

ECONOMIC ARGUMENTS IN FAVOUR OF PROPERTY TAX

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Abstract: When considering arguments that speak in favour of the existence of property tax, one should not lose sight of the fact that property tax is, primarily, a fiscal instrument providing an influx of significant funds to budgets of local self-governments, therefore being of great importance in the context of fiscal decentralisation. Even though the fiscal function of property tax is a priority, we should not disregard its other functions: economic, social, political, administrative-technical, and other. This paper aims to make a detailed analysis of economic arguments that speak in favour of levying tax on property, as well as to point to solutions that can contribute to or hinder the fulfilment of tax property's economic function. The research has shown that economic arguments speaking in favour of property tax primarily come down to the fact that property tax is, in comparison to other types of tax, less distortive and can encourage the productive use of real estate. However, the research has shown that in practice favourable performance of property tax is often lacking at the economic level. This commonly happens due to the tax policy creators envisioning various measures that aim to temper the unpopularity of property tax with taxpayers. Tax base that is not market value and tax reliefs for owner-occupied housing are the best confirmation of this phenomenon. Namely, setting non-fiscal, especially social goals is common for all countries, regardless of level of their development. The paper also assesses to what extent property tax in Serbia achieves its economic functions, and in that regard formulates appropriate *de lege ferenda* proposals. The author believes that the more realistic valuation of the tax base and subjecting second homes to higher tax rates would contribute to more efficient use of real estate.

Keywords: property tax, functions of property tax, economic function of property tax, efficient use of real estate.

Field: Social sciences

1. INTRODUCTION

Property tax is one of the oldest taxes dating back to antiquity. This is not surprising when we take into account the fact that during that time owning property was the best indicator of the taxpayers' economic power. Additionally, levying tax on property did not pose too much of a challenge for tax authorities because visibility made the levying process easy (Cvjetković, 2015). The situation did not change much in the meantime, at least not in terms of owning real estate and movable property that is entered into appropriate registries.

Property tax is a form of tax that can be found in more or less every modern tax system. Its primary role is fiscal, i.e. collecting funds, however, the revenue that it generates differs by country, depending on the country's economic development, degree of fiscal decentralisation (Cvjetković, 2015), coverage of taxable properties, selection of tax base, frequency of tax base valorisation, number of tax reliefs, capacity of tax administration, application of modern technologies in tax administration, etc. (Grote & Wen, 2024). Therefore, in terms of the revenue generated by property tax, we have the USA, Canada and Australia on one hand, where this tax has a greater share in the total tax revenue with more than 10%, while on the other hand, there are countries like Czechia, Estonia and Lithuania where this share is less than 1% (OECD, 2023). In the Republic of Serbia in 2023, the share of the property tax revenue in the total tax revenue was 2.88% (Ministry of Finance, 2024).

Despite property tax being primarily a fiscal instrument, we should not disregard other arguments that speak in favour of its existence: social, political, economic, and administrative-technical. Social arguments come down to the fact that property tax ensures the fairness of a legal system. Although the meaning of fairness depends greatly on historical, cultural, psychological, and ethical factors, in the financial literature it is commonly interpreted by using the benefit and ability-to-pay principles. The benefit principle means that in a fair tax system, taxpayers pay taxes according to the value of services they get from a state, while the ability-to-pay principle means that fairness is ensured when each taxpayer, according to their economic power, contributes to financing public spending. Although the benefit principle is rarely applied in practice because taxes in modern tax systems, as a general rule, do not have purposeful character (Dimitrijević, 2024), fairness of property tax is often interpreted in this way. The reason lies in the fact that benefits from local public services that are also financed by funds collected by levying this tax are partly capitalised in the value of the property and thus increase its value. In relation to the ability-to-

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pay principle, it should be emphasised that this principle made sense in the period when owning property (land, tools, livestock, etc.) was the only true indicator of economic power, i.e. when the role of income was secondary (Cvjetković, 2015).

