jurisdictions. In this respect it is interesting to note that these particular taxes do not have a history of implementation in Jersey, highlighting the importance of the issue of political economy.

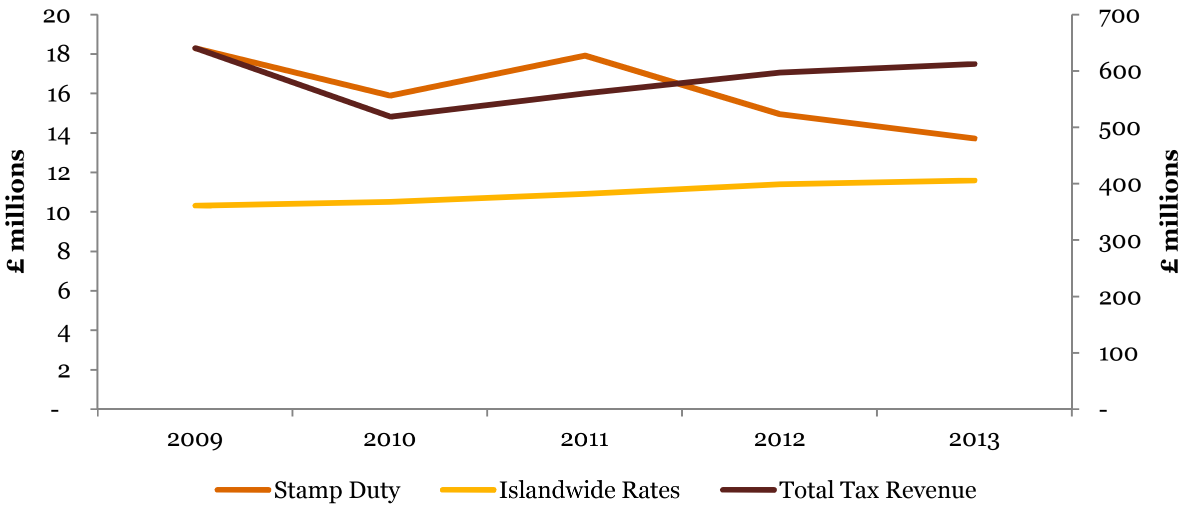
- **Certain features are anomalous to a modern property tax system:** Certain features of Jersey's property tax system are anomalous to what could be considered as a modern property tax system. This is particularly true of mortgage interest relief and stamp duty on mortgages for owner-occupiers, two of which, by comparison, have been abolished in the United Kingdom. Additionally, as research has shown (Van den Noord, 2005; Andrews, 2010), mortgage interest relief is positively correlated with house price volatility and could encourage excessive household debt accumulation during times of rising house prices (Johannesson-Linden & Gayer, 2012).

- **Differentiated taxation of property:** At an aggregate level Jersey's property tax system places a tax burden, in some form, on residential and commercial property and property held by both individuals and businesses. However, at a more granular level it is evident that certain biases exist within each tax. For instance, in the GST and IWR regimes, commercial real estate face higher tax rates than residential. Similarly, the Income Tax regime only taxes the profits arising from the disposal of Jersey real estate that forms part of a trade, leaving all other profits from disposal untaxed. This practice runs counter to that which is put forward in the literature, which suggests that the taxation of commercial real estate is economically inefficient, and is indicative of the political economy of both property taxation and the Jersey context.

- **Implementation of a mix of transaction and recurrent taxes:** Jersey utilises a mix of economically inefficient transaction taxes and economically efficient recurrent taxes. Although this is not uncommon, as discussed with reference to the example of Australia's property tax system presented in **Box 3**, it does present implications for Jersey from a revenue perspective as illustrated by **Figure 8** .

Indeed, at this juncture of the development of the policy options the revenue implications of the use of both transaction and recurrent property taxes bear further examination. As **Figure 8** highlights by comparing Stamp Duty and IWR revenues for the period 2009-2013, the tax base used by different forms of property taxation influences the volatility of revenues. Over the five year period, receipts from IWR have exhibited a steady upwards trend of growth, whereas Stamp Duty receipts have been much more volatile and have been declining in recent years. The upwards trend in receipts from rates is largely a reflection of the indexation methodology, but the underlying stability of the revenues results from the largely unchanging nature of the tax base. Unlike taxes on personal incomes, transactions and profits, recurrent taxes on land and property can be cushioned from much of the volatility of economic performance.

Figure 8: Comparison of Property Tax Revenues 2009-2013



Source: Treasury and Resources, 2014

Stamp Duty uses the monetary value of consideration transferred in a property transaction as its tax base, thereby exposing the level of receipts to volatility in property market trading volumes and property prices. Furthermore, in the context of an island economy, Stamp Duty receipts are significantly affected by small volumes of high value property transactions, which have been less frequent in recent years. Stamp Duty and rates are generally accepted by citizens due to their long standing implementation in Jersey and are difficult to avoid, making them relatively straightforward to collect.

6.3 Theoretical framework

The development of tax policy is often a highly complex and nuanced process and, without careful consideration as to the process, can result in opaque and suboptimal outcomes for governments and taxpayers alike. In order to avoid these pitfalls, this report has employed a robust and transparent mechanism of policy development drawn from the work of the Mirrlees Review, which arguably represents the best articulated and most comprehensive analysis of the taxation of land and property to date.

The Mirrlees Review (Mirrlees *et al.*, 2011) outlines the following recommendations for reform of the taxation of land and property whilst recognising that it is a politically sensitive issue that requires pragmatic policy decisions and the gradual phasing in of any radical reforms:

- **Taxation of land value:** Building on Georgite arguments for the taxation of land, the Mirrlees Review recommends the introduction of a recurrent Land Value Tax (LVT) to promote the productive utilisation of land and to overcome the political difficulties associated with development gains taxes or betterment levies. However, the Review notes that there are certain obstacles to the implementation of an LVT such as the political attractiveness of such a reform and the administrative and political difficulties of valuing land separate from capital improvements. In response to these obstacles, in the context of the United Kingdom the Review proposes a system that continues to be based on combined values of land and property adapting the existing and inefficient Business Rates to become an LVT in effect.

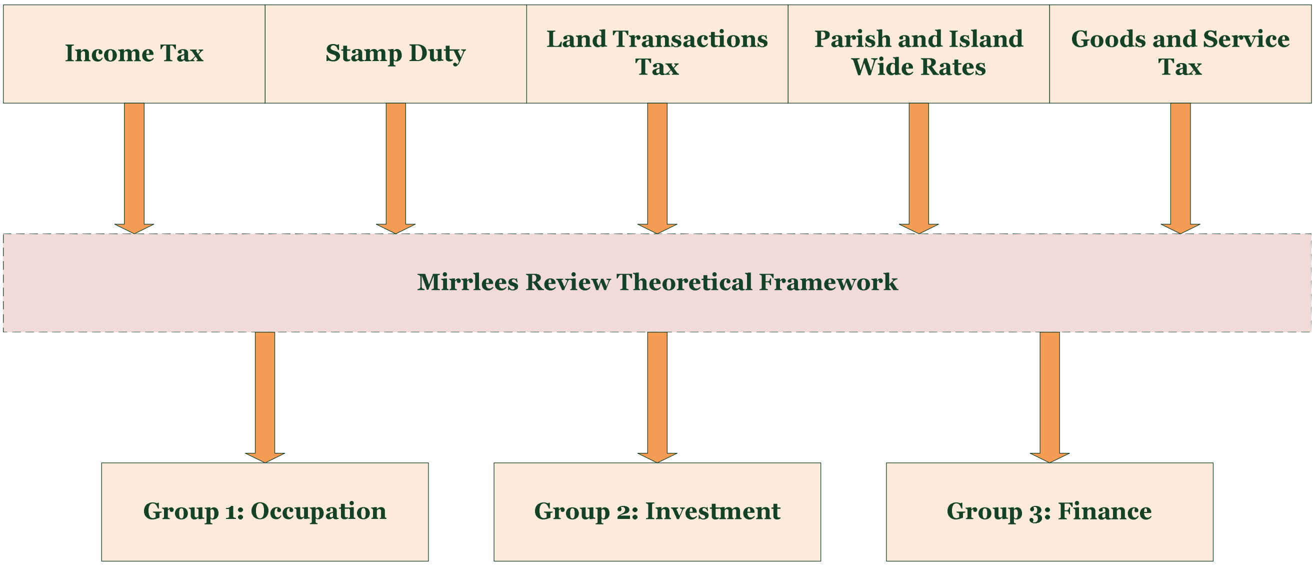
- **Taxation of the consumption value of housing:** Housing can be thought of as a class of consumer durable in that its use and ownership releases a number of benefits that could be taxed under a consumption tax regime. However, due to the fluctuation of house prices and the presence of existing housing stock it would be problematic to tax the consumption value of housing at the point of purchase. To overcome this, a case is put forward for a recurrent Housing Services Tax (HST) levied on the consumption value of housing at the point of consumption. In the context of the United Kingdom, the Review recommends adapting the existing Council Tax regime to ease the implementation and acceptability of a HST.

- **Taxation of housing as an asset:** Owner-occupied housing, as an asset class, is one of the largest recipients of household investment and is closely correlated with lifetime income and wealth. These qualities make it attractive, and potentially progressive, to tax gains arising on the disposal of owner-occupied housing. The Mirrlees Review recommends equalising the tax treatment of owner-occupied housing and rental housing by taxing the gain on disposal of owner-occupied housing on the excess of the gain over a rate of return allowance.

- **Abolition of property transaction taxes:** Property transaction taxes, such as Stamp Duty, are economically inefficient and create distortions in the property market. They discourage investment in property and can adversely affect the mobility of labour. The Mirrlees Review suggests that the case for the continued use of property transaction taxes in a modern tax system is weak and that current property transaction taxes should be phased out over a period of years and eventually replaced with a more efficient form of property taxation. This would avoid foregoing revenue or generating windfall gains for existing property owners.

Using the recommendations of the Mirrlees Review as a theoretical framework through which to conceptualise potential areas for reform in Jersey's property tax system, as illustrated in Figure 9, we have identified three groups of possible reforms. The approach taken in this Report to the development of groups of possible reforms has been as follows.

Figure 9: Mirrlees Review Theoretical Framework



These groups of reform options have been closely aligned to the areas highlighted by the Mirrlees Review and aim to address separable areas of property taxation in order to provide for implementation individually or in combination. The areas of possible reform and the related groups of measures are as follows:

- **Group 1: Occupation –** This group of measures would seek to reform the taxation of the consumption of the benefits conferred to the owners and users of Jersey property in line with the recommendations of the Mirrlees Review

- **Group 2: Investment returns** – This group of measures would reform the taxation of returns to Jersey real estate investment by broadening the tax base beyond profits on disposals constituting a trade.

