Ibec

Review of the Local Property Tax (LPT)

An Ibec submission to the Department of Finance

April 30th 2015

Executive summary

Ibec represents the interests of Irish business including indigenous and multinational enterprises and SMEs, spanning all sectors of the Irish economy. Ibec and its sector associations work with government and policy makers at national and international level to shape business conditions and drive economic growth. In March 2014, Ibec launched its An Ireland that Works campaign setting out the business priorities for the next phase of the recovery. Irish business has identified five pressing issues that will have a major impact on Ireland's future success, two of which are reform of taxation and better local government.

Key messages for the LPT review:

1. **The property tax should remain a key part of the taxation system:** Ibec supports the property tax and its role in the broadening of the tax base. As it stands the LPT makes up just over 1% of total government revenue, we believe this should grow over time offsetting damaging taxes on labour. It is disappointing, however, that the introduction of the local property tax has not seen sufficient reductions in the burden of local government funding on business

2. **Large 'once-off' increases must not damage confidence:** Ibec supports the notion of taking steps to moderate large once-off increases in household's liabilities. It is important, however, that this is done in a way which does not undermine the property tax's link to market values or undermine confidence in the tax. In this context we favour smoothing the impact of the new valuation over time.

3. **The LPT should incentivise efficiencies in local government and support local economic growth:** The current 2014 base year may be a barrier to seeking further efficiencies and cost competitiveness in local services. In addition, decisions in reducing the LPT rate by local authorities should first prioritise local economic development and job creation measures.

4. **The equalisation fund should not be used to cut the LPT rate:** Local authorities benefitting from the LPT equalisation fund should not use it as a mechanism to cut vary the LPT rate in their area. The equalisation process should not leave local authorities in a surplus. Five local authorities did just this in 2015.

5. **Social housing should be exempt from the LPT:** The provision of social housing is a key Government priority and local government remains the main provider. Social housing is not exempt from the LPT and local authorities pay the LPT on their housing stock. A straight exemption for social housing from the LPT would result in expenditure being purely earmarked for housing needs in the areas where it is most needed and not transferring to other uses such as the equalisation fund.

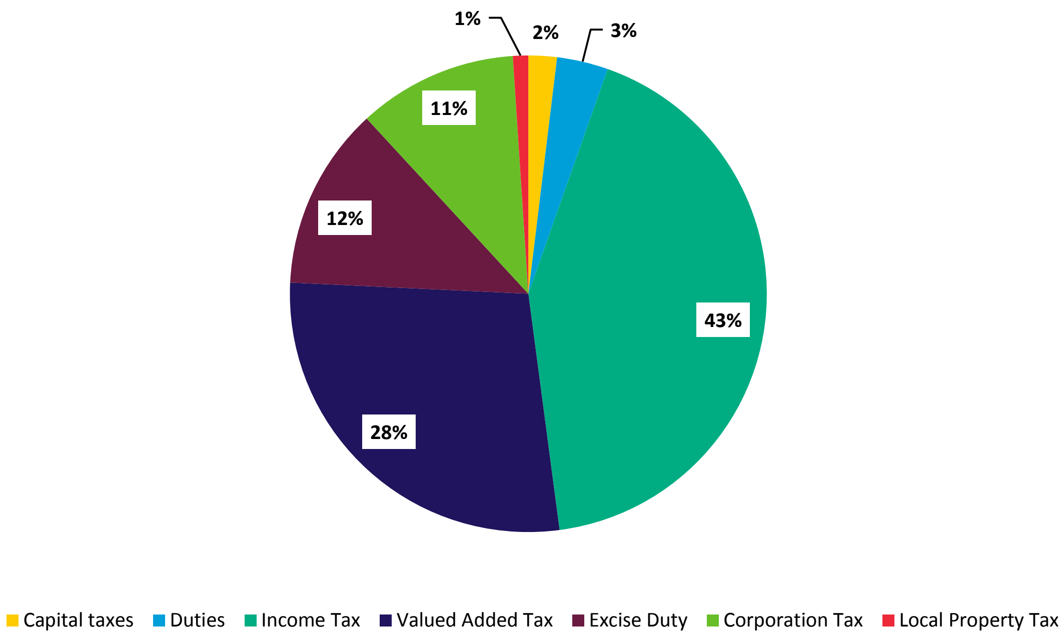
6. **Increases in the LPT central coffers should be used to introduce a competitive "town growth fund":** In order to support the revitalisation of town centres and regional growth, a new competitive fund should be introduced through increased LPT revenue. Projects should be funded on their merits, involve partnership between public and private sectors, as well as leveraging additional funding.

