

Property Taxation – Value Banding

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ABSTRACT

Following the dramatic failure of the British Poll Tax (or Community Charge) to resolve the long-standing problems with the rating system, the government introduced a hybrid property and people tax system. This paper describes the British residential Council Tax system which is a unique local authority property tax based on banded property values.

All residential properties in England, Scotland and Wales are allocated to one of eight value bands, as at 1 April 1991, on the assumption that their values, and therefore the tax liability of their occupiers, would shift uniformly over time. Central government controls the relative tax liability within the bands and has, until recently, limited the level of tax which local authorities can levy. There is an assumption within the tax system that all dwellings are occupied by two or more adults and, where this is not the case, a 25% rebate is automatically given.

The paper reports on recent research which demonstrates the advantages and limitations of such a property tax system, including the flaw in the assumption that property values shift uniformly over time and the problems inherent in the lowest and highest value bands. The regressivity of this banded system and the possible remedies to minimise its impact on occupiers of the lowest value properties are also demonstrated. Issues of equity, fairness and local democratic accountability will also be discussed.

The paper includes an argument for developing a banded system as a tax base for countries with a limited property market and/or limited resources. In effect, such a banded approach, properly constituted, could well have potential application in developing countries and those 'transitional' countries of Central and Eastern Europe

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1. INTRODUCTION

This paper reports on the outcome of research into a unique system of valuing property for landed property taxes which was introduced into England, Scotland and Wales in the early 1990s (Northern Ireland was excluded from this legislation). Despite the complex, active and open property market and the tradition of using an *ad valorem* tax base in the UK, the British government decided to replace the discredited Community Charge (or Poll Tax) with a system of banded property values as a basis for taxing residential property.

This paper describes the British residential Council Tax system which is a unique local authority property tax based on banded property values and reports on recent research which demonstrates the advantages and limitations of such a property tax system. The regressivity of this banded system and the possible remedies to minimise its impact on occupiers of the lowest value properties is also demonstrated. Issues of equity, fairness and local democratic accountability is also discussed. The paper includes an argument for developing a banded system as a tax base for countries with a limited property market.

2. THE BRITISH COUNCIL TAX SYSTEM

Council Tax was introduced in 1993 as a matter of urgency to replace the Community Charge (or Poll Tax) which had resulted in civil unrest in Britain (England, Scotland and Wales) since it was imposed in 1990. With the British 400 year old tradition of paying for local authorities' services with a local tax based on annual value, some kind of property capital value-based tax was perceived as socially-acceptable. In fact, the Council Tax is a hybrid tax, half of the bill being based on the (banded) value of the property (Plimmer *et al.* 1998).

2.1 Personal Element

An inheritance from its poll tax predecessor, the Council Tax comprises a “personal element”, being fifty per cent of the bill, which assumes that there are two taxable adults resident. Where more than two taxable adults are resident, no additional tax is payable. Where there are less than two taxable adults resident, a relief of half of the personal element is permitted, effectively the bill is reduced by 25%. Certain adults are “disregarded” for the purposes of assessing the Council Tax, and these include students.

While this paper and the research is concerned solely with property-related issues, it must be pointed out that this system of reducing the tax bill where only one taxable adult is resident does financially reward the under-utilisation of residential property. In a country with a chronic housing problem, this is indefensible.

Because of the combined personal and property elements, the Council Tax is also a tax on owners of “second” or “holiday” homes. However, such taxpayers pay only the property element of the tax i.e. 50% of the normal amount paid, and this again rewards the underuse of scarce resources.

2.2 Property Element

Briefly, all residential property in Britain (excluding Northern Ireland) were allocated to one of eight value bands according to their values as at 1 April 1991. There are different value bands for England, Scotland and Wales, depending on the average value of typical properties in these countries. In fact, there is one set of value bands applied to England and Scotland and another applied to Wales. Table 1 demonstrates the value bands applied to England.

Table 1 – Value Bands applied to England.

