

No. 195

Germany Should Adopt an Area-Based Property Tax*

Germany's Constitutional Court has declared the current property tax as unconstitutional because it is based on property values that are decades old, ultimately resulting in an arbitrary distribution of the tax burden among taxpayers. The Court explained that a property tax does not necessarily need to be based on real estate values. If, however, the tax is based on the value of plots and houses, sufficiently up-to-date values need to be used, and changes over time need to be taken into account.

Most political parties in Germany do not want to abolish the property tax. They would like to reform it in a revenue-neutral way. The crucial question is whether the future tax will be based on current real estate values, or on other determinants like, for instance, plot size or living space area. The majority of German state finance ministers want to switch to a tax based on current real estate prices. That is a bad idea. There are a number of reasons why it would be better to adopt a tax based on plot sizes and living space.

It is often argued that using real estate values as a basis for property tax is a way of equitably distributing the tax burden. That is a flawed argument. The property tax is a purely non-personal tax that does not take into account individual taxpayers' ability to pay. In the case of rental properties, the property tax is passed onto tenants as part of the additional costs charged anyhow, and it makes no difference whether the tenants are high or low earners. As for owner-occupied houses, they can belong to a largely impoverished widow or a multi-millionaire, the property tax will still be the same, regardless of whether it is based on the property in question's market value; or on the total living space area that it offers. Like value added tax or fuel tax, the very structure of property tax means that its goal is not to burden taxpayers according to their ability to pay.

Another common justification for the property tax is that it is a form of payment for municipal services. It can be interpreted as such, although cities already levy charges and dues for services like waste disposal, sewage, as well as development contributions. This does not mean, however, that the amount of property tax due should depend on a property's value. The costs of municipal services often tend to depend on the plot size of a property or the number of persons residing in a house. The plot value is not the deciding factor.

If there is no convincing justification for assessing property tax based on real estate prices, it is worth asking what kind of tax basis would make sense for simplicity's sake and to avoid unnecessary administration costs. From this point of view a property tax based on market values scores poorly. Market values would have to be regularly determined for a total of around 35 million properties in

Germany. Even if generalised procedures for value determination were to be followed, this would involve a huge amount of effort. Tax revenues of 14 billion euros per year from around 35 million plots mean that annual taxes of around 400 euros per plot are levied. The effort involved in valuing all plots individually, including the buildings on them, would be huge, even if a generalised procedure for value determination were to be applied such as, for example, a so-called cost value geared towards the building costs of a property. Experts expect that it would take a decade to complete the first valuation process. This makes the 2024 deadline set by Germany's Constitutional Court look unrealistic.

This is why the basis for assessing the property tax should be easier to determine. A combination of plot size, living space and usable area would form an appropriate basis for the tax. It would only need to be established once for each property, with adjustments to account for structural changes. Billions of euros in valuation costs could be saved in this manner and endless disputes over the correct amount of taxes to be paid could be avoided.

There may be two reasons why some politicians nevertheless want a property tax based on market prices. Firstly, such a tax would probably mean that economically strong German states with high real estate prices would have to pay more into the German Länder fiscal equalisation scheme. Recipient states would stand to benefit from such a tax, while Bavaria and Baden-Württemberg would be the losers. Determining tax values for real estate may also prove a stepping stone on the way to a general net wealth tax. These are not intended effects of the property tax reform.

* Published in German under the title "Willkürliche Lastenverteilung", *Handelsblatt*, 11 April 2018, p. 48.