British Columbia
Assessment Authority

Real Property Tax 101

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Introduction

British Columbia employs an *ad valorem* system of property taxation. What does "ad valorem" mean? Ad valorem is a phrase meaning "based on value". Thus, an ad valorem tax is a tax that is based on value; in B.C.'s case, a tax based on the value of real property. Real property — land and buildings — can be roughly translated to mean real estate. In B.C. only the value of real property is taxed, not personal property such as jewellery, cars, clothing, etc.[1]

The property tax is a tax based on wealth where wealth is measured by the value of real property. Assessors and their staff are responsible for determining the *distribution* of the property tax burden by setting the value of each piece of real property. Their role is critical in maintaining a healthy tax balance.

At one time, the property tax was thought to be the fairest possible method for raising revenue to finance government activities. In fact, at the beginning of this century it was argued that the property tax should be used to finance *all* government activities.

Historic Roots

Property taxes in various forms are as old as human civilization with an unbroken recorded history of at least 5,000 years. The modern assessor is simply the latest in a long line of government officials who have methodically performed their duties and assisted in the orderly running of the State. No government can operate without revenues — every culture has had the equivalent of the "assessor" somewhere in its government organization, despite the many different systems and languages.

Early Tax System

In the 4th century B.C., Athens levied taxes on land, houses, slaves, cattle, furniture and money. Tax exemptions for temples and tombs were issues the Egyptians dealt with around 2,400 B.C. In fact, the economic resources that continued to be poured into tax-exempt temples eventually crippled the state financially, and contributed to the decline of the Egyptian kingdom. The mighty Roman empire relied heavily on land taxes and experimented with many refinements over the centuries.

Feudal Tax System

In the era of feudalism, the property tax was fair and efficient. Land was the main form of wealth and reflected, to a large degree, a citizen's income and ability-to-pay. At this time, ability and possessions meant the same thing.

Valuation lists were developed, not because possessions were to be deliberately taxed, but as a guide to the relative ability of each citizen. In an agricultural era where everyone of ability-to-pay was a farmer or landowner, it was natural to tax on the basis of the number and quality of acres cultivated, and the number of sheep and cattle. In addition, the property tax was easy to administer. It took place at the local level, complementing the feudal system, and physical property (predominantly land) was easy to find.

Modern Tax System

Our modern system of property taxation has roots which began in England in the Middle Ages. The growth of feudalism in Europe led to widespread use of the property tax. Feudalism, a form of government based on local landowners and their workers who farmed the land, was introduced to England by William the

[1]The expression "real property" stems from the fact that, historically, courts could restore an interest in land to a dispossessed owner, whereas in the case of personal property, the courts could generally only award damages for being deprived of that personal property. In land disputes compensation was "real" so the interest in land was referred to as real property.

Conqueror. In fact, it was under William that a complete inventory of the nation's wealth was conducted, right down to farm animals. This was used to provide a basis for a tax on wealth — the famous Doomsday Book and England's first complete assessment roll.

Other Forms of Tax are Introduced

The property tax as the major source of government revenue continued to be fair and efficient as long as land and real estate dominated the economy and personal property and intangibles were unimportant. As trade increased however, this was not the case.

By the beginning of the 1900's the property tax remained the major form of government revenue in Canada, but it was not a uniform tax on wealth.

Once economies began to commercialize, the concept of property had to be greatly expanded; otherwise, those who owned real property would pay most of the tax while the growing merchant class would pay relatively little tax.

If the definition of property is expanded, assessment becomes an issue. Tangible personal property such as jewellery, clothing, and furniture is difficult to locate and assess. Intangible property such as stocks, bonds, and mortgages, is even more elusive. Therefore, with the switch from an agrarian society to an industrial one, governments began to rely on other forms of taxation in addition to the property tax.

Types of Taxes

By the time Britain began colonizing North America, five types of taxes were in common use.

- **Poll taxes** were flat rate taxes, usually levied on all adult males and sometimes on the slaves of either sex.
- **Property taxes** were often specific taxes, levied at fixed rates, rather than according to value, on items enumerated in statutes.
- **Faculty taxes** were levied on the "faculty" or earning capacity (ability to earn rather than actual earnings) of persons practising certain trades or having certain skills.
- **Impost taxes** were levied on goods imported or exported from a colony.
- **Excise taxes** were levied on enumerated items of consumption goods, especially liquor.