Valuation Band	Range of Values
Band A	Not exceeding £40,000
Band B	Exceeding £40,000 but not exceeding £52,000
Band C	Exceeding £52,000 but not exceeding £68,000
Band D	Exceeding £68,000 but not exceeding £88,000
Band E	Exceeding £88,000 but not exceeding £120,000
Band F	Exceeding £120,000 but not exceeding £160,000
Band G	Exceeding £160,000 but not exceeding £320,000
Band H	Exceeding £320,000

The Council Tax is a local tax, in that the level of the tax is fixed by municipalities and the revenue is raised and spent by the local authorities on services provided within the local area. However, in order to (apparently) protect the taxpayer from excessive liability, central government imposes relative tax burdens on the different bands. Thus, Band D is the so-called “average” tax band and legislation ensures that properties in Band A (the lowest tax band) are charged only two thirds (6/9) the level of tax for Band D. Similarly, properties in Band H (the highest tax band) are charged twice (18/9) the level of tax for Band D. The relative tax levels for the Council Tax are shown in Table 2.

Table 2: Relative Liability between bands

Band A	Band B	Band C	Band D	Band E	Band F	Band G	Band H
6	7	8	9	11	13	15	18

Since 2000, central government has suspended its powers to “cap” the level of spending (effectively limiting the amount of Council Tax) which local authorities can undertake, but has stated that, if excessive levels of Council Tax are levied, “capping” will be reintroduced. Thus, there is only a limited amount of democratic accountability permitted by central government between the Council Tax payers and their local authorities.

The allocation of residential property into one of eight value bands (rather than providing an *ad valorem* tax base) enabled the British government to replace a highly unpopular taxation system within a matter of months. The importance of speed in the introduction of the Council Tax cannot be underestimated. However, the tax was introduced eight years ago and there is no indication that any major reforms are in hand. Indeed, the only sign of any change at all, is the vague intention to re-band the properties to provide a new tax base which will take effect from 2006, at which point, the tax base will have lasted for 15 years. Despite the importance of regular and frequent revaluations for the credibility of a tax and to ensure both vertical and horizontal equity (Plimmer *et al.* 2000), the British taxpayers seem content with the Council Tax (although professional commentators have not been similarly satisfied (e.g. Plimmer, 2000)). So, what are the advantages and disadvantages of the Council Tax?

3. ADVANTAGES AND DISADVANTAGES OF A BANDED SYSTEM

There are some inherent advantages within the principles of a banded system of landed property taxation as compared to the alternative of assessing discrete figures for each property. The urgency which underlay the introduction of the Council Tax in Britain was a clear reason for not undertaking the more complex task of producing an *ad valorem* tax base. However, there are other advantages, some of which were previewed at the time the tax was introduced, others appeared or have been speculated about since.

1. It is a system which can be introduced more quickly than an *ad valorem* tax base, when timing is important, as with the required rapid imposition of the Council Tax. This was one of the stated objectives (HMSO, 1991) in introducing the banded system in 1991 and, indeed, the speed with which the tax base was produced was impressive.
2. It is a cheaper process, when costing is important, which was clearly a determining factor in the selected operation of the Council Tax as a solution to domestic rating problems (HMSO, 1991). It must be recognised that the Community Charge (or Poll Tax) which was replaced by the Council Tax had been an extremely expensive fiasco. While speed of replacement was more important than cost of implementation, a cheap solution to the problem clearly had advantages for the then British government.
3. Banding makes the valuation task easier, because no discrete valuation is required and banding can therefore be undertaken by less qualified staff, as indeed was the case in 1991-2 when the tax base was created. It also permitted “valuations” to be undertaken by external inspection only.
4. Banding is a robust system which can be capable of containing value movements within its broad framework and therefore extending the useful life of the initial Council Tax bands. However, there must be a balance between vertical equity (occupiers of properties of different values paying different levels of tax) and the extent to which value movements can be accommodated within bands. The British government at the time of the introduction of the banded system predicted that banding would obviate the need for frequent revaluations. Indeed, it was only in 2001 that it recognised that a revaluation (or rebanding) of the tax base should be undertaken. The assumption was that the values of

properties would increase uniformly over time and therefore that all properties would shift upwards through the value bands. This has not proved to be the case, and research (Plimmer, 2000; Plimmer, *et al.* 2001) has demonstrated that the failure to revalue or to reband the tax base has greatly increased the regressivity of the tax.