Since property tax, as a typical local tax, plays an important role in the processes of fiscal decentralisation, which implies transferring public revenue and public expenditure from higher to lower levels of government, we cannot disregard its political dimension. Namely, in the base of fiscal decentralisation lies political reasons, i.e. the need to bring holders of political power closer to citizens and in that way ensure a higher degree of democracy. We must not disregard the fact that in conditions of economic and political integrations, property tax, whose base cannot be transferred to another jurisdiction and for which application of the territorial principle is indisputable, is truly justified. Namely, regardless of the tax harmonisation tendency, fiscal sovereignty in terms of property tax remains firmly in the hands of states (Cvjetković, 2015).

Since the tax base of property tax is observable, administrative-technical reasons also speak in favour of its existence. They come down to the fact that, due to the visibility of the subject of taxation, even in the absence of quality registers, tax administration can fairly easily levy tax on real estate, as well as correct possible oversights when levying tax on income from an earlier period. This demonstrates the so-called control role of property tax (Cvjetković, 2015). Levying tax on property, essentially, achieves cross-control between these two tax forms, i.e. income tax and property tax (Popović, 1997).

Other arguments also speak in favour of the existence of this tax. Thus, one can often hear property tax being justified by the fact that property is a guarantee of a certain social security for its owner, that it gives them certain power, reputation, and creditworthiness, as well as the possibility of generating certain income (Cvjetković, 2015).

2. MATERIALS AND METHODS

The subject matter of the paper will be analysed by using several different scientific research methods. The initial method, like in any other study of law, will be legal (dogmatic, normative) method, in order to reveal the logical content of norms dedicated to some aspects of property tax, i.e. to describe them as they are in practice. Use axiological method is necessary in order to show the goal of certain norms, which relate to subject of the paper. Also, to a certain extent, the comparative method was used in order to consider solutions in comparative law.

3. RESULTS AND DISCUSSIONS

As emphasised above, economic reasons also speak in favour of property tax's existence. Research conducted has shown that property tax in comparison to some other taxes is more efficient, i.e. less distortive or in other words, it changes modalities of taxpayers' economic behaviour on the market to a lesser extent. Namely, this tax ensures stable and predictable revenue and often has a small effect on decisions of economic subjects in terms of labour supply, savings, and investments (Leodolter, Princen, & Rutkowski, 2022). Furthermore, research has shown that property tax is the least harmful to economic growth (Rodriguez-Vives & Gavilan-Rubio, 2021). Based on that, and on the fact that its fiscal potential is not utilised enough in a large number of countries, there are views that in these countries tax burden should be shifted from more distortive taxes, primarily income tax, to property tax (European Commission, 2012).

However, in certain tax systems, the distortive effects of property tax are increased due to the manner in which its elements are conceived. Firstly, the distortive effects of property tax come to the fore where this tax is a significant expenditure for taxpayers. Therefore, there are views that property tax in the USA, as one of the most important revenues for local governments, is potentially highly distortive because it increases business expenditures of the business sector consequently affecting the decisions relating to investments, employment, place of business, etc. (Enami, Reynolds, & Rohlin, 2023).

The distortive effects of the property tax in practice can also come to the fore due to the tax reliefs that are prescribed to temper the pronounced unpopularity of this tax with taxpayers. The best confirmation of this is the tax relief for owner-occupied objects, which, together with their privileged treatment in the field of income tax, creates market distortions (Leodolter et al., 2022). According to some estimates, tax reliefs to homeowners reduce the user cost of housing capital by almost 40% compared to the efficient level under neutral taxation (Fatica & Prammer, 2017). Namely, modern countries encourage the ownership of residential objects with various measures, including tax measures. The reasons for such behaviour are, primarily, of a social-political nature, i.e. providing affordable and quality housing and gaining voter

