

Immovable Property Tax Exemptions as a Tool of Tax Policy

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Abstract

This text is dealing with the exemptions from the immovable property tax in the Czech Republic. It brings a new classification of tax exemptions and it overviews this type of correction components. It critically analyses de lege lata regulations in the given area. The hypothesis to be confirmed or disproved is that the Immovable Property Tax Act enables the implementation of the tax policy of both state and local governments. At the end, possible regulations de lege ferenda are drafted.

Keywords

tax; property tax; correction component; tax policy

1 Introduction

At the International Conference on the Financial Law of Local Government “The Financing of Local Self-government and Its Tasks in the Light of the Regional Policy of the European Union” taken place in April 2018 in Gdansk, Poland, there were many interesting contributions. To prepare this article, I was inspired by two of them. The first one was Mariusz Popławski, who was talking about tax exemptions in local taxes as an element of state and local government tax policies (Popławski, 2018). The second was Małgorzata Wróblewska, who was more detailed in the same topic

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dealing with exemption of port infrastructure from the real estate tax (Wróblewska, 2018). The main conclusion in both of the presentations was the same: the law on local taxes does not enable the implementation of the tax policy of local governments. The State introduces property tax exemptions while bearing no economic consequences of those exemptions. Popławski generally calls for the compensation for the lost incomes of the (Polish) municipalities caused by the statutory exemptions, which are introduced in local taxes. Wróblewska, dealing more with the local issues of Gdansk, suggests abolishing exemptions for the ports.

Influenced by these two researchers and their presentations, I have decided to write a contribution to similar issues but focused on the Czech Republic. The following text is dealing with the exemptions from the immovable property tax in the Czech Republic. The main aim of the article is to bring a new classification of tax exemptions and to overview this type of correction component. It critically analyses *de lege lata* regulations in the given area, and in several cases offers a historical comparison. The hypothesis to be confirmed or disproved is that the Immoveable Property Tax Act enables the implementation of the tax policy of both state and local governments. At the end, using the synthesis method, possible regulations *de lege ferenda* are drafted. At the moment, there is no scientific literature in the Czech Republic concerning these problems.

2 Property Tax Correction Components Classification

Immovable property tax in the Czech Republic is regulated by the Immoveable Property Tax Act (Act No. 338/1992 Sb.). This Act provides for two taxes on immovable property: the land tax; and the tax on buildings including houses, flats/apartments and non-residential premises. Primarily, the unit/area (in terms of square metres) system is used. Only in case of agricultural land, commercial forests and ponds used for fish-farming is the *ad valorem* system partially used.

There are many correction components in the Immoveable Property Tax Act. The most common is the exemption. The first classification of exemptions is *based on the duty to apply for the exemption in the tax return*. There are many “automatic” exemptions (the exemption is applied by the tax administrator without any duty of the taxpayer to announce or apply for the exemption: land and buildings owned by the State, municipalities, regional governments and diplomatic representatives, etc.). The same regime is in fact applied to the property not liable to tax; that is why these situations must be analysed together with the property exempted without the duty to file the tax return. For the second group of exempted property, the claims for exemptions must be made in the first tax return after acquiring the immovable property. This affects land and buildings owned by churches, schools and universities, museums, galleries and hospitals, buildings used in public passenger transport or in water management, etc.

The second possible classification is based on the fact *whether the generally exempted property is used for profit-making purposes*. There is a list of general exemptions, but if the property is used for profit-making purposes, the taxpayer loses the right for the exemption. This applies for example on land and buildings used for public interests, ecological purposes, and those under reciprocal international treaties, etc.

The third classification is based on the *duration of the exemption*. Most of the property is exempted permanently and only a limited number of land and buildings are exempted for a limited period: agricultural land returned to agriculture cultivation (5 years), woodland returned to forestry use (25 years), land and buildings affected by a natural disaster (5 years), land and buildings in special industrial zones designated as such by the Government of the Czech Republic (5 years), reconstructed cultural monuments (8 years), structures where the heating system was changed from solid fuels to a renewable energy system (solar, wind, geothermal, biomass – 5 years).

The fourth possible classification is based on the *level of making the decision on the exemption*. Some states are clever enough to know that local self-government units as the tax beneficiaries have experience and better knowledge of local circumstances to evaluate possible impacts of taxation and related exemptions. This rule is valid for the regions in Belgium and municipalities in Lithuania, Slovakia and Slovenia; in France, the decision regarding an exemption is in the hands of regions and municipalities. On the other hand, in Bulgaria, Cyprus, Finland, Greece, Ireland, Luxembourg, Germany, Spain and Sweden only the State sets the exemptions. All the other EU member states are using the mixed system, similarly to the Czech Republic (Radvan, 2012: 194–195).