5. The volume of appeal challenges from Council Taxpayers is reduced because banding affords a less precise area of valuation dispute. This has important resource implications for the organisations responsible for valuations and appeals, leaving more time to be spent on other issues and also, in theory at least, providing more time to devote to more frequent and regular revaluations.
6. The banded approach is to a large extent flexible in two respects firstly, the number and width of the bands can be altered relatively easily; and secondly, the relationship in respect to tax paid can be changed by altering the relative weights between the bands. Thus, it is entirely possible to establish a system of banding which reflects the nature and spread of the property market in any jurisdiction (lots of narrow value bands or a few wide value bands) and to provide an element of tax relief (or tax penalty) to properties within certain value ranges.
7. Banding is a system which can be varied between different regions or jurisdictions, thus allowing for a separate geographical taxation effect, as appropriate.
8. As a system, banding is simple to understand. However, there are complexities within the Council Tax which it seems unlikely that the British taxpayer has fully appreciated (e.g. the relative liability imposed on different bands and the Personal Element). Nevertheless, the advantage of simplicity should not be overlooked.
9. When banding was introduced in Britain, it was accompanied by a process of competitive tendering using the expertise of the private sector in the production of the tax base. Thus, the Valuation Office Agency provided the quality assurance in the banding process, while undertaking only a portion of the work itself.

One of the characteristics of Council Tax which may be surprising is the high level of public acceptance it has received from the British taxpayer. In the light of the results of earlier investigation into UK local property taxes (HMSO, 1976), there must be a suspicion that this level of acceptance has something to do with the high level of ignorance surrounding the details of the tax. Nevertheless, collection rates generally exceed 98% and there is little, if any, criticism of the tax in the popular press.

Despite this, it is recognised that banding, or perhaps more exactly, the way banding has been introduced in Britain, has certain disadvantages.

1. The loss of horizontal and vertical equity. Regardless of the number and breadth of bands, no system of banded values will produce the degree of vertical and horizontal equity achieved by an *ad valorem* system of land taxation. It may be that administrations are prepared to sacrifice such precision for the advantages of banding, but there must come a

point at which the width of a few bands seriously jeopardises the credibility of a system which purports to be based (at least to some extent) on landed property values. In the British system, for example, at the highest band, properties above £320,000 can be liable for the same level of tax as properties worth over ten times that value.

2. Fixed relativities between value bands. The British government has imposed different ratios of tax burden on properties in the different bands (refer Table 2). Thus, the Council Tax is manifestly not a proportional tax which would increase as a continuous linear function of a dwelling's market value. Band D was taken as the 'base band', and relativities distributed according to a centrally imposed ratio. Thus, properties in Band A, attract only two thirds of the tax bill of Band D properties and properties in Band H attract double the level of tax of Band D properties. Thus, the tax is structured to ensure that those properties in the lower value bands attract a higher proportion of the level of tax than those properties in the higher value bands. This, it can be argued, ensures the regressivity of the tax and is a device which can equally be amended to minimise regressivity, with political will.

Criticisms from informed commentators on the implementation of the tax focus on the absence of revaluation and the limitations of the existing band structure. This was part of the response from the Institute of Revenues, Rating and Valuation (IRRV) to the government's 1997/98 consultation document:

"Splitting Band A into two or more bands would have the potential to reduce the Council Tax bills of those living in the properties with the lowest values. There is a strong positive correlation between residency in the lowest council tax band and receipt of council tax benefit. As a result, splitting Band A would be very likely to reduce the total cost of council tax benefit, which is currently borne by the Exchequer.

"There is also merit in altering the ratios of taxes paid by taxpayers in different bands. Currently, a taxpayer in a Band H property pays three times the level of Council Tax paid by a resident in a Band A property, yet their property is worth at least eight times as much." (IRRV, 1998).