support. However, if every acquisition, disposal and ownership of a residential object was privileged from a tax point of view, such a solution could not claim fairness, because those with greater economic power would benefit the most from this advantage because it is more or less common for them to own a large number of residential objects. At the same time, such a solution could result in inefficient management of assets and could lead to an increased demand for them, and therefore to an increase in their price. This automatically means that they would be more inaccessible to those with less economic power. This is why some countries, in an effort to achieve a balance between the need to facilitate the solution of the housing issue with tax measures and the need to prevent the accumulation of residential objects in the hands of one person for tax reasons, denied tax benefits for second homes, i.e. some countries have subjected this category of residential objects to stricter tax treatment (Cvjetković Ivetić, 2024). Comparative legal analysis has shown that in some countries (e.g. Albania) second homes are subject to higher tax rates (Canaj & Lavdari, 2021), but also that some countries, such as Montenegro and Slovenia, not only subject these objects to higher tax rates but at the same time deny them the right to a tax credit, i.e. the right to a reduction of the tax base (Obradović & Klikovac, 2021; Žibrik & Humor, 2021). In comparative law, one can even find solutions where property tax is paid only on second homes, or only on certain categories of second homes, such as vacation homes or residential objects that are being rented (Cvjetković Ivetić, 2024).

Some research has shown that, on the one hand, tax reliefs for homeownership have positive effects in the sense that homeowners may experience a higher increase of net wealth over time, be more engaged in the local community and experience higher life satisfaction, etc., but also that, on the other hand, it should not be disregarded that they can reduce the mobility of the labour force, as well as the employment rate (Leodolter et al., 2022). Furthermore, it is emphasised that they can have an impact on the real estate market, because they increase the net revenue of their owners and reduce the costs of taking out mortgage loans, especially when paired with reliefs in the field of income tax (Fatica & Prammer, 2017). Thus, we see that these tax reliefs are capitalised into higher real estate prices.

The distortive effects of property tax can also occur due to the property tax's scope, i.e. situations where, in certain countries, this tax covers only certain categories of real estate. To illustrate, in Vietnam, only non-agricultural land is subject to tax by its symbolic value, excluding other land and buildings on it at market value. This creates opportunities for various speculations (Trung et al., 2024).

Certain theoreticians believe that property tax, which would be paid only for land, could be characterized as an instrument of revenue collection without distortive effects. The basis for such a point of view lies in the fact that the supply of land is perfectly inelastic, therefore its introduction would result in minimal allocative losses. It means that this tax would be a smaller economic burden for taxpayers, compared to some other taxes that affect the supply of taxed goods and services. At the same time, it does not create an excess tax burden, which means a loss of well-being that exceeds the amount of collected tax revenue. As some financial theorists have pointed out, levying tax on any good, except land, will automatically mean less of that good. Due to its effectiveness, even in the works of the physiocrats, there is a view that the land tax can serve as a good substitute for the conventional property tax (Cohen & Coughlin, 2005). Some countries have adopted this approach. An example is Estonia, where property tax comes down to land tax (Tiits, 2021).

If treated as an unavoidable cost of owning real estate, property tax can also be an incentive for taxpayers to use it optimally. In other words, the property tax should encourage productive investment because it is paid regardless of whether the property generates income or not. In order to achieve the stated goal, it is necessary for the market value to be the tax base (Leodolter, Princen, & Rutkowski, 2022). Namely, the property tax whose tax base is market value is based on the concept of 'highest and best use', therefore taxpayers have an incentive to either use their property as productively as possible, to compensate for the loss of income due to the payment of property tax, or to sell it. This prevents various market speculations (Cvjetković, 2015). To achieve the stated goal, it is not enough just for the market value to be the base, it is necessary to revalue it in regular time intervals, that is, it is necessary for this value to be in accordance with the current market trends as much as possible. Otherwise, real estate is taxed less than other types of assets (Kiss et al., 2024). Despite the above-mentioned, in some countries, the base of property tax is still the area (e.g. in the Czechia), while in other countries the data on the market values of real estate is not being updated regularly. The reasons for the non-alignment of the tax base to the real estate market conditions are twofold. On the one hand, updating the tax base implies the engagement of significant human and material resources, on the other hand, the property tax base that follows market conditions, especially in conditions of a high inflation rate, encounters resistance from taxpayers. Hence, it is often the case that modern tax systems resort to measures, such as the establishment of tax relief for low-income households, postponement of property tax payments, payments

in instalments, etc., all in order to reduce the resistance of taxpayers as much as possible (Kiss et al., 2024).