1. The contribution of the LPT to overall tax revenue

In general terms the introduction of the LPT has been a crucial part of broadening the tax base in recent years, away from an overreliance on non-recurrent, transaction based construction taxes. Ibec welcomed the introduction of the LPT in 2012. At the time we advocated a more ambitious LPT than the one currently in place for two equally important reasons. Firstly, it was our view that Government should use the additional revenue to avoid further increases in labour taxes which, we continue to believe, have risen to excessively high levels. In the OECD's tax hierarchy, increasing personal income tax is a damaging way of raising revenue, second only to corporate income tax. Analysis in Ireland has shown positive economic effects of shifting the burden of taxation away from income and on to property (O'Connor, 2013).

Secondly, we believed that to improve the equity in business and non-business share of property taxation and funding of local government, that the burden arising from commercial rates should be lessened in line with the dramatic decline in firm turnover experienced in recent years. This continues to be the case.

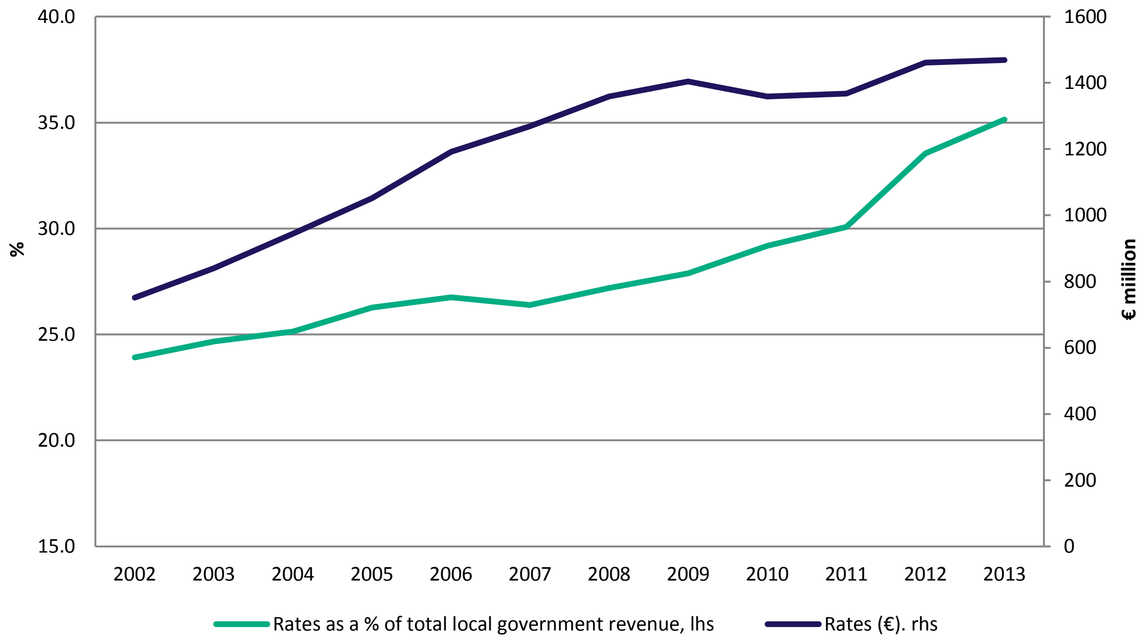
Figure 1: Tax profile 2015



Source: Department of Finance

As it stands the LPT makes up just over 1% of total government revenue. In terms of taxation this means that recurrent charges on property (including the property tax) are equivalent to 0.9% of GDP or 9th highest in the EU. In our 2012 submission we stated that recurrent taxes on property could usefully make up 5% of the total tax base over the long term with reliance on labour taxation reduced. This remains our position. Despite this we believe that given sufficient fiscal space this rebalancing should be achieved through reductions in labour taxation rather than increases in the LPT in the short run.