The Tax/Assessment System in Canada

When the United States broke away from England, about 10,000 United Empire Loyalists migrated north to Canada and settled in what is now Ontario. These settlers, who had already been accustomed to local self-rule through elected bodies, strenuously agitated against the Colonial Government until they won the right to elect their own municipal officers in 1793. The inhabitants of populated townships could choose two assessors, one tax collector, and certain other municipal officers.

Initially, both real and personal property were taxed in Canada. The tax on personal property was gradually phased out by the early 1900's (although some provinces still levy a tax on the machinery and equipment of businesses). The revenues raised from property taxes went towards expenses like the wages of municipal officers, the erection and maintenance of jails, payments of jailers' salaries, and the destruction of bears and wolves. Education and social services, which now make large demands on municipal taxpayers, were financed by a combination of provincial grants and voluntary subscriptions.

Property Tax left to Local Governments

By the beginning of the 1900's the property tax remained the major form of government revenue in Canada, but it was apparent that it had not lived up to its expectation as a uniform tax on all wealth. Criticism of the property tax was widespread. It was attacked as being unsound in theory and practice. Tax administrators and academics suggested that the attempt to tax all kinds of property be abandoned and that higher levels of government seek other sources of revenue, leaving the property tax to local governments. This is essentially what has happened.

Taxation in Canada Today

Three Types of Tax

Today, Canadian governments rely on three types of taxation:

- **Wealth taxes** – the property tax and the capital gains tax.
- **Income taxes** – the income tax.
- **Consumption taxes** – taxes on goods produced or sold (principally provincial sales taxes and the Goods and Services Tax).

A property tax exists in about 130 countries but its importance varies. In most countries, property tax revenue is from one to three per cent of the total tax revenue for all levels of government. In the United States, it is nine per cent and in Canada it is 12 per cent. These differences reflect the relative size of countries and structure of government.

In Canada and the United States, local governments supply many goods and services that are typically supplied by higher levels of government in smaller countries where the central government exercises a greater degree of control.

Property taxes in Canada are used almost exclusively to support local government activities and represent the main source of revenue over which local governments have control (about 40 per cent of total local government revenue). The other main source of revenue is specific purpose grants from the provincial government (also about 40 per cent).

Taxation by Type by Level of Government - 1990-91 estimates (millions of dollars)

TYPE OF TAXATION	FEDERAL	PROVINCIAL	LOCAL	TOTAL
Income Taxes	74,144.0	44,579.3	0.0	118,723.3 (60%)
Consumption Taxes	28,771.0	27,761.9	0.0	56,532.9 (28%)
Property Taxes	0.0	2,057.5	21,400.8	23,458.3 (12%)
Total	102,915.0 (52%)	74,398.7 (37%)	21,400.8	198,714.5 (11%)

Local Governments' Revenue Sources

The figures in the following table cite the revenues of all local governments including municipalities, school boards, hospital boards, local improvement districts, etc. For municipalities alone, reliance on the property tax itself is far more significant.

For example, in 1989, property taxes raised 62 per cent of the total revenue for B.C. municipalities (excluding Vancouver). In Vancouver, the property tax supplies 50 per cent of total revenue.

Citizens of small communities initially elected local governments to look after roads, the water supply, and police and fire protection. They raised their own taxes and borrowed money to pay for infrastructure. This made sense in a country of small and scattered towns and villages. In 1867, only one Canadian in six lived in one of the 21 urban communities of greater than 5,000 people.

Today, only one Canadian in five lives outside of an area of less than 1,000 people. Many of these rural dwellers live on the outskirts of sprawling cities and towns.

The rise in industry and growth in population dramatically changed the nature of local government. In fact, the expectations of Canadians with respect to services provided by *all* levels of government has significantly changed. Health care and education, once considered a privilege, are now treated as a right. Governments currently undertake massive redistribution of wealth to maintain basic minimum standards of living. Something that would have been inconceivable one hundred years ago.

Services Purchased with Tax Dollars

Local governments use the revenue they raise to supply a vast array of goods and services including:

- **Culture and recreation** – parks, swimming pools, ice arenas, community centres, libraries, museums, art galleries.
- **Health and welfare** – public health services, ambulances, welfare administration.
- **Housing** – building permits and standards, homes for the elderly, low cost rental housing.