The Royal Institution of Chartered Surveyors (RICS, 1998) took the view that the banding exercise carried out when the Council Tax was introduced is now becoming tainted with inaccuracy due to the increasing value of certain types of residential accommodation when compared with others in the same geographical locus and, in some cases, a general reduction in value of other types of accommodation often due to economic influences. It also called for a revaluation or rebanding, commenting that ten years is a very long time in any market, and especially so in the volatile and reactive residential housing market.

Thus, initial allocations for banding now have reached a questionable "sell by date" and the arguments for an *ad valorem* revaluation or at least a rebanding are looming large. Despite promising a rebanding for 2006, there is no indication as to the form such a rebanding will take – whether it will involve reallocating all properties to the same value band structure, or to a set of more numerous but narrower bands; and no indication about the relative weighting between the bands has been given.

Perhaps the real problem with the banded system in the UK is that there really is no need to band property values. On the contrary, there is a tradition in the UK of discrete valuations and the expertise to undertake the work. The UK has a complex, active and (relatively) open residential property market and a large number of competent property valuers (or appraisers). There is, therefore, a talented and experienced UK valuation (or appraisal) profession to undertake the task of producing *ad valorem* property values on which a local property tax could be levied. There is a sophisticated property-owning taxpayer community well capable of understanding a discrete *ad valorem* tax base and numerous other regimes have demonstrated that computer-based systems of mass appraisal can undertake rolling revaluations at regular and frequent (three yearly or annual) intervals (McCluskey, 1997).

Banding, by its very nature, sacrifices both horizontal and vertical equity – the vital principles which mean that everyone in the same financial situation pays the same amount of tax and those in different financial situations pay different amounts of tax (usually proportionate). The current system of banding (together with the artificially-imposed relativities of the tax burden between bands) has scant recognition of these two principles. It is curious, therefore, that the tax appears to be highly acceptable to the taxpaying community.

3.1 Potential Remedies

For the British system, horizontal and vertical equity would be reintroduced by a discrete *ad valorem* tax base. However, if banding is to remain, then more and narrower tax bands are necessary. This would continue the advantages of a banded system, while improving both the horizontal and the vertical equity of the liability.

It is also important to eliminate (or at least reduce) the regressivity of the tax at the lower value end of the scale, and to ensure a greater tax burden is borne by those who can most afford it. Thus, if the relativities of the tax are to continue to be imposed artificially, then more tax should be taken from those who occupy property in the highest value bands. This demonstrates the potential flexibility of the banding system. It should also be remembered that different value bands can be introduced in different jurisdictions which permits a greater degree of flexibility to, perhaps, encourage urban regeneration or restrict development.

However, we believe that it is important to recognise the sophistication within property appraisal techniques and the expectations of British taxpayers and take advantage of the available modern technology of mass appraisal, which is well-established in other parts of the world. This could entail a discrete valuation process, easily subsumable into a wider range of band allocations, with the added opportunity of frequent updating at minimised cost and effort. Vertical equity also demands a greater link between relative banded values and the level of tax imposed on those bands in order to reduce the currently high level of regressivity.

4. OPPORTUNITIES FOR BANDED SYSTEMS

This paper has reviewed the British system of taxing banded property values and speculated on how the existing system could be reformed to improve the degree of horizontal and vertical equity currently enjoyed by British Council Tax payers. Nevertheless, this is a unique

system of taxing property and it must be important to consider the advantages (and the disadvantages) which banding could offer other countries where the issues differ from those in the Britain.

In the experience of the authors, the banded residential property tax as used in Britain is unique within the field of value-based property tax systems. This part of the Paper considers the strengths of such a system and highlights its potential for greater international use, particularly for developing and transitional countries. It is considered that a banded property tax would be a useful interim measure for those transitional countries who have decided to move to a discrete *ad valorem* approach but where the infrastructure and administration is not yet in place (Central and East European countries). In addition, the banded approach could well have an important application for countries/jurisdictions where the existing *ad valorem* property tax system is in severe decline due to various problems including few qualified staff, lack of resources etc (as in a large number of African and South American countries).

