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# Reform of Property Tax Is Unnecessarily Complicated

Following lengthy negotiations, the federal and state governments in Germany have agreed to a reform of property tax, and the Bundestag has now enacted the reform. The debate centered on two concepts: an area-based tax and a value-based one. In the end, it was agreed to use value as the basis for measurement.

It was also decided, however, that taxpayers should be spared the trouble and expense of getting their property valued individually. Furthermore, there is a so called opening clause, which allows the Länder to deviate from the national tax base. This solution is a good compromise. Nevertheless, the reform is ultimately unconvincing. The new property tax is unnecessarily complicated and torpedoed key aims of value-based taxation. However, it is misguided to criticize as harmful the opening clause in the reform that permits different property tax bases in the individual Länder. On the contrary, it provides an opportunity to rectify the reform's weaknesses.

## Flawed in the Detail

Why is the new property tax unnecessarily complicated? Complexity in the tax system can be justified when it achieves greater fairness for individual cases. However, that does not pertain here. For each building, a value is calculated for its remaining useful life, on the basis of the lease. During this period, it is assumed that the land value forms part of the lease. For the period thereafter, only the discounted land value is counted. The longer the building's useful life, the greater the discount and the less influence land value has on the amount of the property tax. To determine the land value, average regional land values based on observed transactions are applied. Their suitability is disputed, but they are easily available.

The problem now consists in determining the value of the building during its useful life. In spite of the generalized approach, the calculation still manages to be complicated. A distinction is drawn between property types, build year and living area categories, and types of municipality. The most startling aspect of the whole process is that it makes no difference whether a building is situated in a central or desirable location or on the outskirts of a city. And yet the advocates of a value-based property tax wanted precisely to ensure within municipalities that the tax burden on expensive properties was increased and the tax burden on less valuable properties in poorer locations was reduced. The new property tax can hardly be said to achieve this. Although the standard land values tend to serve this purpose, they play only a subordinate role on account of the long useful life of buildings.

## Greater Fairness through New Valuation?

The proposition that a property tax based on property values is fairer than an area-based tax is in any event disputed. Property tax is an 'object tax' for which the ability to pay of the users of the property is irrelevant. At most, there is a statistical correlation between the value of a property per square meter and the average income of the user. Whether that suffices to justify the considerable time and expense involved in property valuations is the subject of debate. What certainly cannot be justified, however, is a generalized but nevertheless costly and time-consuming valuation process that largely disregards the most important reason for differences in market value: whether a location is central or peripheral within a city.

The planned property tax valuation leads to a sort of pseudo-fairness in the distribution of the tax burden, one that has precious little in common with taxing according to actual value. It would be more convincing to choose a direct combination of standard land values and floor area as the basis for measurement, as recently proposed by the Scientific Advisory Board at the German Federal Ministry of Finance. The decisive factor for value differences between real estate would be taken into account, and the tax would be much simpler.

## Opening Clause Provides Opportunity

Much less persuasive, however, is the criticism frequently leveled at the opening clause for the Länder. The charge that the move could prompt unwanted tax competition is unwarranted by virtue of the fact that the assessment rate is in any case set at the municipal level. But the opening clause has a big advantage. Some states will opt for an area-based tax or for a combination of standard land values and building area as the basis for measurement. Practical experience can then show which model works better. All states have the opportunity to circumvent the problems of the property valuation now enshrined in law, by choosing a different basis for measurement. The ability to learn from different solutions is an advantage of federalism that is used all too infrequently.

**Clemens Fuest**  
Professor of Public Economics and Finance  
President of the ifo Institute

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