- **Group 3: Finance** – This group of measures is comprised of targeted reforms to the tax treatment of finance for both residential and commercial property.

Each of these groups of measures is tested for consistency with the proposed Principles of Jersey Property Taxation developed in Box 10.

It should be noted that neither the revenue yield nor the economic impact of the measures set out below has been modelled at this stage. This was outside the scope of the current Report.

Such modelling, to the extent permitted by availability of data, could make a valuable contribution to consideration of the options for implementation. It would inform public consultation and debate and should take place before implementation.

6.4 Group 1: Occupation

6.4.1 Overview

This group of measures would comprise two main elements, the effect of which could be to tax more fully the occupation of both domestic and non-domestic property in Jersey:

1. The development of domestic rates into a levy on the consumption value of domestic property, following the Mirrlees concept of a Housing Services Tax. It could be levied solely on the occupier, whether or not the owner was the occupier; and,

2. In respect of the non-domestic sector, a choice between:

    a) The transformation of non-domestic rates into a land value tax, payable by reference to the value of land zoned for commercial purposes

    b) The introduction of a system that could parallel the proposal for domestic rates, with a charge levied only on occupation, using an up-to-date valuation base.

These measures could be combined with Group 2 and/or Group 3 below.

The overarching intent of this group of measures is to reform and modernise the way in which ownership and occupation of property are currently taxed in Jersey. At present, the rates system taxes ownership and occupation separately using adjusted 2003 rental values as the tax base for both activities. This could be considered anomalous in a modern property tax system as two distinct activities are taxed on the same bases and the current rates system provides for a double taxation of owner-occupiers. An additional layer of double taxation for owners of rental properties is also created as both imputed and actual rental income is currently taxed under the rates system and Schedule A of the income tax regime respectively.

As such, the objective of introducing these measures on a stand-alone basis would be to modernise the rates system, based on clearly articulated principles, using instruments that would:

- Create a new framework for an annual charge on all land and property in the domestic sector and all land zoned for commercial use;

- Underpin the Jersey tax system with a stable and sustainable revenue stream and a mechanism through which tax revenues could be increased over time, if necessary, without creating new distortions. At certain levels, it could potentially allow less economically efficient and more distortive taxes to be reduced; and

In principle the incidence of these measures could be as follows:

- Owner-occupiers and tenants in the domestic sector could potentially see an increase in their level of taxation.

- Owners of rental properties in the domestic sector could have a reduced level of taxation.

- The incidence borne by the commercial sector could be such that either:

- o The level of taxation on owners could increase because property owners would become solely liable for a charge based on unimproved land values; or
- o The level of taxation on tenants and occupiers could increase as they would become solely liable for an uprated tax on land and improvements.

The precise sharing of the tax burden of this group of measures will be dependent on the supply and demand dynamics of the rented housing market in Jersey.
From a revenue perspective it should be noted that the implementation of these measures on a stand-alone basis would not necessarily lead to private landlords being better off. Schedule A income could still be taxable and, depending on the efficiency of the Jersey property market, the heavier taxation of tenants could lead to a downwards adjustment in rental prices. Therefore, although the form of these measures suggests that landlords could benefit through a reduced burden on ownership the substance is that there could be a rebalancing between owners and occupiers and an implicit transfer between them.

Any proposals for change in this area should be the subject of wide consultation and are likely to be most successful if they are introduced over an extended period of time.

6.4.2 Domestic property

It is widely recognised that the occupation of housing confers benefits on individuals that could reasonably be taxed under a consumption tax regime. The Mirrlees Review recommends, pragmatically, that *"If we want to tax the consumption value of housing,... it is probably best to do so at the point at which the services are consumed... This suggests an annual tax related to the (consumption) value of the property."*

Jersey already has a tax that is similar to the Mirrlees Review's concept of a Housing Services Tax, in the form of domestic rates, comprising Parish and IWR, which are levied on both the owner and the occupier of a property. However, the scale of domestic rates on the Island is relatively modest by international standards, as noted in **Section 3** above.

In Denmark, for example, as noted in **Box 4** there is an annual national property tax set at 1% of the (adjusted) capital value for properties up to DKK 3,040,000 (approximately £325,000) and 3% above that level and an annual municipal property tax levied at rates between 1.6% and 3.2% of the value of the land only. The total yield from the annual property tax in Denmark is 2.8% of tax revenues in 2012 and 1.6% of GDP.

The recently introduced Local Property Tax in Ireland is levied as an annual charge of 0.18% on the (self-assessed) capital value of domestic property up to €1 million and 0.25% thereafter. In 2013, the year of its introduction, Local Property Tax raised €316 million representing 0.83% of total tax revenues and 0.19% of Irish GDP. It is designed to raise €500 million in a full year. For a house valued at €425,000, the annual tax charge would be €765. Ireland has had a number of different recurrent property taxes over the years. Prior to 1969/70, there was an income tax, levied on owners, based on the imputed rental value of buildings. This was abolished in 1969. There was also a system of domestic rates levied by local government, based on the net annual valuation of a property. This was abolished in 1978. In 1983, an annual tax was introduced on residential property where the value was above a certain limit, but the tax base was quickly eroded and in 1997 this tax was also abolished. Since that time, although there have been many calls for some sort of recurrent tax on property to be re-instated, Irish governments have been understandably reluctant to do so. However, the desire to strengthen and rebuild the public finances led the government to re-evaluate the case for a tax on land and property and this eventually resulted in the development of the Local Property Tax.

In the UK, Council Tax raised £26.3 billion in 2012-13, representing 4.7% of tax revenues and 1.7% of GDP. The average Council tax bill by household was £1,201 and the average Band D charge was somewhat higher at £1,444. (Band D is the central reference point for the system.)

In Jersey, according to the Fiscal Strategy Review of June 2010, the combined revenues from rates on domestic and non-domestic property were £22 million, comprising £14 million raised by domestic rates and £8 million from non-domestic rates. Domestic rates therefore accounted for 2.7% of tax revenues in Jersey in 2010 and less than 0.4% of GVA.

According to the 2010 Fiscal Strategy Review, the average rates bill for a domestic property was approximately £350 in 2010, taking Parish rates and IWR together, compared with an average Council Tax bill in the UK at that time of £1,100.

Average earnings (excluding bonuses) in Jersey across all sectors in 2010 were approximately £32,000, compared with £25,900 in the UK, making the average Jersey rates bill approximately 1% of average earnings compared with an average Council Tax bill in the UK of 4.2% of gross average earnings.

These international comparisons suggest that an increase in domestic rates in Jersey beyond the current level could be achievable over a number of years. In 2010, the Fiscal Strategy Review explored the possibility of a threefold increase in domestic rates, putting them on a par with the UK and raising an estimated £28 million. Based on 2013 numbers, a similar increase today would generate an additional £32.5 million. Care should however be taken in making direct comparisons of this nature with the UK. The Jersey Statistics Unit estimates that the cost of living is as much as 20% higher in Jersey than in the UK, when housing, health and education are taken into account. So issues of affordability may not be as clear-cut as they appear at first sight.

In principle, the most straightforward approach to implementing reform could be to modernise the framework for domestic rates by abolishing both the Parish Rates and the IWR and replacing them with a Domestic Property Tax, using current capital values as the base. Attaching this levy firmly to familiar concepts of taxation and to current market values, as a proxy for the capitalised value of future consumption could provide a stronger but still very stable yield without the issues of public acceptance normally associated with introducing a new tax. Such a change would be economically efficient.

The two most significant changes that this element of the measures would make are that:

- Rates would become entirely the responsibility of the occupier of the property. Where a property was owner-occupied, there would be no difference from today, but where a property was rented out, the owner would no longer have a liability. This change recognises that it is the occupier who enjoys the property and who should, logically, bear the responsibility under a tax designed to capture the benefit that the occupation of housing confers. Group 2 contains changes that could provide some counterbalance to the advantage conferred on the owners of rented property in this proposal.

- The system would require a new valuation of domestic property. This can be a significant undertaking with at least some initial scope for dispute between the owner or occupier and the authorities. However, there are some lessons to be learned from the approach taken by the Irish government that might help in this regard.

As noted above in **Box 5**, when the Local Property Tax was introduced in Ireland in 2013, the government used a system of self-assessment to establish property values. There are a number of potential advantages to self-assessment in this context, in particular, minimising disputed valuations, obtaining taxpayer buy-in and keeping to a minimum the up-front costs to the government and the administrative effort of introducing the new tax. The self-assessment process required taxpayers to estimate the value of their property within €50,000 bands. (See **Table A15**) The Irish valuation bands should ideally be adapted to be more appropriate to Jersey. For example, while the use of relatively narrow bands might be suitable for the bottom end of the Jersey property market, it might be better to broaden the higher bands and provide a number of bands beyond the values used in the Irish system.

There might normally be a natural bias in a self-assessment system towards the selection of lower values but this can be restricted by the development of an audit process and there would be an element of peer pressure in many areas that may help to keep valuations close to true market value.

The self-assessed values could also be influenced by the adoption of some of the key elements of Group 2 which could also require the valuation of domestic properties. For Group 2, there could be benefits to owners in ascribing a higher rather than a lower value to their property. So there would be some balanced tension in the valuation process, provided Group 2 is also implemented.
One area where there might be initial scope for disagreement is between landlord and tenant. The proposal here is that it would be the *owner* who self-assesses the value of the property. For rented property that could affect the level of tax that the tenant pays but would not immediately affect the position of the landlord. Sitting tenants in particular might want the system to provide a mechanism through which they

could challenge the value attributed to the property they occupy. However, there is a broad mutuality of interest in a landlord-tenant situation that makes the arrangements work and it seems likely, again, that the market could allow the achievement of a new equilibrium that satisfies all parties.

The changes outlined are significant enough for them to require some changes in the collection process as well. There would be some cost in that but this would be an investment by the government in establishing a new framework that could have the potential to generate significant, stable and sustainable revenues long into the future, so the cost could be justifiable on that basis.

On the macro level, rates have been a very stable source of revenues in Jersey over a long period of time. As illustrated in **Figure 8**, they have yielded a consistent and steadily rising income to Treasury and Resources at a time of considerable volatility in other revenues. There is no reason to believe that they would perform in a significantly different way if they were to be increased.

The exact level at which domestic rates might be set both currently and prospectively is a matter for political judgement and will require a more detailed analysis that is outside the scope of this report. However, it will be clear from **Figure 8** that there could be advantages for the public finances in placing more emphasis on this source of revenues and reducing the burden elsewhere.

