



OLR RESEARCH REPORT

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AREA-BASED VERSUS VALUE-BASED PROPERTY TAX SYSTEMS

By: Mark Randall, Research Fellow

You asked (1) whether any states currently use an area-based property tax system and (2) about the advantages and disadvantages of an area-based property tax versus a value-based tax (i.e., ad valorem).

SUMMARY

Currently, no state in the U.S. uses an area-based property tax system. Although the U.S. does not use such a system, it has gained popularity in developing countries. These countries calculate the tax owed by multiplying the measured area of land and buildings by a per-unit assessment rate instead of collecting a percentage of the market value of property.

There are advantages and disadvantages to both tax systems. An area-based tax may be simpler to administer than a value-based property tax system, however, it may be unable to generate adequate revenues to fund locally provided goods and services compared to the value-based tax. Conversely, while a value-based tax is more equitable in terms of the taxpayer's ability-to-pay, market value estimations are not as objective as area measurements when determining the tax owed.

PROS AND CONS OF AN AREA-BASED PROPERTY TAX

According to the Lincoln Land Institute, no state or municipality in the U.S. bases property tax on area square footage. But, area may figure into the calculation of some fees (e.g., for water districts or for special assessments – the costs of roads and street lighting often are allocated on a per-front-foot basis).

According to the Lincoln Land Institute's *Area-Based Property Tax Systems: Current Practice and Equity Concerns*, although the U.S. does not use area-based property tax, it has gained popularity in developing and transitional countries around the world and currently is administered in 38 countries. These countries calculate the tax owed by multiplying the measured area of land and buildings by a per-unit assessment rate, instead of collecting a percentage of the market value of property as tax. Most of the countries that rely on area-based valuation (1) do not have the administrative capacity to maintain updated records with the information necessary for market valuation, (2) lack property markets, or (3) have institutional barriers that obstruct market based valuation.

Pros

The study examined the area-based property tax system against a value-based tax using commonly accepted criteria for evaluating alternative revenue (revenue productivity, simplicity, and equity). An area-based property tax has certain advantages over a value-based system. An area-based system (1) scores well in terms of revenue stability and predictability; (2) may be simpler to administer than a value-based property tax system by requiring only area measurements, and eliminating the need for costly collection and analysis of market data and revaluations; and (3) may be equitable in terms of an individual's tax burden in proportion to the amount of benefit received from the property. In addition, the measurement of area is more objective than estimations of property market value because assessors make judgments about comparable properties when estimating market value.

Cons

One disadvantage of an area-based system is its inability to generate adequate revenues to fund locally provided goods and services compared to a market value-based property tax. A value-based property tax also scores better on ability-to-pay equity grounds. An area-based assessment results in a relatively greater burden on low-income

taxpayers than high-income taxpayers when compared to value-based assessment. This is because average household incomes in high-value neighborhoods are higher than in low-value neighborhoods. Finally, an area based system taxes all properties that are the same size equally, regardless of whether they are in high-income or low-income neighborhoods.

SOURCE:

Area-Based Property Tax Systems: Current Practice and Equity Concerns:
https://www.lincolnst.edu/pubs/dl/1624_848_Connolly%20Bell%20Finnal.pdf

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