Within a banded system, it is not necessary to value each property individually but rather to assess in which value band the property should be placed. Inherent within this methodology are the arguments for and against the need to have an exact, discrete estimate of values, given the fact that valuation is not an exact science.

In the ideal world, it would be preferable to have current and up-to-date values on each taxable property, but we do not live in the ideal world. The compromise is that with discrete value systems, costs of revaluation tend to result in irregular and infrequent general revaluations. Therefore within discrete systems the principle of fairness is compromised. Would a banded system fare any better?

Clearly, all properties within a value band pay the same amount of property tax and will continue doing so until some overt act requires a reassessment of a property's value or where all properties are reassessed at a revaluation. Ignoring any change in assessed value due to physical changes in the property, there is a greater built-in 'comfort zone' whereby value increases occasioned by market movements do not radically affect the banding of the property over the short- to medium-term. This is unlike the discrete system where any change in value will or should result in a revised assessment and tax liability. In addition, small structural changes within the banded system would not normally result in such a significant value shift as to move the property into a higher tax band, again, unlike the discrete system.

A banded approach, properly constructed could well have potential application in developing countries and those 'transitional' countries of Central and Eastern Europe. Within this latter group of countries, the legacy of Communism and socialist polices has created an environment where the majority of real property was held by the state. These transitional countries, so called because of their move towards democracy and away from the previous centrally planned economies, are seeking to promote aspects of fiscal decentralisation (Paugam, 1999).

A number of countries including Poland, Czech Republic, Hungary, Bulgaria and Romania have a form of property tax based on the floor area of the building (structures) and the land

(McCluskey *et al.*, 1998). In the Czech Republic for example, the assessed value of developed land is determined by applying a fixed rate per square metre based on the ground floor area of the building and then applying a coefficient to this based on the population size of the local authority. For the capital Prague, the coefficient is 4.5, and for a local authority of less than 300 inhabitants the figure is 0.3 (Rohlickova, 1999). In Slovenia, a point system is used in association with the area of the property. Each building is allocated a number of points based on its age, location, amenities, condition etc.. The number of points is multiplied by the area of the building and the value per point (the value per point is determined annually by the municipality) (Bevc, 2001). Other more rudimentary approaches are adopted such as categorising real property into groups and then applying differing flat rates per m² for each property (Zorn, *et al.*, 1999)

Area and point based tax systems have been introduced in recognition of the need to tax real property within local authority areas as a means to raise finance to meet infrastructural and other locally-based expenditures. Nevertheless, these systems are practicable and socially acceptable and, for as long as these systems remain so, there may be little incentive/political will to change them. There are however, several problems associated with non-value based taxes, mostly related to ability to pay, fairness and tax buoyancy. Clearly, many of these countries view their existing property tax systems as temporary until they have reached a stage when discrete *ad valorem* systems can be put in place. There may be an opportunity to refine such systems to reflect an *ad valorem* property value once the property market develops to the stage where such a tax base can be sustained. In an effort to improve equity and to take advantage of the rapidly developing property markets, many transitional countries have implemented fiscal reforms, which include the utilisation of *ad valorem* systems.

The introduction of *ad valorem*-based local property taxes is generally recognised as an important and essential development to create fiscal autonomy for local government. There is now a growing trend in transitional economies towards the introduction of *ad valorem*-based property taxes. Estonia has been in the process of implementing such a tax since 1993 (Tiits and Tomson, 1999); Lithuania is engaged in a reform process regarding both market valuation methodology for the existing land tax and extending the tax to include buildings (IMF, 1998a); Latvia is also finalising its property tax reforms (IMF, 1998b); Romania formally adopted a market value-based property tax in 1997, but assessed values bear little relationship to market values; Poland (Eckert and Kelly, 1991), Czech Republic (OECD, 1996), Hungary (Balas and Kovacs, 1999), Slovenia (Bevc, 2001) and Armenia (USAID, 1997) are all at various stages of a property tax reform process. Land and property markets within these countries are beginning to mature and benefit from the processes of privatisation and the influx of external funds into real estate.