Low taxes on property have historically played a modest role in establishing the overall climate of taxation in Jersey and it is possible that there could be some negative reaction to increasing domestic rates. However, a phased increase would seem, intuitively, unlikely by itself to provoke an exodus of mobile residents, even to neighbouring islands.

As the literature indicates, there could be likely to be some issues with a small group of owner-occupiers with domestic property assets out of balance with their income and cash resources. Again, as the literature illustrates, there are a number of basic models which can be adopted to ease this problem. The Danish model and one that is widely supported in the literature, is to allow the roll up of all or part of domestic rate liabilities for those in retirement and with limited income. This puts the burden of the tax into the future and onto the estate. An alternative could be simply to limit the domestic rate liability to a certain proportion of income, so that the individual's ability to pay would never be compromised.

Neither of these solutions is perfect and the latter could be quite open to abuse. As a practical matter, at the levels of tax envisaged here, there should be few relatively few situations in Jersey where the problem should arise and the most pragmatic and equitable approach would probably be to allow a roll-up of the liability with interest, until the death of the owner.

For rented property, there is a strong likelihood that the market could quickly find a new equilibrium that accommodates the change in the way the tax is levied. In the relatively few anticipated situations where genuine hardship arises, a limited form of housing support possibly in the form of direct payments to homeowners or reductions in the rates levied, determined by reference to household circumstances, is likely to provide the most appropriate solution. This option could be explored more fully in the implementation process.

These could be important and potentially long-lasting reforms to the framework of the taxation of domestic property and, with this in mind, it would be prudent to consider and consult on the proposals in some detail, including possible measures to lower the burden for the most disadvantaged households, while preferably maintaining the underlying principle that everyone should contribute.

6.4.3 Commercial property

Just as the attractions of an annual tax on the housing stock are widely understood by economists and policy-makers, so too are the benefits of having a similar tax on the commercial sector. Mirrlees finds stronger arguments for levying a land value tax in respect of land zoned for commercial purposes than for domestic property. The Mirrlees Review recognises the potential efficiency gains from replacing a tax on property (including improvements) with a tax based on land values but it also highlights the practical difficulty of achieving such a shift.

Mirrlees argues that, for the UK, removing business rates and replacing the system with a land value tax would promote economic efficiency but the Mirrlees Review recognises that it could only be achieved at the cost of some considerable short-term dislocation. It would require a very substantial valuation exercise; it would create winners and losers depending on the extent to which land was developed and potentially, to no clear purpose, put windfall gains into the hands of some with an interest in business property; and unless the intention was to tax at a somewhat higher level overall, these short-term costs and the inevitable political fall-out would not be counterbalanced by additional government revenues. The Mirrlees Review therefore accepts, with the same pragmatism as is applied to the housing sector, that there is a case, albeit a weaker case, for maintaining something close to the *status quo* in the form of business rates in the UK on non-domestic property.

Some of the same reasoning that led The Mirrlees Review to accept the case for continuing with a form of business rates in the UK also applies in Jersey. Non-domestic rates already provide a stable and sustainable, long-term flow of revenues for the Island with some buoyancy. Replacing rates with a land value tax would improve economic efficiency while retaining a stable flow of revenues but there could be some significant short-term issues to address and a range of factors would have to be balanced with some care.

In this group of measures, alternative solutions are presented. We consider first the potential introduction of a land value tax and then the more pragmatic approach of broadening and deepening a charge similar to the current non-domestic rates, levied exclusively on the tenant and based on current market values.

6.4.3.1 Land value tax

The tax system in Jersey has some different dynamics from the tax system in the UK and there could potentially be more to gain in Jersey from making the shift from non-domestic rates to a land value tax. Two factors that are particular to Jersey make the case for the introduction of a land value tax on the Island stronger than it is for the UK.

One of these is the vital importance of ensuring that the available land is put to the most economically efficient use. An important advantage of a land value tax is that, by decoupling the valuation of the land from the valuation of the improvements, it brings a sharper incentive to owners than a broader property tax to ensure that the land is used with the greatest economic efficiency. This is particularly important in Jersey because the supply of land is very limited and the supply of land zoned for commercial use or development is even more limited. A tax based on the underlying value of that land could reflect that scarcity and could encourage the most efficient development.

The second is the need to achieve a better balance between individuals and businesses in their respective contribution to meeting the social costs of the Island. The UK has a broadly-based tax on business income within both the income tax and corporation tax systems. Jersey has a narrower tax on business profits and a significant number of businesses make a smaller contribution to the social costs of the Island than they would if they were, for example, within the UK system. This situation is the result of a complex history of business taxation in Jersey. The introduction of a land value tax on land zoned for commercial purposes instead of the current non-domestic rate system could help to address that situation by allowing the level of taxation on the business sector to be raised in an economically efficient way.

Nevertheless, there could be some short-term issues to address. Principal among those could be that:

- A shift to a land value tax on land for commercial use would require a valuation of that land to be undertaken. Self-assessment would be too difficult; and

- The incidence, both in terms of direct cash effect and indirect passed-on impacts, of the tax could be different from the current system. This could have an impact on all businesses and investors in such land and it could be likely to affect most those owners with relatively low density developments on prime sites. This would suggest that any shift should be made gradually to allow time for adjustment.

Fortunately, the scale of the valuation exercise that could be required would be relatively modest. There is a significant area of land approved for commercial use but the task of valuing it is ultimately manageable. The overall scale of the Island would help to make the valuation process more straightforward. Although there are prime sites and prime business locations, the variation across the Island in terms of geography, infrastructure, accessibility etc. is not as wide as it is in many countries so values of similar-sized areas of land would not be as polarised.

There would, however, be some cost involved in the valuation process and it would be desirable both to minimise that cost and to ensure that, as far as possible it was a one-off cost rather than a recurring cost. One of the ways of achieving that which Treasury and Resources might explore could be to treat land approved for commercial use as a single block for as long as the zoning remained unchanged. On a relatively small island, this is more practical than it would be for a larger country such as the UK.

In principle, this approach would allow each piece of land to be valued as a proportion of the whole rather than on an absolute basis, reducing the scope for disputed valuations. If this proved to be unsatisfactory on equity grounds, the valuations could be adjusted by reference to a small number of broad zones by applying a coefficient to reflect differences between prime and some degrees of non-prime location. This need not disturb the principle of valuing the commercially-zoned land as a single block in the first instance.

The level of the land value tax should not, in principle, as Mirrlees recognises, affect business decisions, although in the context of Jersey the issue of international competitiveness could be more significant and would have to be factored into the balance in a way that Mirrlees does not.

In principle, Mirrlees concludes that "*Land…used for business…, can be taxed at an arbitrarily high rate on economic efficiency grounds.*" This is not a licence to print money but the use of a land tax could help to redress the balance in Jersey between the taxation of individuals and the taxation of business activities. As already noted, for the most part, the latter are quite lightly taxed in Jersey today, with utilities and finance companies bearing the main burden, although at a much lower level than in many parts of the world.

A land value tax set at a rather higher level than the level of non-domestic rates could ensure that the business community made a more substantial and arguably more equitable contribution to the social costs of the Island. Levied on the owners, the financial and economic effects of the tax could nevertheless be such that the incidence was on owner-occupiers and was passed on to tenants of business premises.

The scale of their contribution and its distribution would depend not just on the level at which the land value tax was set but also to some extent on its treatment within the broader framework of the taxation of businesses in Jersey. Land value tax could simply be regarded as a replacement for non-domestic rates and, as such, it could naturally be deductible for corporate income tax purposes. But, as with any tax, the authorities could arguably choose between allowing the tax to continue to be deducted against profits chargeable to corporate income tax or making it non-deductible. Allowing a more substantial land value tax as a deduction could result in companies operating in Jersey contributing proportionately more to the social costs than they do today, which the public might regard as more equitable.

6.4.3.2 Annual non-domestic property tax

International experience to date with land value taxes is relatively limited and there are features of the system that make it less intuitive than a system of taxation based on the value of both land and improvements. While the absence of a wide range of precedents is not a good enough reason for passing up the opportunity to introduce a system that would be more economically efficient, a number of complex factors, including matters of political economy, need to be considered.

For this reason, this element includes the alternative of retaining an annual tax on land and improvements in the non-domestic sector, but framing it in a slightly different way from the current tax. The proposal is to introduce for the non-domestic sector a tax very similar to that proposed as a replacement for domestic rates, levied simply on owner-occupiers and tenants. It could be based on the current market value of land and improvements. Owners of rented property would not pay the tax although it could, of course, have some ripple-through effect on the economics of ownership. An annual tax on ownership, even if based on property as well as the underlying land, is likely to be less distorting than, say, a tax on transactions. Many countries have introduced them and they generate a stable flow of revenues.

Such a system would require a current market valuation of the land and property. In principle, this could be achieved on the same self-assessment basis as is proposed for the domestic sector. However, the proposal here is that it should be the subject of a normal, professional valuation. The valuation process should, in principle, be more familiar to valuers than a valuation of the underlying land which could have some advantages.

The similarity of this approach to the current system has some benefits, although a significantly higher level of charge than under the current system may look politically more challenging than under a land value tax system.

This type of annual charge is unlikely to be as efficient from an economic perspective as a land value tax. It does not provide the same incentives for efficient development. Nevertheless, it should be capable of producing a strong and stable flow of revenues with good compliance. It would have a logical coherence with the annual tax on the domestic sector. It would be important on equity grounds, to levy it on the basis of an up-to-date valuation.

Importantly, it should also have a political resonance within the community. One of the potential problems with a land value tax is that although it will have either a direct or an indirect financial effect on all businesses, it could be seen to apply primarily to the owners rather than the occupiers of rented property. So, for those citizens concerned with achieving equity among businesses and the right balance between the individual and business sectors, a land value tax might appear to leave untouched those businesses operating through rented premises, including many large businesses represented on the high street. A tax that was seen to be levied on all occupiers of business premises might, therefore, enjoy a higher level of acceptance than a land value tax even though the former could be regarded as less economically efficient.

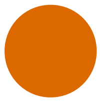
In principle, just as the land value tax should facilitate the introduction of a somewhat higher level of charge than non-domestic rates if that is needed, so too should this model. And it could potentially receive a higher level of support because it could be seen to be levied on those most lightly taxed in the current framework.

Within this model, there would also be a decision to be made by the authorities as to whether the tax should be deductible or disallowed in computing taxes on profits.