Figure 2: Rates increases 2002 - 2013



Source: Department of the Environment, Local government accounts

It is disappointing, however, that the introduction of the local property tax has not seen sufficient reductions in the burden of local government funding on business, rather it has rebalanced the central government contribution. Rates currently account over 35% of local government revenue, the single largest source. This represents an increase from under 24% in 2002 and has contributed heavily to business costs in some areas.

The level of this pressure varies across counties. Councils in Dublin on one hand receive over half their income from rates whereas on the other hand business contributes more modestly to the overall budget, albeit with still high rates**.** Across the board, however, businesses are now receiving fewer services than in previous years while funding more subsidised household services. The revenues from future increases in the LPT should in this context focus either on reductions in labour taxation, reductions in rates or using the funds to empower local authorities in their role in local economic development.

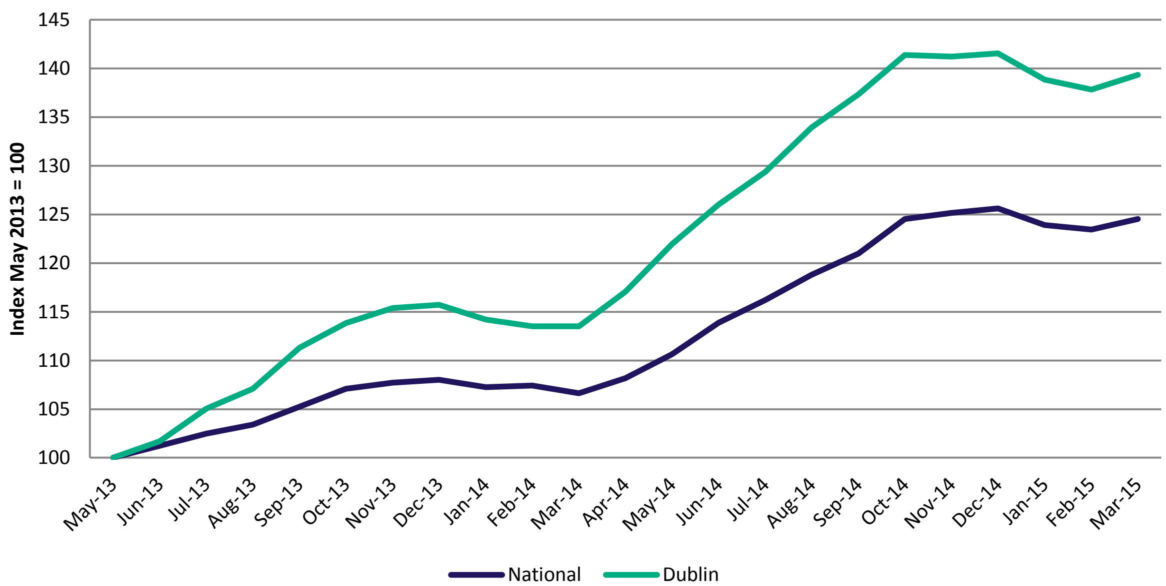
2. Recent residential property price developments and the LPT

House prices have risen substantially since the first valuation deadline in May 2013. Over that period house prices have risen by 39% in Dublin and by 24% on average in the country as measured by the CSO. It must be borne in mind, however, that the impact of the Central Bank's mortgage lending regulation seems to have moderated the levels of those increases significantly in recent months. While, the long-term effect of this is yet to be seen it may lead to more reasonable increases in valuations in the future.

Each one band increase in the house valuation for a homeowner would result in an additional €90 per annum in household LPT liability. Although it is difficult to put an absolute estimate on it, it is clear that a large number of houses in areas outside Dublin will gain at least one band, adding €90 per annum to their LPT liability. At the same time the average house in Dublin will move two bands. Houses of higher value will move in the region of three or even four bands reflecting their higher base. In an extreme minority of cases (less than 2.5% nationally), where the house value is high by national standards (ordinarily in excess of €500,000 in 2013) the LPT liability could increase by as much as €360.