Local Government Gross Revenue - Canada Total, 1990 (thousands of dollars)

Own Source Revenue	**$31,634,035**	**% Total**
Property and Related Taxes	21,411,815	36.4
Miscellaneous Taxes	296,244	.2
Privileges, Licenses and Permits	427,833	.6
Sales of Goods and Services	6,945,957	12.2
Return on Investment	1,589,373	2.7
Other Own Source Revenue	962,813	1.6
Transfers	**26,514,978**	
General Purpose	3,060,512	5.2
Specific Purpose	23,454,466	41.1
Total Gross Revenue	**$58,038,013**	**100.0**

- **Protective Services** – police, fire, animal control, building and construction, emergency measures.
- **Transportation** – public transit, streets, roads, traffic control.
- **Utilities** – water collection, disposal of garbage and sewer.

A changing society led to local and provincial government roles that became much more important than was originally intended by the division of powers set out in the *British North America Act* of 1867.

Two points can be noted on the following graphs:

- the dramatic increase in government expenditure.
- the changing composition of government expenditure.

The increase in government expenditure reflects the importance of the government in redistributing wealth and providing goods and services that many of us take for granted. The chang-

FIGURE 1

The Growth of Government Expenditures in Canada

(Total Government Expenditures as a % of Gross Domestic Product – Expendure-based)

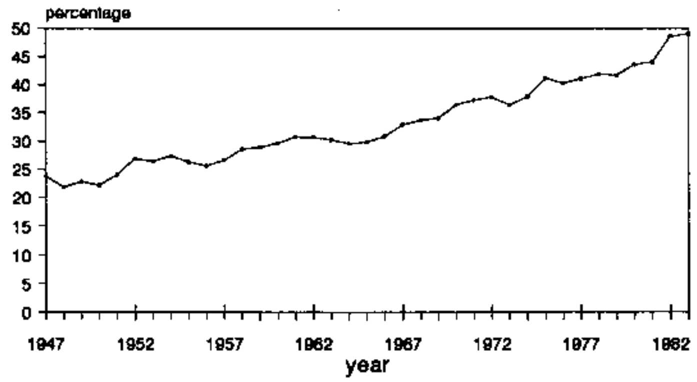
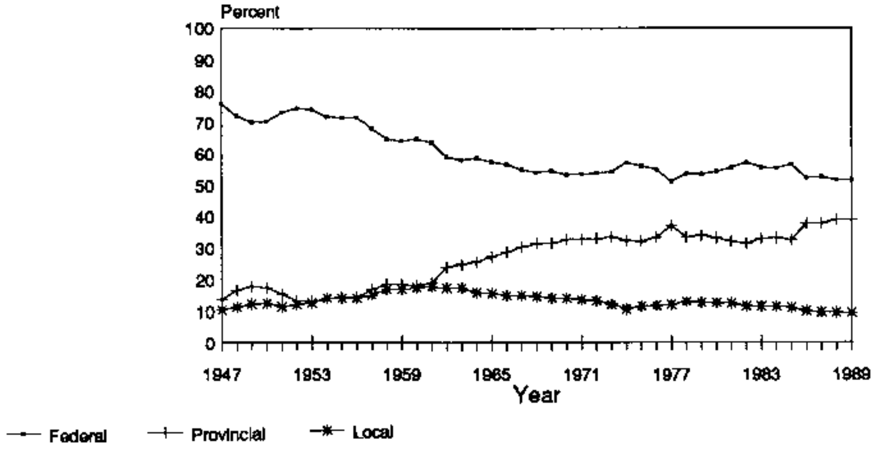


FIGURE 2

The Changing Composition of Taxation

(Taxes at each level of government as a % of total taxes)



ing composition of government expenditure reflects the increasing importance of provincial governments.

Note however, that the per cent of taxes raised by local governments has been relatively constant over time.

Principles of Property Taxation

Much of the dissatisfaction with our current property tax system occurs because taxpayers believe two principles are violated with the ad valorem system:

- ability-to-pay.
- benefits received.

Ability to Pay

Ability-to-pay means taxpayers should pay according to their ability. The income tax is a good example of a tax based on ability-to-pay; there is a clear relationship between income earned and taxes paid. The property tax follows this principle because higher valued properties pay higher taxes. In this sense, one's real property is used as a proxy for one's ability-to-pay.