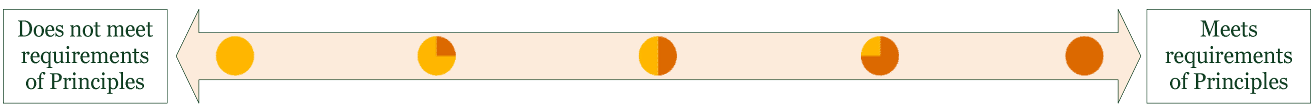
6.4.4 Evaluation of Group 1

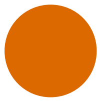
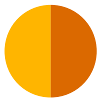
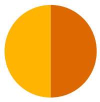
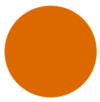
We have evaluated this group of measures using the proposed Principles of Jersey Property Taxation from **Box 10** as criteria with the exception of the principle of consultation, which is a practical and political matter that is entirely in the hands of Treasury and Resources. The table below sets out a qualitative evaluation:

Table 3: Evaluation of Group 1

Principle of Jersey Property Taxation	Performance[2]	Description
Coherence and Certainty		• The implementation of this group of measures would result in a framework of taxation that would be familiar in that it adapts the tax bases of existing taxes. • Liabilities should be straightforward to calculate. • Valuations could be self-assessed, contributing to confidence and certainty for taxpayers.

[2] The performance of the groups of measures against the proposed Principles of Jersey Property Taxation has been qualitatively assessed using the following scale.



Principle of Jersey Property Taxation	Performance[2]	Description
Efficiency and Growth		• Economic efficiency can be achieved through the use of residential recurrent property taxes and the possible implementation of a Land Value Tax. • The possible implementation of a recurrent Commercial Property Tax would be more economically efficient than other methods of taxing commercial property. • The fiscal space created by this group of measures could be used to make efficiency gains by reducing distortive transaction taxes.
Support for the Competitive Environment		• Taxes on domestic property would be unlikely to affect the competitive profile of Jersey as they are not directly linked to the production and consumption decisions of businesses and not substantial enough to affect locational decisions of mobile high net worth individuals. • The Non-Domestic Property Tax could, depending on the choice of rate, affect the competitive profile of Jersey.
Fairness		• The elements of this group of measures targeted at domestic property could be designed to be progressive. • Attention would need to be given to the ability to pay of property owners and tenants in designing the reliefs.
Fiscal Stability and Sustainability		• This group of measures could yield stable and sustainable revenues as the revenue receipts would be unaffected by short-term economic performance or market trading volumes.

6.5 Group 2: Investment returns

6.5.1 Overview

This group of measures contains a number of elements, the effect of which would be to extend the range of circumstances in which returns to real estate investment would be taxed. The principal elements would be:

1. The broadening of the current scheme for taxing disposals of land and property as part of a trade so that a wider range of realisations could potentially give rise to tax;

2. The introduction of a concept of a normal return to investment which would reduce the profits that could otherwise be taxable on a realisation of an interest in land and property; and

3. The taxation of accrued development returns where land is rezoned and its potential use is changed.

Some or all of these measures could also be combined with the measures in Group 1 and/or Group 3.

There are currently only limited circumstances in which profits arising on the sale or other realisation of land or property are taxed in Jersey. Disposals in the course of a trade are taxable but there is no capital gains tax that captures the profits earned by businesses or individuals outside that framework. These measures do not contemplate the introduction of such a broad-based tax. The objective of introducing them on a stand-alone basis would be:

- To recognise that windfall gains may sometimes arise to owners of land and property as a result of factors that they do not control. This is especially important because of the fixed supply of land which is compounded by the island context and land use planning;

- To seek, where such circumstances arise, a contribution from those owners to the social costs of the Island; and

- To build economic efficiency into that framework.

In principle these measures could increase the level of taxation that owners of rental property could face in the future. They would also tax earlier and more fully, gains arising from the rezoning of land.

As with the measures in Group 1, any proposals for change in this area should be the subject of wide public consultation.

6.5.2 Realisation of interests in land and property

Notwithstanding the financial crisis, prices of domestic property have been relatively buoyant over the last decade, as illustrated in **Figure 7**, although there is a continuing softness in the market. Limited supply and strong demand generally underpin Jersey property values. This has advantages for existing owners but can have some negative implications for society as a whole, especially where the growth in the price of property outstrips normal returns on other forms of investment and growth in other factors such as real wages and Jersey GVA.

For many individuals, the purchase of property is an investment decision and this tends to be true whether the property is bought by a prospective owner-occupier or for rental. It is, therefore, appropriate for property to be considered as an asset in that context. Mirrlees considers a range of possible approaches consistent with that analysis and broadly concludes that returns to investment in property should be taxed at the individual's marginal rate of income tax, with an allowance made for a normal rate of return. This group of measures could adopt some key elements of that approach.

The underlying principle would be that super-normal profits[3] arising on the sale or other realisation of land and property could be taxed through an extension of the existing income tax rules, after an allowance for a normal return on the investment.

In this group of measures, the new regime could apply only to property held for rental and it could leave the taxation treatment of the rental income on the property itself unchanged, imposing a tax that could, in most cases, arise only on a disposal. There could be provision for the relief for losses on realisation, with restrictions applying so that any losses were only available for relief against other income listed under the current Schedule A.

There is a strong economic efficiency and equity argument for applying this system to both owner-occupied properties and properties held for rental. However, it would be prudent to apply the tax, at least in the first instance, to a smaller proportion of the housing stock to limit the dislocation that might arise from the widespread introduction of a change such as this. Owners of rental properties are normally accustomed to maintaining good records of expenditure and could, therefore, more easily make the adjustment to a system of taxing profits on realisation.

A change of this nature would be best introduced prospectively, thereby eliminating concerns about the historical growth in value. In principle, property owners would be able to use the value that they supply today for the purposes of the domestic rates to establish the basis for a future calculation of profit. This could have the advantage of encouraging good compliance within that valuation process. Given that a high valuation would raise the base for domestic rates but would lower the profit on a realisation, the system should provide some balance but it would, of course, need to be supported by appropriate audit and appeals mechanisms.

The Mirrlees Review envisages that any profit on a realisation would be mitigated by a rate of return allowance or *RRA* which would be based on the purchase price and calculated on an annual basis with appropriate compounding. In this measure, the intention would be to base the RRA on the value of the property at the time of the introduction of this system. There are choices to be made about the treatment of

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3 Super-normal profits are generated from economic rents that are in excess of what would normally be expected from an investment in a particular asset class.

future capital expenditure but a simple system could just allow for the RRA to be calculated from the date of the expenditure itself.

The level of RRA postulated by Mirrlees is 5%. In practice, a reference point for the actual RRA should be chosen that reflects economic principles and investment returns on a range of asset classes domestically and internationally. There are both domestic and international possibilities that can be considered. Using two price scenarios for a realisation of a property purchased for £10,000,000 on 1st January 2015 and sold two years later on 31st December 2016 either for £11,025,000 or £15,000,000 and assuming that the RRA was set at 5%, it could be compounded and applied as follows to tax only above average returns (super-normal profits) to real estate investment:

Table 4: Rate of Return Allowance

	Scenario 1 – Average Profit	**Scenario 2 – Above Average Profit**
Property value on purchase 01/01/2015	£10,000,000	£10,000,000
Property value on realisation 31/12/2016	£11,025,000	£15,000,000
Profit on realisation	£1,025,000	£5,000,000
Less: RRA (5% of purchase value)		
2015 RRA	(£500,000)	(£500,000)
2016 RRA	(£525,000)	(£525,000)
Total RRA	(£1,025,000)	(£1,025,000)
Taxable Income	**£0**	**£3,975,000**

The pattern of property disposals in Jersey varies from year to year and any tax revenues arising from it would be slightly more volatile than those from an annual tax on the value of land and property. In relation to this element, the initial revenues would be very small because the system could essentially allow current market values to be used as a base for calculating profits. However, to the extent that the market yields super-normal profits in the future, revenues could pick up over time.

The impact on the market itself should also be small and lead to little or no immediate adjustment in prices. Future growth in the market may be moderated by the introduction of the new rules but, in practice, this is likely to have only a modest impact. The extension of the same system for owner-occupation could have a bigger impact but could still be expected to be quite small. The setting of the reference point for the RRA could condition expectations and therefore have an influence on pricing. For prospective new entrants to the market, any moderation in price growth would be welcome.

Notwithstanding the fact that this measure proposes to limit the scope of these arrangements to rental properties, there is a strong case for establishing a framework of taxation that applies in principle to all domestic properties. In practice, this could mean that, for rental properties, tax could be levied, as set out above, at normal income tax rates. Owner-occupied properties could be within the system but profits on realisation could be taxed at 0%. The Jersey community is accustomed to the concept of 0% taxes and its application here could have some advantages. From an administrative perspective, it would leverage off the self-assessment valuation that is proposed for the reformed domestic rates and ensure a consistent set of dynamics across the housing market. It would strengthen the principle that the whole community should be involved. It would provide an up-to-date base line for the whole housing stock against which to compare and monitor movements in rental sector capital values; and it would support the compliance process where properties moved between the rented and owner-occupied sectors.

This group of measures envisages that the realisation of investments in business properties could also be taxed, with appropriate adjustments and that the rules could apply to both domestic and international investors. Some adjustment to the valuation mechanism might be required.

Changes are also envisaged to the way in which income tax and corporate income tax apply to gains arising in connection with development. These are outlined below.

6.5.3 Development gains

In principle, under the system outlined above, profits on the realisation of land and property could normally be taxed in a way that encompasses gains arising from development. The intention with this element is to use a tax instrument to strengthen the impetus towards development in situations where land has been rezoned for development, by imposing a presumptive charge. It is envisaged as a tax on landowners.

The taxation of development gains can take many forms, some involving true tax instruments, others involving, for example, the transfer of assets from the private to the public sector through planning agreements. The approach set out here is based on the premise that there would be a single event, namely rezoning, that triggers a particular form of taxation at the start of the process of development and that other profits arising through the continuation of that process could be taxed under normal rules.

The tax could be framed around the assumption that rezoning has the intention of encouraging development within a limited period, say 5 years. The tax could, therefore, be levied under normal income tax or corporate income tax rules at the date of rezoning, with collection occurring in such a way that, in this model, it is collected at an even rate over the 5 year period or at the point of realisation, if that occurs sooner. So, the liability could be calculated based on the windfall rezoning gain accruing to the landowner at the date of rezoning (the simple difference between the original use value at the date of rezoning and the new use value) and collected at a rate of 20% of the tax liability every year over the 5-year period or until realisation (at which point it could be due in full). The cash-flow effect of the collection mechanism could, in most circumstances, be a spur to development, which could presumably be the intention of the Island authorities. In the rare situation that unexpected factors intervene, the system should allow a deferral but the grounds for this should be transparent and the case for deferral should be subject to a high burden of proof.