For example a house costing €300,000 in Dublin during the 2013 valuation would now be worth €417,000 moving it up two valuation bands. This increase would see the homeowners LPT liability increase from €585 to €765 an increase of €180 per annum.

Figure 3: House price valuation since May 2013



Source: CSO

Ibec recognises that for some households this may be an excessive increase, particularly for those in urban areas. The extreme rises in house prices in some areas will lead to increases in annual LPT liabilities which are in excess of what could have been envisaged when the LPT was introduced. This may have knock on effects on domestic demand and may undermine public support for the tax. This is particularly a risk in Dublin, where increases will be highest and among non-waged homeowners particularly those on modest incomes. In this context Ibec believes the ability to pay mechanisms existent in the tax should be supplemented by some smoothing mechanism to limit the impact of the recent price rises on household liabilities. This mechanism should, however, not become a permanent feature of the tax.

There are a number of options available to government which could help mitigate the increases in the tax which are used in other jurisdictions. These include:

1. **Reducing the LPT rate**

   A simple option in mitigating the effects of the LPT increase would be to reduce the 0.18% rate of the tax. For example in our previous example of a house costing €300,000 in Dublin during the 2013 where the valuation would now be worth €417,000 moving it up two valuation bands (or €180) a rate decrease could mitigate some of this increase. For example moving the rate from 0.18% to 0.16% would reduce the LPT liability from €765 to €680. The downside of this approach, however, is that if and when house price rises moderate it will be politically difficult to re-introduce the 0.18% rate.

2. **Link to CPI/HICP**

   Another option used internationally would be to link increases in the LPT to the CPI. This would mean in effect that the property tax could not rise any faster than the rate of inflation. Given the benign inflation environment this would in effect mean little or no property tax increases for most households. In actual fact given that the CPI today is 1% below where it was during the 2013 valuation this would mean cuts to the LPT for all households.

   Linking the LPT to the CPI is a poor option for a number of reasons. Firstly, linking the LPT to the CPI would effectively end its status as a property tax. The tax would become simply a lump sum 'inflation tax' tied to an out of date valuation. Secondly, the linking of the LPT to the CPI would see a loss of tax revenue at present – undermining the funding of local government structures and leading potentially to increases in rates on local business. Finally, linking the tax to the CPI would seriously disadvantage owners of new build homes which would be necessarily valued much higher than the 2013 valuation or linked to the hypothetical 2013 or similar local homes creating greater administrative complexity.

3. **Introduce a Cap on annual increases**

   A third way in which the LPT increases could be mitigated would be to limit annual increases in the LPT to some figures, say 10% of the value of the house. So even if the LPT liability in our example rose by €180 it could in effect only rise by €58.50 (€585 * 0.10). This approach, along with suffering the same drawbacks of linking to LPT to the CPI, would be completely arbitrary and serve to undermine the concept of the LPT as a tax on wealth.

4. **Smooth the introduction of new valuation**

   Although there is no perfect way to mitigate the impact of large LPT rises on households one way to account for some of the most extreme of the recent rises on household's budgets would be to smooth the introduction of the new LPT liability based on the 2016 re-valuation.

   Taking our example where a house valued at €300,000 in 2013 has risen in value by 39% to €417,000 over the period, thus rising by two LPT bands. The new valuation would remain the same, however, the increase in the LPT of €180 would be phased in equally in the four years to the next valuation; rising by €45 per annum. Under this system the largest increase any one household could have in 2017 would be €90, followed by €90 in each of the following three years. This extreme case would affect less than 2.5% of houses with the majority seeing increases of €45 (€3.75 per month) or €22.50 (€1.90 per month) per annum.

   This approach has the advantage of retaining the link to property value, not seriously undermining local government financing, whilst also avoiding the major once-off impacts on household budgets and limiting the impact of increases on public support for the tax. As such this choice would seem to fit all of our criteria for the offset mechanism.