Ultimately it is the balance of the taxation burden among all types of taxes in relation to the balance among all types of benefits that taxpayers must consider.

The principle of ability-to-pay is also cause for a great deal of criticism of the ad valorem tax system because owning a higher valued property does not automatically translate into the ability to pay higher property taxes. Real estate is an illiquid asset that, while attaining a high value, does not lead to more cash with which to pay property taxes.

For this reason, all provinces provide relief from property taxation for those on low or fixed incomes. While purists argue these taxes should only be deferred until the wealth is finally realized on the sale of the property, property tax deferral programmes have a dismal acceptance rate.

Benefits Received

Under the second principle, benefits received, a tax levied on the owners of real property is justified because of the benefits that accrue to property due to the actions of local governments. Local governments provide many services including roads, sidewalks, sewers, water and fire protection. As these services directly benefit local property owners, it is the local property owners who should pay for them.

Taxes Paid vs. Benefits Received

Problems occur where the property tax is used to supply people-related services such as schools, community health centres, parks, recreation centres, hospitals, and subsidized rental housing.

While it is true that the relationship between the benefits that accrue to property and certain people-related services is indirect and difficult to determine, this does not mean property is unaffected by these services. In every taxation system, however, there should be a relationship between the total taxes paid and the total benefits received.

We live in a society that endorses the redistribution of wealth. This is not a new idea. Throughout history all cultures have recognized the advantages of sharing wealth. Enormous transfers of income take place in our country to assist those in financially poorer circumstances. Those who need the benefits governments provide, are not always in a position to pay for them at the time of need. Likewise, a taxpayer may be paying today, for a benefit to be received in the future.

Ultimately, it is the balance of the taxation burden among all types of taxes in relation to the balance among all types of benefits that taxpayers must consider. As citizens of a caring society, we must use a broader perspective in examining the relationship between the taxes we pay and the benefits we receive.

Components of an Ideal Property Taxation System

A discussion of property taxation would not be complete without a set of criteria that would exist in an ideal property taxation system.

Administration

The administration of the property taxation and assessment system should be simple and efficient. It should raise revenue in a cost effective manner and be easily understood by taxpayers.

Accountability

Accountability implies tax policies should be clear and hidden taxes avoided. There should be a direct relationship between locally raised taxes and local expenditures. There is less tendency to over-supply services when those receiving the benefits must pay for them. Tax exporting should be avoided. Tax exporting refers to a municipality's ability to raise revenue by taxes levied on taxpayers who live beyond the municipal border; for example, taxes levied on a manufacturing plant which exports it products. Accountability is violated when a nonresident consumes local services; for example visitors use locally financed recreation centres and parks.

Understandability

The taxation system should be easily understood by administrator and taxpayer alike even though it is levied on a broad range of properties. Every taxpayer must understand the basis of assessment for taxation, the grounds on which the assessment can be appealed, the process of appeal, and the method of calculation of the tax based on the assessment.

Neutrality

A neutral tax is non-distorting: landowners are not inclined to behave in a certain way to avoid the tax. In other words, after the imposition of the property tax, there should be no change to the way property owners use their property. Governments do, of course, frequently violate this principle by using taxes to encourage taxpayers to behave in a certain way in order to achieve social or economic objectives. The property tax however, has not been an effective policy tool for either enticing business or achieving social policy objectives. Attempts to manipulate the property tax system frequently lead to unintended beneficiaries and land use incentives.

Fairness

Fairness implies horizontal and vertical equity. Horizontal equity requires the equal treatment of equals; that is, all properties of identical value should be taxed in the same way. Vertical equity requires the unequal treatment of unequals; properties of greater value should face higher taxes. With regard to equity, most taxes focus on income as a measure of ability to pay; for example, the income tax. The property tax is, however, a tax on wealth. Clearly, if all taxes were based on income, the tax system would not be fair. Under these circumstances, two individuals with exactly the same income, but very different amounts of wealth, would pay exactly the same tax.

Stable Tax Base

The property tax should provide stable levels of tax revenue as the services provided by local governments remain relatively constant regardless of the level of local economic activity. Local governments should also be able to reasonably forecast the level of property taxes attainable from year to year.