The windfall gain on rezoning, if it were to be introduced, should be established through a normal valuation exercise, agreed between the authorities, the taxpayer and outside valuers, as appropriate. This rezoning gain could be taxed at normal income tax and corporate income tax rates and adjustments made, as appropriate, to other tax bases. The value determined on rezoning could form the base for any future calculation of profit arising on a realisation.

The rezoning tax charge could be levied only on the increase in the value of the land that arises from the rezoning. This distinguishes the approach set out here from those models that attempt to capture both the rezoning gain and the profits arising on the granting of planning permission and subsequent development. It can be argued that the granting of planning consent also confers a windfall gain and should be taxed alongside the gain on rezoning. However, this complicates the process and the timing and potentially involves more taxpayers. It would seem to be justified only where the intention is to tax rezoning and other “development” gains at a higher rate than other profits from the exploitation of land. The policy intention inherent here is not to apply a higher rate but to tax the profits in all cases at 20%.

As to timing, in most circumstances, particularly if the cash flow feature of the tax is effective, a realisation will follow relatively soon after rezoning and the profits from the remaining parts of the development process will be taxed at that time. Taxing the rezoning gain and the ultimate realisation in this way will establish a coherent framework for the treatment of development profits.

In practice, rezoning will occur relatively infrequently but these provisions will seek to ensure that tax is levied when it does happen and is collected in such a way as to encourage the development that the authorities are seeking.

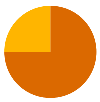
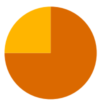
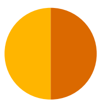
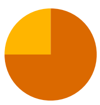
The taxation of development gains is regarded as economically efficienct as, based on Ricardo’s Law of Rents and Georgite arguments it is in effect a tax on an economic rent. Indeed, under both the Traditional and New views of property tax incidence, a tax of this nature could be considered equitable as the incidence would be borne by the landowner at the date of rezoning. Additionally, these taxes have also been argued to create incentives to property development by placing a tax cost on the ownership of rezoned land. However, the taxation of property development has a chequered history in many countries and Jersey is no exception. Governments often lack the political will to introduce and maintain development taxes and, as a consequence, the taxes themselves often lack credibility. Developers simply hold onto land and wait in the expectation that the development taxes will soon be abolished. A tax on rezoning should, in principle, avoid some of the quagmires in which other taxes on development have floundered; and the requirement for annual instalments of the tax to be paid should speed up the realisation process.

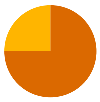
However, a tax of this nature would nevertheless require strong political support if it is to be introduced successfully. In 2008, consultants Oxera were commissioned to produce a report on the taxation of development and one of their key conclusions was: "*unless there is strong* political *will for this tax, there is a significant risk of negative consequences, even if all the detailed issues of practicality are successfully addressed*." The fiscal landscape has changed quite significantly in the intervening years and the path to introducing a tax on development should, in principle, be somewhat smoother, but credible and sustained political support would still be extremely important to the long-term success of this group of reforms, if it were to be introduced.

6.5.4 Evaluation of Group 2

We have evaluated this group of measures using the proposed Principles of Jersey Property Taxation from **Box 10** as criteria with the exception of the principle of consultation which has been omitted for reasons stated above. The table below sets out a qualitative evaluation:

Table 5: Evaluation of Group 2

Principle of Jersey Property Taxation	Performance	Description
Coherence and Certainty		• The implementation of this group of measures could fit within the existing property tax system, expanding the current application of tax on realisation to a wider range of transactions in land and property and establishing the principle of a RRA. Although the RRA would be unfamiliar in Jersey, it would be expected to be a welcome aspect of the reforms. • Basing the treatment of realisations on current market values could provide certainty and allow effective future planning.
Efficiency and Growth		• The taxation of profits arising on the realisation of property held by businesses would represent a tax on business profits which are widely regarded as inefficient but the limitation to super-normal profits should minimise the impact on decision-making. • The taxation of development gains would be economically efficient as it would tax an unearned increment and would incentivise the development of land. • The fiscal space created by this group of measures could be used to make efficiency gains by reducing distortive transaction taxes.
Support for the Competitive Environment		• The taxation of development gains arising on rezoning could create stronger incentives for the development of land, creating opportunities for investors. • The competitive profile of Jersey could be adversely affected by the taxation of profits on realisation. However, this would be limited by the use of an appropriate and internationally relevant RRA.
Fairness		• This group of measures could enhance the perceived fairness of the property tax system by making the tax treatment of realisations of property in the commercial sector more uniform. • As with other taxes on business profits, the financial

Principle of Jersey Property Taxation	Performance	Description
		impact of these measures could be passed onto shareholders and employees through lower dividends and remuneration. However, the impact is likely to be minimal especially if a RRA is introduced.
Fiscal Stability and Sustainability		• This group of measures could strengthen the revenue base. However, the revenue yield would be linked to the dynamics of the property market which could affect the stability of revenues.

6.6 Group 3: Finance

6.6.1 Overview

This group of measures comprises two main elements, the effect of which would be to modernise the treatment of debt finance in the Jersey market for land and property.

The adoption of these measures would:

1. Phase out relief for mortgage interest on domestic properties that are owner-occupied; and

2. Impose a minimum level of taxation on rental income, where the use of debt finance would otherwise reduce it below a pre-set benchmark.

Some or all of these measures could be combined with the measures in Group 1 and/or Group 2.

The objective of such changes would be:

- To remove a distortion in the housing market caused by the rules for the treatment of financing costs for tax purposes;

- To reduce the current bias in favour of owner occupation of the housing stock in a progressive way; and

- To ensure that the existing rules that seek to limit the artificial use of debt finance for the purchase of land and property operate in a transparent manner.

In principle the incidence of these measures could be as follows:

- The level of taxation on some owner-occupiers of domestic property with mortgage finance could increase due to the phased removal of mortgage interest tax relief.

- The tax yield from properties held for rental, especially by international investors, could be protected.

As with the measures in Groups 1 and 2, any proposals in this area should be the subject of wide public consultation.

6.6.2 Mortgage interest tax relief

The current system of mortgage interest tax relief for residential property in Jersey is arguably anomalous in a modern system of taxation as set out below.

The arguments against providing relief for mortgage interest are well-rehearsed in the academic literature. These include the following:

- That it supports artificially high prices for housing that benefit current owners and create unnecessarily high barriers to entry for new buyers.

- That it encourages the use of debt, with potentially negative consequences for financial stability and household finances.

- That it drives a wedge between the costs of owner-occupation and the rental market that primarily disadvantages those on lower incomes and with less capital available to them.

- That it provides the largest benefits to those with the highest debt and the highest incomes.

- That it appears to be positively correlated to greater volatility in the housing market.

The potential disadvantages of providing unlimited tax relief for mortgage interest were recognised in Jersey when legislation was passed to eliminate relief for interest on loans over £300,000.

The Fiscal Strategy Review of 2010 notes:

"Mortgage interest relief provides a subsidy to owner-occupiers who purchase their house with a mortgage. There is little economic justification for such a relief, and worse, its existence is not in keeping with policy to make housing more affordable since the evidence suggests that such tax relief simply gets capitalised into house prices."

At that time, the annual cost of providing the relief was £20 million.

Internationally, the picture is mixed. In spite of the strong economic arguments against deductibility of mortgage interest in the domestic housing market, it has proved to be remarkably resilient in many countries, as shown in **Figure 3**. Its survival often owes more to the political system than to any weakness in the economic rationale for its removal. The level of resistance to any change has occasionally been remarkable, as evidenced by the campaigns mounted by real estate industry groups in response to the Tax Reform Act 1986 which cut the value of housing subsidies in the United States. More recently this has been well-illustrated in Guernsey and it will be important, in making any changes in Jersey, to ensure that there is a full process of consultation during which the issues can be explained and discussed.
One of the key reasons that mortgage interest tax relief has been maintained in a number of jurisdictions is the political attractiveness of providing tax expenditure designed to support owner-occupiers. However, this goes against principles of tenure neutrality in public policy by creating incentives for owner-occupier models of property occupation and consequently distorting the decision making of actors in property markets. Kemeny's (1981) classic formulation of tenure neutrality in public policy states that *"Housing policy should be 'tenure-neutral': that is, the role of governments in housing should be to maximize effective consumer choice by encouraging the development of a wide range of tenures of comparable cost. [...] [Tenure neutrality is] based on the principle that governments should balance subsidies between tenures and maximize comparability between the social-legal status of households in different tenures"*. In this respect, the maintenance of mortgage interest tax relief runs counter to what is considered to be a core principle of housing policy.

A number of jurisdictions have relatively recently implemented measures to limit or remove mortgage interest tax relief. For instance, the relief was abolished in Germany in 1987, in France in 1997 for new homes and 1998 for purchases and improvements and in the UK in 2000. The UK's removal of mortgage interest tax relief provides an interesting example of how it could be carried out in practice. In 1976 the UK started the phased mortgage interest tax relief by reducing the qualifying amount of borrowings to £25,000 (later raised to £30,000), and then in 1991 the relief was limited to the standard rate of tax and was finally abolished in 2000. The UK's mortgage interest tax relief was widely criticised as being regressive, with those owner-occupiers on higher incomes benefiting the most, and it was thought that its removal reduced inequality in post-tax incomes.

The lesson learned from the UK is that the removal of this relief is possible and that it is best achieved over a relatively long period of time. In the UK, this period was arguably much longer than was strictly necessary but nevertheless the strategy ultimately achieved the intended objective with a minimum of taxpayer opposition and no visible impact on the housing market. The case of the UK also illustrates how the removal of mortgage interest tax relief can be conducted in a broadly progressive manner by loading the impacts on higher earners towards the start of the programme of reform.

For the purposes of this group of measures, implementation could be achieved in any one of three ways. Firstly, the maximum size of borrowings qualifying for relief could be gradually reduced over a preannounced number of years. Secondly, the level of interest qualifying for relief could be capped or gradually reduced over a number of years. Thirdly, a combined approach could be taken where both the size of qualifying borrowings and interest are capped or reduced over a number of years. While these three approaches ultimately achieve the same objective, they generate very different consequences.

By capping or reducing the maximum level of interest qualifying for relief the distributional impacts of the policy measure are purely dictated by the changes in interest rates. This could create uncertainty within the tax system as the future fluctuations in interest rates could generate differing levels of impacts on mortgage holders. By contrast, the gradual reduction of the maximum level of qualifying borrowings could generate certainty as to the impacts for mortgage holders because the level of tax relief granted would not be affected by changes in monetary policy. A combined approach could benefit from a limited degree of certainty, but would still be exposed to uncertainty generated by fluctuations in interest rates and would have added complexity.