3. The LPT and the funding of local government

LPT should incentivise efficiencies in local government

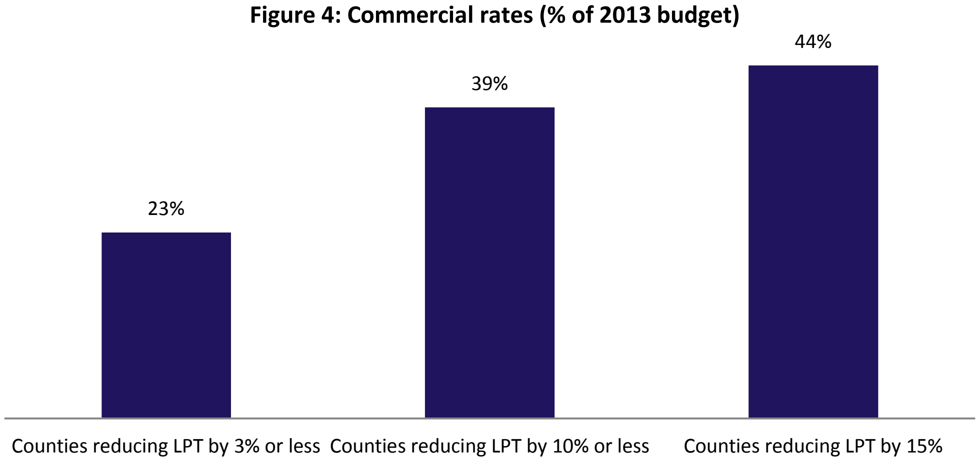
Local government in Ireland has been the subject of substantial change in recent years. As a key part of the public service reform agenda, the need to make local government more effective and efficient was recognised. This has resulted in changes to the structures of local government, staffing numbers and a reduction in the number of local authorities across the country. The number of councils was reduced from 114 to 31, with possible further changes to local government arrangements in Cork and Galway. Core local authority functions such as water, student grants and driver registration have been removed and others are being shared across all 31 local authorities. Staffing levels across local government have fallen by 25%.

During this period of reform, Government has altered how local authorities are funded. In addition to commercial rates, Government introduced the Local Property Tax (LPT). The LPT has replaced the short-lived household charge and the non-principal private residence charge and provides an additional source of funding for local services. The LPT offsets the reductions in central government allocations to local authorities. Under current arrangements, local authorities cannot be worse off than in 2014 under direct exchequer contributions. The LPT equalisation fund ensures local authorities are in line with 2014 levels. This baseline can act as a disincentive to seek and implement further efficiencies in local government, beyond those directed from central government.

Local property tax cuts should focus on jobs

Reductions in income from the local property tax should not result in a rise in commercial rates. Fourteen local authorities reduced the local property tax by between 1.5% and 15%, with more than half voting to reduce it by between 10% and 15%. Those that reduced it by 15% have the highest average proportion of their income coming directly from local businesses through commercial rates, with 56.5% of South County Dublin's revenue coming from commercial rates alone. It should be noted that Galway City Council, Kerry County Council and Meath County Council chose not to vary the LPT rate for 2015. This is a commendable stance to have taken and should be replicated by others in future years.

Figure 4: Commercial rates (% of 2013 budget)



Varying the local property tax rate is unsustainable. It amounts to a giveaway to those who contribute least to local authority finances but consume the majority of services provided. Instead of reducing the local property tax take, the money could have been better spent supporting job creation and boosting local employment in the area, particularly in the SME community. Indeed, future reductions to local charges or savings from local government reform should first prioritise local job creation measures. Any potential funding shortfall for local services must not fall on local businesses whose growth is already being hampered by high commercial rates.

The equalisation fund should not be used to cut the LPT rate

Only 12 local authorities were net beneficiaries from the LPT itself. Of the remaining 19 local authorities, five voted to reduce the LPT rate in their area for 2015. This was due to the fact that following the local retention of 80% of the LPT and a top-up from the equalisation fund, these areas had a surplus in terms of the 2014 baseline. This surplus was passed back to property owners. In effect this means that rate payers and property owners in

counties which are net contributors to the equalisation fund are subsidising LPT cuts for property owners in other counties; this was not the intended purpose of the equalisation fund.