There is an argument that a logical step in the development of *ad valorem* property taxes for these countries would be to consider a banded property tax. Several countries already utilise property groupings based on geographic location which in some respects are robust proxies for value zones. To develop value bands would therefore not necessitate or create large scale administrative of assessment difficulties.

The problems facing countries in Africa and South America stem from a different source. In

many of these countries there are long traditions in the use and application of *ad valorem* (discrete value) property tax systems. Many of these originally imported during the colonial expansion of Britain, France and Spain. Whilst there is a tradition of implementing and administering such systems the problems being faced by many countries in these regions result from the systematic decline and neglect of such systems. The declining importance of the property tax is at variance with the need for municipalities to raise even greater levels of revenue from fewer tax sources. Such a scenario can be found in such countries as Kenya (Konyimbih, 2001; Kelly, 1998), Botswana (Monagen, 1999), South Africa (Franzsen, 1999), Tanzania (Kelly, 2000), Brazil (Villela, 2001), Chile (de Cesare, 2001), Columbia (ibid.), and Mexico (ibid.).

To re-establish a fully fledged *ad valorem* system could well be outside of the financial resources of jurisdictions and countries alike. Valuation rolls become dated, assessments bear little relationship to the underlying market value and the task of realigning assessments to market values becomes a significant financial risk, particularly where collection rates are low. This disequilibrium of cost and revenue collected is at the centre of the lack of political will to reinvest in the property tax administrative machinery. Countries seeking either to introduce a property tax or undertaking major reforms need to evaluate the various options available, one of which should be a system of banded property values.

5. CONCLUSIONS

This paper has focused on the banding of residential properties and one of the main views of the authors is that value banding for property tax purposes could have a wider application in terms of its usage within transitional and developing countries. It is considered that a banded approach, if appropriately designed, in terms of the number of bands, size of bands, tax structure etc. can overcome those technical and administrative valuation-based issues typically found in most developing and transitional countries. This will ensure that investment in property tax reform will be rewarded with a more stable and predictable tax yield. The necessity of having simple, cost effective solutions to the *ad valorem* problem will lead to enhancements in the system and ultimately to the potential to introduce more advanced assessment approaches, if required. Banding allows the establishment of different value bands (and therefore the imposition of differential tax levels between different types of property) between different jurisdictions.

Placing domestic properties into one of several value bands is a relatively inexpensive and efficient procedure to produce assessed values on which to base a source for local authority revenue. The use of private sector valuers in co-operation with government valuers can speed up the process and reduces the cost with minimal loss of accuracy.

Value bands and the frequency of revaluations/rebanding should reflect the nature of the property market within a given jurisdiction. The relativities of level of tax imposed between bands should reflect closely the relative values within each band. In this way, vertical equity can be optimised and social acceptability improved.

Banding of property values does not, however, obviate the need for revaluations of the tax

base. Regular and frequent revaluations are necessary to ensure that the tax is levied on values which are current, thereby improving both horizontal and vertical equity between taxpayers. However, under a banded system it is likely that revaluations could be more infrequent in comparison to discrete value systems.

The flexibility of the banded approach has already been mentioned but this particular attribute should not be under-estimated. It would allow jurisdictions at the local or regional level to establish a banding structure which suits the local property market and at the same time to develop a tax rate structure which adequately reflects the concepts of progressivity.

It is vital to remember that the object of any local authority tax is to ensure sufficient finance to provide for appropriate local authority services to the community. In that light, it is important to ensure that the tax does not fall on those without appropriate financial resources to pay. An efficient and effective tax rebate and hardship system, either incorporated within the tax system or which operates alongside it, is vital to protect those on low incomes. Resources should be concentrated on those without the financial resources to pay, rather than offered to other sectors of the community e.g. a sole occupier, whose financial needs are not assessed.

Local authorities should be given sufficient respect, freedom and responsibility to establish and administer a taxation system which provides them with sufficient financial resources and direct democratic accountability with their electorate, without the need for central government to monitor the authorities or assume the role of protector for the local taxpayers.

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