Given the way in which the initial restriction was introduced in Jersey and the attendant advantages and disadvantages of different approaches, the most appropriate approach would seem to be a phased introduction with a gradual reduction in the scale of borrowings that qualify for relief.

This could:

- Protect existing long-term borrowers.
- Provide stability in market.
- Allow for the development of the Jersey tax system in a predictable way that could maintain confidence.
- Give signals to new buyers and lenders in good time.
- Ensure adequate time for the adaption of systems.

The current low interest rate environment is broadly helpful to starting the process of change at the present time.

The phased removal of this relief could potentially allow principled reform of other aspects of property taxation. For example, the yield from stamp duty on property transactions and the cost of the relief are broadly similar.

In practice, the approach to phasing out mortgage interest relief might involve a reduction by £50,000 every 2 or 3 years, in the maximum size of borrowings qualifying for relief. For a £50,000 loan, that would leave it still qualifying for relief for the next 10 or 15 years, depending on the option chosen. For a maximum qualifying £300,000 mortgage, the impact would be greater sooner. But the effect would be broadly progressive on the assumption that there is a broad correlation between the size of mortgage loans and income. The picture is complicated by the marginal rate system in Jersey so the reduction and eventual elimination of this relief could probably have its biggest impact on those with incomes that are not at the very top of the distribution.

To promote market stability, trust and transparency it could be helpful if the programme was fully announced in advance of the initial implementation.

No changes to the current system of tax relief for interest expense against rental income are proposed as part of this group of measures other than in a situation where there is artificial use of debt.

6.6.3 Rental income and the use of artificial debt

Rental income is subject to tax in Jersey and this Report does not suggest any fundamental changes to that principle but there are situations in which the rental return on a property investment is not, or might not be, taxed as fully as some would argue it should be. In order to provide additional protection against the artificial use of debt in a manner that might compromise the effectiveness of the taxation provisions for rental income, some changes were introduced to the law in 2013.

The second element of this group of measures would aim to ensure the transparency of these provisions.

Jersey has a tradition of simplicity and transparency in the functioning of its tax system and there is an opportunity to strengthen those principles in relation to the operation of the law in this area.

Section 90AE of the Income Tax (Jersey) Law 1961 currently provides as follows:

2A. Where the Comptroller determines that, having regard to all relevant circumstances, including any guarantee or security given, either or both of the following circumstances exist –

(a) the amount of a loan to which Article 90AB applies exceeds the amount which a lender could reasonably be expected to lend to the person by whom the interest is payable on a commercial basis;

(b) the amount of interest which is payable by a person on a loan to which any of Articles 90AB to 90AD applies exceeds the amount which a lender could reasonably be expected to charge such a person on a commercial basis,

the Comptroller shall determine the amount of interest to be eligible for relief, the amount being such as is just and reasonable having regard to all the relevant circumstances.

The powers given to the Comptroller under this legislation are quite broad and they lack some of the certainty of operation that is normally found in Jersey tax law. Uncertainty can be an effective behavioural deterrent to aggressive tax planning and the creation of uncertainty is an underlying, if unspoken, principle of many General Anti-Avoidance Rules. However, there are also many downsides to uncertainty and in this case there is an opportunity to clarify how the Comptroller's power will be used and in what circumstances the effect of the interest deductions will be adjusted.

This element of the group of measures could establish the principle that the use of debt should not normally be allowed to reduce to nil, or close to nil, the taxation payable in respect of rental income on property investment. It could do this through the adoption of a simple test based on gross rental income that could enable the Comptroller to focus attention on potentially abusive situations.

Only rental income from Jersey property would be within the scope of the provisions. The formula could set the expected minimum level of taxable income based on gross rentals. It could be published as a percentage of gross rental income and the approach to setting it could be established through a process of consultation. The rate should reflect a combination of factors, including principally: a limit on the amount of allowable debt finance and the spread between rental yields and commercial interest rates. It could also reflect a notional allowance for repair and maintenance costs. The rate could be confirmed or reset annually. In normal market conditions, the expectation would be that there would be little or no change from year to year.

Taxpayers using debt finance could be required to calculate their taxable profits on property income in accordance with the current Schedule A rules and would then compare the outcome with the result under the formula. This would require only a simple calculation of gross rental income.

To demonstrate how this test could be applied in practice, the table below sets out the comparison that would be made between computations of taxable rental income under current Schedule A guidelines and the test formula. For the purposes of this example the following assumptions have been made:

- The value of the property in question is £10,000,000.
- Gross rental income is 6% of property value per annum (£600,000).

- Debt finance allowed by the Comptroller has been limited to 70% of property value (£7,000,000).
- For the purposes of the test formula the minimum level of taxable rental income has been set at 25% of gross rental income. This has been arrived at by recognising the following additional assumptions, which when deducted from the assumed gross rental income generate a minimum level of taxable rental income equivalent to 25% of gross rental income:
    - An allowance for property maintenance has been set at 1% of property value (£100,000) for the purposes of the test formula.
    - Deductible interest costs have been limited to 5% per annum (£350,000) for the purposes of the test formula.

Table 6: Minimum Level of Tax Test

	Assuming artificial use of debt finance under current Schedule A guidelines (8.57% interest p. a.)	**Application of test under proposed measures (25% of Gross Rental Income)**
Property Value	£10,000,000	£10,000,000
Gross Rental Income (6% p. a.)	£600,000	£600,000
Deduction of Interest Costs	(£599,900)	N/A
Taxable Rental Income	**£100**	**£150,000**

Under the example set out above a taxpayer would be subject to tax on the taxable rental income computed by the test formula as it yields the higher figure and in doing so, has mitigated the effects of the artificial use of debt finance. In practice, the assumptions used by the test formula in arriving at the minimum level of taxable rental income should be the subject of public consultation and periodic review.

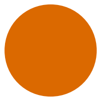
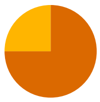
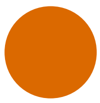
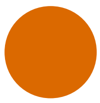
The rules could apply with adjustments where necessary for losses, rent-free periods, periods of non-occupation and lease premiums. The process would identify outliers and allow a focused approach to dealing with any situations where artificial debt was being used. In practice, it should deter only the use of artificially high levels of debt, as the current provisions intend, while providing a level of transparency and certainty in keeping with the high standards of Jersey tax law. For most taxpayers, it would require little additional compliance effort or cost.

6.6.4 Evaluation of Group 3

We have evaluated this group of measures using the proposed Principles of Jersey Property Taxation from **Box 10** as criteria with the exception of the principle of consultation which has been omitted for reasons stated above. The table below sets out a qualitative evaluation:

Table 7: Evaluation of Group 3

Principle of Jersey Property Taxation	**Performance**	**Description**
Coherence and Certainty		• The implementation of this group of measures would be coherent with the current property tax system as it works within the existing framework of taxation, limiting the extent to which legislative amendments are required. • These measures could add certainty and coherence to the current rules for interest deductibility by providing a clear and consistent methodology for the Comptroller to limit

Principle of Jersey Property Taxation	Performance	Description
		the use of artificial debt in property investment.
Efficiency and Growth		• These measures would be economically efficient as they could remove distortions in the property market and volatility in the mortgage market created by the preferential tax treatment of debt. • The fiscal space created by the adoption of these measures could be used to make efficiency gains by reducing distortive transaction taxes.
Support for the Competitive Environment		• This group of measures could adversely affect Jersey's competitive profile, albeit to a limited extent, by reducing the benefit that investors can obtain artificial use of debt finance. • It could also benefit Jersey's competitive profile by providing certainty and transparency to the rules on the Comptroller's limitation of interest deductibility. • The removal of mortgage interest tax relief would not be expected to significantly affect the competitive profile of Jersey.
Fairness		• The phased removal of mortgage interest tax relief should be progressive as it could be assumed that those mortgage holders that could be impacted the most would be those with higher rather than lower levels of income. • This group of measures could limit the extent to which businesses could benefit from the artificial use of debt, thereby improving the fairness of the taxation of business profits.
Fiscal Stability and Sustainability		• Fiscal stability and sustainability could be enhanced by protecting the income tax revenues from the artificial use of debt. • The phased withdrawal of mortgage interest tax relief could have a small negative impact on the cost of living experienced by some households but could also strengthen the economy by removing an incentive for the use of debt.

6.7 Stamp duty

None of the groups of measures outlined above includes an explicit proposal for the abolition of stamp duty. Nevertheless, the literature has little positive to say about this form of transaction tax. It is economically inefficient and creates distortions in the property market. It discourages investment in property and can, albeit to a modest degree in Jersey, adversely affect the mobility of labour.

The strongest points in favour of the retention of stamp duty are that:

- It is an established and accepted tax.
- It is easy to collect and, especially since the introduction of the Land Transaction Tax, compliance rates are high.
- It has a yield of around £14 million from real estate transactions which would otherwise have to be raised in a different way, if current levels of government spending were to be maintained.

However, these points alone do not justify its retention in a broad reform of the taxation of land and property.

The measures set out in Groups 1-3 could create a new framework of taxation that is more principles-based, more balanced and more equitable than the current system and which could allow similar levels of taxation to be raised with less distortion and greater economic efficiency. They could also potentially allow a higher yield to be achieved over a period of years, creating room to phase out over a similar period, less efficient and more distorting taxes. The gradual removal of stamp duty on real estate transactions could reduce the level of taxation on property owners and could generate positive impacts for occupiers of property dependent on the extent to which the incidence of stamp duty is passed through in rents. The positive impacts of the removal of stamp duty could help to offset the anticipated impact of the groups of measures presented above. However, the precise net effect would be dependent on the rates of tax applied. The dynamic interaction of the adopted tax measures would also have to be considered and should be investigated more thoroughly.

The phasing out of stamp duty levied on real estate transactions could be the subject of consultation alongside the other issues. Stamp duty could be phased out over a number of years to coincide with the phased implementation of any of the groups of measures presented above. This could be achieved by either reducing the rates at which stamp duty is levied, by gradually removing bands from the rate structure or by a combination of the two. The measures taken to remove stamp duty could be made broadly progressive if they initially target transactions falling within the lower bands of the rate structure. Additionally, stamp duty on the creation of security interests over Jersey property could be abolished.