Table 1: Equalisation fund and LPT cuts

Local Authority	80% LPT retained locally €m	Equalisation Fund Contribution €m	Total LPT to be provided in 2015 €m	Value of full LPT increase €m	LPT Rate Reduction
Limerick	12.96	1.67	14.63	2.43	3%
Longford	1.74	6.38	8.12	0.33	3%
Louth	7.76	0.48	8.24	1.46	1.5%
Mayo	8.57	8.92	17.49	1.61	3%
Westmeath	5.26	4.85	10.12	0.99	3%

Source: Department of the Environment, Revenue Commissioners

The equalisation fund should not result in generating a profit for a local authority to be used for a local rebate to property owners. The equalisation fund should merely ensure that local authorities are exactly at 2014 levels. Any surplus should be returned to the equalisation fund pot to be used to support economic growth measures. At the very least, the use of surplus funding resulting from the equalisation process to vary the LPT rate should be prohibited. This would give further impetus to all local authorities to seek real cost savings and efficiencies in services provided

Supporting local economic growth

Recent local government reforms have resulted in the 31 local authorities formally assuming an active role in promoting local economic development, supporting entrepreneurs and helping existing businesses. For example, the new Local Enterprise Offices (LEOs) will play a key role in supporting local entrepreneurs and helping existing local businesses to grow. Local authorities must do all in their power to incentivise local enterprise and entrepreneurship.

Commercial rates not the LPT are the primary source of income for local authorities across Ireland. Local authorities have a significant impact on business conditions and cost competitiveness in their locality through commercial rates, other charges and policies. Rates affect a company's cost base and pressures on cash flow of a new business can threaten its very survival. As such, any surplus revenue resulting from the local property tax must first prioritise local economic development and job creation measures.

Introduce a competitive "town growth fund"

Over the coming years with the economy improving, the valuation of properties will increase as will the total number of properties liable for the LPT. This will in turn lead to a rise in the overall income generated from the LPT. The trend of the urban areas contributing most to the LPT will increase and there will be pressures from those local authorities for the capability to vary the LPT rate above the current 15% limit. This would be due to the fact that a significant surplus would remain after payment into the equalisation fund and application of the maximum discount to property holders. Ibec any further increase in the discretionary rate that local authorities may apply.

The economy is recovering much faster than many expected but not all parts of the country are benefiting. We need a detailed plan to support balanced regional development and the revitalising of town centres will underpin future growth across the regions. However, successful and sustainable town centre revitalisation can only be achieved through determined efforts at local and national level. We need to prioritise investment in these areas and the LPT can play an important role.

Increases in the LPT equalisation fund should be earmarked for a new "town growth fund" to support the revitalisation of town centres across the country. Projects will be funded through a competitive process in order to ensure a rigorous focus on boosting growth in towns across the country. Proposals should be based on a genuine partnership between public and private sectors. They should also require matching funding in order to leverage funding coming from the LPT central pot. This would allow our town centres to become regional centres of growth once more.

Exempt social housing from the LPT

Each the State will provide around €1 billion of direct housing support through the provision of social housing and rent supplement (with an additional €1 billion indirectly through mortgage interest relief). This system of almost wholly publicly funded social housing is unique to Ireland. Budget 2105 saw a further €300 million to be invested in PPP schemes and €400 million to support off-balance sheet investment.

Increasing the social housing stock is a key Government priority. Local authorities remain the largest provider of socially rented housing (107,000 units approx) in the State followed by much lower levels coming from housing agencies. Existing low rent levels, tight staffing conditions and funding for local government make it difficult for local authorities to increase the stock of social housing.

Table 2: Social housing provision

Housing	€ spend per person	% of budget
Cork City	€359.88	26%
Dublin City	€387.21	25%
Dun Laoghaire-Rathdown	€148.33	18.5%
Fingal	€146.17	19%
Galway City	€226.93	21%
Limerick	€150.40	17%
South Dublin	€209.53	26%
Waterford	€204.73	19%
National Average	€165.21	18.12%

Source: Publicpolicy.ie

Housing remains an acute service provided largely urban local authorities (i.e. city councils). It is not however one of the exempted areas from the LPT and we have the strange situation of local authorities paying the LPT on their social housing stock. A straight exemption for social housing from the LPT would result in expenditure being purely earmarked for housing needs in the areas where it is most needed and not transferring to other uses such as the equalisation fund. Government is also altering the structures through which social housing is delivered and a LPT exemption would make it more attractive to external investments.

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