It should also be noted that property tax plays a significant role in small and 'open' economies exposed to tax competition, as it contributes to the greater resistance of the tax system to external shocks (Norregaard, 2013). This characteristic is attributed to the property tax, not only because it provides stable revenue, the amount of which does not depend on the state of the economy, but also because with this tax there is no danger of moving the base to other jurisdictions. Moreover, property tax could, together with tax on the transfer of absolute rights, play a significant role in stopping the growth of real estate prices. Such a role is given to them, since these taxes reduce the owner's income after taxation, that is, because they increase the cost of holding real estate. Property tax contributes to stopping the growth of real estate prices even if they are used unproductively because then their number on the market increases, which leads to a drop in their price (European Commission, 2013). In the financial literature, some viewpoints question the effectiveness of using the property tax as an anti-cyclical measure aimed at mitigating price fluctuations in the real estate market. Namely, it is pointed out that its use for that purpose is disputed and that, in the best case, it can only have a one-time effect on the price level (Norregaard, 2013).

Regarding the economic role of property tax in the Serbian tax system, the following should be stressed. Firstly, since the base of property tax for taxpayers who do not keep business books is not the market value of the real estate, but the value determined based on the usable area and the average price per square meter of the corresponding category of real estate in the zone where the real estate is located, it cannot be said that the Serbian property tax fully encourages the efficient use of the property. In addition, the value of the real estate of taxpayers who do not keep business books is reduced by a certain percentage for depreciation, depending on the object's age (Law on Property Taxes, Article 5). According to some views, the reduction of the base using depreciation is more an expression of the tendency to achieve social and political goals because the age of the object has already influenced the formation of the average price per square meter by zone, in the sense that it is lower than if there were only 'new' construction objects in circulation (Cvjetković Ivetić, Milošević, & Baturan, 2019).

In terms of land taxation, contrary to solutions present in other countries (Grote & Wen, 2024), different rates for arable and vacant or unimproved land are not provided for in Serbia. However, it should be noted that significant progress has been made in terms of encouraging the productive use of land. Namely, in contrast to the situation before the reforms of 2013, the base is no longer a completely devalued cadastral revenue and it is calculated based on data on the usable area and the average price per square meter of the corresponding type of land. In this context, we should also mention the temporary tax exemption for five years for uncultivable agricultural land that is converted into arable agricultural or forest land (Law on Property Taxes, Article 12, Paragraph 1, Point 6).

Serbian tax law also provides different tax treatment for first and second homes, because a 50% reduction in tax debt is provided only for residential buildings in which taxpayers have a registered residence and in which they reside. However, more efficient use of residential objects to a greater extent would be ensured by less favourable treatment of second homes and in the field of tax rates. That measure would prevent the accumulation of real estate owned by the same person, i.e. it would encourage taxpayers to use them efficiently.

4. CONCLUSIONS

It is not easy for the creators of tax policy to conceive a tax that would yield revenue, and be fair, efficient and simple at the same time because these requirements are often conflicting. Such is the situation with property tax. Namely, even though the property tax is the least harmful to economic growth, its fiscal potential is not sufficiently used in most countries. The reasons for this lie in the fact that in a large number of tax systems, social and political goals prevail over buoyancy and efficiency. The privileged tax treatment of owner-occupied objects and the tax base that does not follow fluctuations in the real estate market are the best proof of that.

The analysis of provisions dedicated to property tax in Serbian tax law has shown that the Serbian legislation has been perfecting these norms for the last ten years, all in order to increase the efficiency (but also buoyancy) of this tax. However, it should be noted that there is still room for improving the efficiency of the Serbian property tax. This could be achieved by valuing the tax base more realistically so that it is as close as possible to the market value. In that regard, the Serbian legislation could review the real estate depreciation (except land) to determine property tax. Furthermore, subjecting second homes to higher tax rates, i.e. establishment of a dual scale of tax progression – the existing one, which would be applied to first homes and the introduction of a new scale of tax progression for second homes. In this

case, the Serbian legislation would have to simplify the scale of tax progression, so that the tax base is not divided into four, but into two tranches.

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