7. Summary

As set out in **Section 2**, the purpose of this report was to:

- Review the most recent academic and institutional literature published on the taxation of immovable property and develop a set of guiding principles for the taxation of immovable property in Jersey.
- Identify and analyse a number of property taxes considered and/or implemented in different jurisdictions.
- Develop options for the reform of the taxation of immovable property in Jersey.

In furtherance of these objectives, the following sections present a summary of the most salient point for each objective in turn.

7.1 Theory and practice

To address the objectives of this report, a review of the academic and institutional literature was conducted. Cases of international property taxation were embedded within the review of the literature to highlight how particular approaches have been put into practice. This revealed the following key points:

- **Revenue generation:** Despite widespread implementation, property taxes typically generate modest levels of revenue. Additionally, the level of revenue buoyancy and stability is dependent on the choice of tax base, with property transaction taxes normally exhibiting higher levels of revenue volatility and buoyancy than recurrent property taxes.
- **Economic efficiency:** Property taxes are widely cited as being an economically efficient form of taxation, however this characteristic is not uniform and differs between different forms of property taxation. Recurrent property taxes are held to be more economically efficient than transaction taxes and taxes on residential property are more efficient than taxes on commercial property. In practice, a number of jurisdictions implement a mix of efficient and inefficient property taxes.
- **Equity:** Similarly, property taxes are also widely held as being an equitable form of taxation as it is the common view that property ownership is correlated with wealth. However, the literature has shown that the equity of a property tax is influenced by how it is viewed, with three distinct views of property tax incidence being espoused. The Traditional view of the incidence of property taxes in terms of taxes on land and property, with the former being held as equitable and the latter as inequitable. The New view sees property taxes as capital taxes which, when borne by the owners of capital, are equitable. The Benefit view departs from the previous two views by seeing property taxes as benefit taxes linked to the provision of public services which are inherently fair. In the absence of a consensus in the literature it would appear that the equity of a property tax is purely dependent on the characteristics of the tax itself.
- **Administration:** Property taxes present policymakers with a number of design considerations that contribute to their overall efficiency and equity. Among these considerations are the tax base, the valuation model and the system of reliefs. A number of these design considerations are informed, sometime unduly informed, by the political economy of property taxation, for example the system of reliefs.
- **Political economy:** The taxation of immovable property is a political issue as much as it is an economic one. Just as property taxes are held to be efficient and equitable, they are also viewed as unpopular taxes. Given this, a key determinant to the success of property tax reforms has been shown to be the effort expended to achieve political and social buy-in.

Using these points as a theoretical framework in conjunction with international practice, a set of guiding principles of property taxation was drafted to support the development of the options for reform presented in this report and the development of property tax policy in Jersey. These guiding principles can be found in Box 10 and seek to capture the nuances of property taxation whilst promoting principles of good tax policy.

7.2 Options for reform

Drawing on the preceding sections, specifically utilising the content of the Mirrlees Review as a theoretical framework, three groups of measures for a principles-based reform of the taxation of property in Jersey were developed and discussed at a conceptual level. The three groups of measures are outlined in Table 8 below.

Table 8: Summary of Groups of Measures

Thematic Area	Objective	Key Features	Impact
Group 1: Occupation	• Create a new framework for an annual charge on residential real estate. • Develop a more stable and sustainable revenue stream and a mechanism by which tax revenues can be grown over time.	• Align domestic rates to Mirrlees' concept of a Housing Services Tax levied solely on the occupier. • Transformation of the non-domestic rates to either a land value tax or a tax solely on occupation.	• The tax burden on owner-occupiers and tenants of domestic property could increase. • Owners of rental properties could no longer be taxed. • Modernise the property tax system for the commercial sector and provide a more effective framework for raising additional revenues.
Group 2: Investment returns	• Recognise that property owners can receive windfall gains on the rezoning of property. • Ensure that property owners contribute to the social costs of Jersey. • Promote economically efficient taxation.	• Broaden the taxation of property realisations. • Introduce a concept of a normal Rate of Return Allowance (RRA). • The taxation of accrued development returns arising on rezoning of land.	• The tax burden on owners of rental property could be increased. • Gains arising from the rezoning of land would be taxed more fully.
Group 3: Finance	• Remove distortions in the housing market caused by mortgage interest relief. • Reduce the current bias in favour of owner-occupation of housing. • Ensure the transparent limitation of artificial debt finance.	• Phase out mortgage interest relief on owner-occupied domestic properties. • Impose a minimum level of taxation on rental income where interest deductibility could reduce beyond a predetermined threshold.	• The tax burden on owner-occupiers of domestic property purchased with mortgage finance would be increased. • The tax yield could be protected from exploitation where rental properties are held by international investors.

All of the groups of measures presented above potentially provide fiscal space for the phasing out of Stamp Duty over a period of years to remove the distortions it creates to the Jersey property market.

7.3 The next steps

The overarching objective of this report is to serve as an input to support Treasury and Resources in the development of tax policy. As such, this report has presented a synthesis of the literature on the taxation of immovable property, distilled the policy implications for Jersey and set out three groups of potential reforms to Jersey's property tax system.

In a tax reform process, the starting point and the journey are as important as the destination itself, and timely and transparent communication is essential throughout all stages. The way in which the objective and nature of tax reform is presented is a key determinant of its successful implementation and acceptance from taxpayers and policymakers alike. This is perhaps more true for property taxes than other forms of tax policy due to the considerable political economy issues that tax policy of this nature raises.

The knowledge base and options for reform presented in this report are intended to serve as an input for the discussion as well as a point of reference throughout all stages of the reform process for both the States of Jersey and the Jersey taxpayer community.

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Appendix 1: Current tax treatment of property

A1.1 Introduction

The purpose of this appendix is to set out a high-level summary of the ways in which the purchase or transfer of Jersey real estate and Jersey-source property income is currently taxed in Jersey. This appendix will serve as a basis for comparison between the *status quo* and the three options for reform presented in **Section 6** of this report.

A1.2 Current tax treatment

Under the current tax legislation, tax revenue from Jersey real estate and Jersey-source property income is collected through a number of recurrent and transfer taxes levied on commercial and residential real estate held by business and individuals. These include:

- Income Tax
- Stamp Duty
- Land Transaction Tax
- Goods and Services Tax
- Parish and Island-Wide Rates

Relative to the property tax systems implemented in other jurisdictions Jersey is notable for not taxing property through the following taxes:

- Capital Gains Tax
- Inheritance Tax
- Development Gains Tax

A1.2.1 Income Tax

Income arising from Jersey real estate is subject to tax at a rate of 20% for both businesses and individuals under the Income Tax Law 1961.[4] Schedule A of the Law lists taxable income arising from Jersey real estate as the annual profits or gains arising or accruing:

- In respect of any rents or receipts.
- From the trade, carried on in Jersey, of the disposal, on a commercial basis, of land or any building or structure, or any part thereof, which is situated in Jersey.
- From the trade of the exploitation of land in Jersey by the exploration, excavation, excision, extrication, extirpation, exsiccation, expropriation or extraction or recovery of stone, minerals and other inorganic solid materials.

Article 90AA of the Income Tax Law 1961 permits the deductibility of annual interest costs on loans made to allow the borrower to buy or develop Jersey real estate to be used as their principal private residence. Interest costs on a capital sum of up to £300,000 is deductible, however the capital sum over £300,000 does not qualify for such relief.

Article 90AB of the Income Tax Law 1961 permits the deductibility on annual interest costs on loans made to allow the borrower to buy/develop land for the purpose of letting it out on commercial terms to unconnected persons from the income tax liability generated by the activities prescribed in Schedule A.

[4] Income Tax (Jersey) Law 1961. http://www.jerseylaw.je/Law/display.aspx?url=lawsinforce%2fconsolidated%2f24%2f24.750_IncomeTaxLaw1961_RevisedEdition_1January2014.htm

Under Article 90AE, should the Comptroller determine that either or both the amount of a loan or the amount of interest exceeds the amount which could reasonably be expected on a commercial basis, the Comptroller shall limit the amount of interest deductible for the purposes outlined in Article 90AB to that which is just and reasonable having regard to all the relevant circumstances.

A1.2.2 Stamp Duty

Under the Stamp Duties and Fees Law 1998,[5] stamp duty is charged on the freehold purchase and transfer, including where it is transferred through a will, of Jersey real estate and the creation of a security interest over Jersey real estate.

Stamp duty on the purchase or transfer of Jersey real estate is payable at the following rates:

Table A9: Stamp Duty on Freehold Purchase or Transfer of Jersey Real Estate

Property Value	Stamp Duty Payable
Up to £50,000	£0.50 for each £100 or part of £100 with a minimum fee of £10
£50,000 - £300,000	£250 in respect of the first £50,000 plus £1.50 for each £100 or part of £100 in excess thereof
£300,000 - £500,000	£4,000 in respect of the first £300,000, plus £2.00 for each £100 or part of £100 in excess thereof
£500,000 - £700,000	£8,000 in respect of the first £500,000, plus £2.50 for each £100 or part of £100 in excess thereof
£700,000 - £1,000,000	£13,000 in respect of the first £700,000, plus £3 for each £100 in excess thereof
£1,000,000 - £1,500,000	£22,000 in respect of the first £1,000,000, plus £3.50 for each £100 in excess thereof
£1,500,000 - £2,000,000	£39,500 in respect of the first £1,500,000, plus £4.00 for each £100 in excess thereof
Over £2,000,000	£59,500 in respect of the first £2,000,000, plus £5.00 for each £100 in excess thereof

Stamp duty on the transfer of Jersey real estate in a will is payable at the following rates in addition to a £150 administrative fee:

Table A10: Stamp Duty on Transfer of Jersey Real Estate in a Will

Property Value	Stamp Duty Payable
Value does not exceed £50,000	£0.50 for each £100 or part of £100, with a minimum fee of £12.00
£50,000 to £300,000	£250 for the first £50,000, plus £1.50 for each £100 or part of £100 in excess thereof.
£300,000 to £500,000	£4,000 in respect of the first £300,000 plus £2 for each £100 or part of £100 in excess thereof.

5 Stamp Duties and Fees (Jersey) Law 1998.
http://www.jerseylaw.je/Law/display.aspx?url=lawsinforce%2fconsolidated%2f24%2f24.960_StampDutiesandFeesLaw1998_RevisedEdition_1January2014.htm

Property Value	Stamp Duty Payable
£500,000 to £700,000	£8,000 in respect of the first £500,000 plus £2.50 for each £100 or part of £100 in excess thereof.
£700,000 - £1,000,000	£13,000 in respect of the first £700,000, plus £3 for each £100 in excess thereof
£1,000,000 - £1,500,000	£22,000 in respect of the first £1,000,000, plus £3.50 for each £100 in excess thereof
£1,500,000 - £2,000,000	£39,500 in respect of the first £1,500,000, plus £4.00 for each £100 in excess thereof
Over £2,000,000	£59,500 in respect of the first £2,000,000, plus £5.00 for each £100 in excess thereof

Stamp duty on the creation of a security interest over Jersey real estate is payable at the following rates in addition to a £50 administrative fee:

Table A11: Stamp Duty on Creation of a Security Interest over Jersey Real Estate

Debt Value	Stamp Duty Payable
Up to £300,000	Nil
£300,000 - £450,000 for those debts falling due before 1st January 2015 or £400,000 for those debts falling due after 1st January 2015	Nil in respect of the first £300,000, plus £0.25 for each £100 in excess thereof, with a minimum fee of £25.00

The Stamp Duties and Fees Law 1998 provides for the following reliefs:

- Purchase of, and creation of a security interest over, Jersey real estate by first-time buyers, subject to a property value cap of £450,000 until 31st December 2014.
- Reregistration of Jersey real estate held by married and co-habiting couples.
- Changing mortgage providers.
- Purchase or transfer of Jersey real estate by charities.

A1.2.3 Land Transaction Tax

Under Article 3 of the Land Transaction Law 2009[6] a Land Transaction Tax (LTT) is levied on the following taxable transactions:

- The purchase or transfer of shares in companies to a person, the ownership of which confers a right to the occupation of land in Jersey.
- The purchase or transfer of shares in companies to be held on trust for the benefit of a person, the ownership of which confers a right to the occupation of land in Jersey.
- The creation of a security interest, pursuant to a security agreement, in any share in a company, the ownership of which confers a right to the occupation of land in Jersey.

[6] Taxation (Land Transactions) (Jersey) Law 2009. http://www.jerseylaw.je/Law/display.aspx?url=lawsinforce%2fconsolidated%2f24%2f24.980_Taxation(LandTransactions)Law2009_RevisedEdition_2January2014.htm

The LTT is levied at a rate that would be equal to the Stamp Duty that would have been suffered if the rights to the occupation of land in Jersey were obtained through direct means.

A1.2.4 Goods and Services Tax

Under the Goods and Services Tax Law 2007,[7] a number of supplies of goods and services in relation to Jersey real estate are considered to be taxable supplies. The table below sets out the good or service related to Jersey real estate and their corresponding rate of Goods and Services Tax (GST).

Table A12: Taxable Supplies of Goods and Services Related to Jersey Real Estate

Taxable Good or Service	Rate of GST
Financial services	Exempt
Insurance	Exempt
Transfer of property through shares	Exempt
Supply (freehold and leasehold) of residential real estate	Zero-rated
Supply of land for the purposes of constructing residential real estate (lease terms over 9 years)	Zero-rated
Supply of building materials	Zero-rated
Renovation of residential real estate	Zero-rated
Supply of imported goods or services	5%
Supply (freehold and leasehold) of commercial real estate	5%
Supply of land for the purposes of constructing commercial real estate (lease terms over 9 years)	5%
Renovation of commercial real estate	5%
Disposals of real estate constituting a trade	5%

The GST charged on the supply of goods and services related to the construction of a dwelling, other than in the furtherance of any business, is refundable by the Comptroller under Article 51 of the Goods and Services Tax Law 2007.

International Service Entities (ISEs) are exempt from GST in that they cannot charge, or be charged GST on supplies of goods and services under Article 57 of the Goods and Services Tax Law 2007.

The registration threshold for GST is £300,000 of taxable supplies in the previous 12 months, or the next 12 months.

A1.2.5 Parish and Island-Wide Rates

Under the Rates Law 2005[8] Parish Rates and Island-Wide Rates (IWR) are levied on a calendar year basis on the rateable value of commercial and residential Jersey real estate owned or occupied by businesses or individuals.

[7] Goods and Services Tax (Jersey) Law 2007. http://www.jerseylaw.je/Law/display.aspx?url=lawsinforce%2fconsolidated%2f24%2f24.700_GoodsandServicesTaxLaw2007_RevisedEdition_1January2014.htm

[8] Rates (Jersey) Law 2005.

The rateable value of Jersey real estate is computed based on rental values from 2003 adjusted for changes in property attributes using the information contained in annual returns made by the owners to the administering parish. The Parish Rates and IWR system makes the distinction between ownership and occupation of Jersey real estate, levying different rates on each activity, making owner-occupiers of Jersey real estate liable to both owner and occupier rates. Additionally, IWR make the distinction between property use, levying different rates for domestic and non-domestic property. The rateable value is computed as 1 quarter for every unit of rateable value for each of the *foncier* (owner) and occupier.

Parish rates for each of Jersey's twelve parishes are set by the Parish Assembly in relation to the budgetary needs of each parish. IWR are set by the Supervisory Committee and are applied uniformly throughout the twelve parishes. The Parish Rates and IWR for 2013 are shown in the tables below.

Table A13: Parish Rates 2013

Parish Name	Owner Rates (pence per quarter)	Occupier Rates (pence per quarter)
Saint Brelade	0.90	0.90
Saint Clement	0.88	0.88
Grouville	0.71	0.71
Saint Helier	1.13	1.13
Saint John	1.00	1.00
Saint Lawrence	0.81	0.81
Saint Martin	1.12	1.12
Saint Mary	1.10	1.10
Saint Ouen	1.30	1.30
Saint Peter	1.10	1.10
Saint Saviour	1.00	1.00
Trinity	1.15	1.15

Table A14: Island-Wide Rates 2013

Type of Property	Owner Rates (pence per quarter)	Occupier Rates (pence per quarter)
Domestic	0.69	0.69
Non-Domestic	1.21	1.21

Under Article 17 of the Rates Law 2005 the following real estate is exempt from owner rates:

- Real estate owned by religious organisations.
- Real estate owned by Her Majesty.
- Real estate owned by Her Majesty's Government and used exclusively in Her Majesty's service.
- Real estate owned by any public or parochial authority and used exclusively for public or parochial purposes.

http://www.jerseylaw.je/Law/display.aspx?url=lawsinforce%2fconsolidated%2f24%2f24.950_RatesLaw2005_RevisedEdition_1January2011.htm

- Real estate used by the Minister for Education, Sport and Culture predominantly for the purposes of its undertaking.
- Real estate owned by the Don Baudains.

Under Article 18 of the Rates Law 2005 the following real estate is exempt from occupier rates:

- Real estate occupied by religious organisations.
- Real estate occupied by Her Majesty or by any department of Her Majesty's Government and used exclusively in Her Majesty's service.
- Real estate occupied by any public or parochial authority and used exclusively for public or parochial purposes, but excluding real estate in the occupation of any employee of any such authority.

Appendix 2: Cross-country tax regimes

A2.1 UK Stamp Duty Land Tax

Table A15: Stamp Duty Land Tax Residential Rates 2014/15

Purchase price/lease premium or transfer value	*SDLT Rate*
Up to £125,000	0%
Over £125,000 to £250,000	1%
Over £250,000 to £500,000	3%
Over £500,000 to £1,000,000	4%
Over £1,000,000 to £2,000,000	5%
Over £2,000,000	7%
Over £2,000,000 (purchased by corporate bodies)	15%

Source: HMRC, 2014

Table A16: Stamp Duty Land Tax Non-Residential and Mixed Use Rates 2014/15

Purchase price/lease premium or transfer value	*SDLT Rate*
Up to £150,000 –annual rent is under £1,000	0%
Up to £150,000 – annual rent is £1,000 or more	1%
Over 150,000 to £250,000	1%
Over £250,000 to £500,000	3%
Over £500,000	4%

Source: HMRC, 2014

A2.2 Irish Local Property Tax

Table A17: Local Property Tax Rates 2014

Valuation band (€)	*Mid-Point*	*Rate*	*LPT Liability(€)*
0 – 100,000	50,000	0.18%	90
100,001 – 150,000	125,000	0.18%	225
150,001 – 200,000	175,000	0.18%	315
200,001 – 250,000	225,000	0.18%	405
250,001 – 300,000	275,000	0.18%	495
300,001 – 350,000	325,000	0.18%	585
350,001 – 400,000	375,000	0.18%	675
400,001 – 450,000	425,000	0.18%	765
450,001 – 500,000	475,000	0.18%	855
500,001 – 550,000	525,000	0.18%	945
550,001 – 600,000	575,000	0.18%	1,035
600,001 – 650,000	625,000	0.18%	1,125
650,001- 700,000	675,000	0.18%	1,215
700,001 – 750,000	725,000	0.18%	1,305
750,001 – 800,000	775,000	0.18%	1,395
800,001 – 850,000	825,000	0.18%	1,485
850,001 – 900,000	875,000	0.18%	1,575
900,001 – 950,000	925,000	0.18%	1,665
950,001 – 1,000,000	975,000	0.18%	1,755

Properties worth more than €1 million will be assessed on the actual value at 0.18% on the first €1 million and 0.25% thereafter.

Source: Revenue, 2014

A2.3 Australian Property Tax System

Table A18: Stamp Duty and Land Tax Implementation and Differences

State	Stamp Duty		Land Tax	
	Implemented	Key Differences	Implemented	Key Differences
Australian Capital Territory	Yes	Not levied of mortgages	Yes	Applicable to all residential properties rented or owned by a trust or corporation
New South Wales	Yes	Not levied on leases and home loans to natural persons	Yes	No differences
Northern Territory	Yes	Not levied of mortgages and leases	No	N/A
Queensland	Yes	Not levied on leases	Yes	No differences
South Australia	Yes	Not levied of mortgages and leases	Yes	No differences
Tasmania	Yes	Not levied of mortgages and leases	Yes	No differences
Victoria	Yes	Not levied of mortgages and certain leases	Yes	No differences
Western Australia	Yes	Not levied of mortgages and leases	Yes	No differences

Source: Australian Taxation Office, 2014

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Terms of reference

PricewaterhouseCoopers LLP ("PwC") has been commissioned by Treasury and Resources of the States of Jersey to produce a report that reviews the literature on property taxes, reviews several historical and contemporary property taxes, develops a set of guiding principles for property tax policy in Jersey and develops three policy options for the reform of Jersey's property tax system.

This document has been prepared only for Treasury and Resources and solely for the purpose and on the terms agreed with Treasury and Resources under the terms of our engagement letter dated 15th April 2014.

Whilst Treasury and Resources commissioned and financed the work, and commented on our draft reports, the final reports represent the independent analysis of PwC. We accept no liability (including for negligence) to anyone else in connection with this document, and it may not be provided to anyone else.

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