Most of the exemptions in the Czech Republic are adopted by the Parliament on the state level, stated in the Immovable Property Tax Act. This Act allows the municipalities to adopt their own exemptions by a local bylaw – a generally binding ordinance. However, the list of these exemptions is also stated in the Immovable Property Tax Act and municipalities are not allowed to adopt any other exemption. There are three possible exemptions for the municipalities. When eliminating consequences of natural disaster, a municipality may fully or partly (as a percentage) exempt the property, which is located within its area and which was affected by a natural disaster, for a period of up to five years. Various types of agricultural land such as arable land, hop-gardens, vineyards, orchards and land under permanent grass can be exempted as a subsidy for the agricultural industry. As an investment incentive, immovable property in special industrial zones, designated as such by the Government of the Czech Republic, may be exempt for up to five years (Radvan, 2016: 69–82).

The fifth classification is the most common one, based on the *reason for the exemption*. I have defined five criteria applicable in the Czech Republic:

1. Public ownership – property owned by the State, region, municipality, used for diplomatic purposes, used by the army;
2. Public benefit – cultural heritage, church property including cemeteries, property owned by generally beneficial subjects and foundations, schools, universities and research institutes, museums and galleries, libraries, public archives,

- hospitals, social services providers, parks, sport grounds, property used for public transportation including ports, airports, railway stations;
3. Ecological aspect – water areas excluding ponds, woodland excluding commercial forests, property used for waste management and water management including irrigation facilities, small water power plants, wind power plants, biogas power plants, geothermal facilities, biomass facilities, structures where the heating system was changed from solid fuels to a renewable energy system (solar, wind, geothermal, biomass), specially protected land and 1st zones of natural parks, land to protect animals in the fields and grass growths, woodland returned to forestry use and agricultural land returned to agriculture cultivation;
 4. (Investment) incentive – land used for heat and energy distribution, agricultural land (arable land, hop-gardens, vineyards, orchards and land under permanent grass), property in special industrial zones;
 5. Social reason – family houses, flats and summer houses (cottages) owned by disabled person.

2.1 Critique

As it is obvious from the text above, there are too many exemptions in the Czech Immovable Property Tax Act. Moreover, the same regime is in fact applied to the property not liable to tax. It would be clearer to state that all the property is liable to tax, with the defined exemptions. In this case, the most important is the exemption for land within the ground plan of a building (i.e. land under the building – its “footprint”) and apartment block buildings, in respect of which the tax is payable on the apartments/flats and associated non-residential premises. Because of the higher coefficient for the units, land owned by the owner of the unit where the land is used together with the unit (flat and non-residential premise) should be exempted, too.

Concerning the duty to file the tax return for the exempted property, there are two theories. The first one respects the needs of the State and every taxpayer should calculate its own tax (but not pay the tax if the property is exempted) so that it is obvious what the “lost” revenue is, from the exempted property. The second approach respects the principle of efficiency, i.e. if the tax office can get the reason to exempt the property itself, there should not be any obligation of the announcement by the taxpayer. However, in several cases, it might be difficult (for example if the property is used for business purposes). It seems to be necessary to analyse every exemption and decide whether there is any other possibility to get the information for the exemption without the announcement by the taxpayer.

Dealing with time-limited exemptions, especially the reason should be analysed as it is closely connected to the time limit. Similarly, the total exempted tax duty in the period should be taken into account. More on these issues below.

Comparing the number of exemptions on the state and the local level, it is clear that the powers of municipalities are limited. Of course, the principle that taxes and fees can only be imposed by acts of Parliament, must be respected [Art. 11(5) of the Charter of Fundamental Rights and Freedoms]. But the Immovable Property Tax Act can give municipalities the same powers as they have in the Local Charges Act, i.e. they should be allowed to set exemptions in the local bylaw – a generally binding ordinance.²

From practice, it is obvious that existing possibilities are not used frequently. In case of a natural disaster, it is difficult to say what property or which part of the property was affected by the natural disaster (for example flats in the first floor were damaged, but flats in the fourth floor are all right). Agricultural land exemption has no sense in large cities with small number of agricultural land. The exemption of immovable property taxation as an investment incentive is very new (can be used for the first time in the taxable year of 2016 and there is not enough data for analyses), but compared to the total investment, the saved property tax is really negligible. And in all cases, it is necessary to take into account the primal function of the property tax – its fiscal function. After every natural disaster, the municipality needs higher revenues to finance the reconstructions of public property (roads, pavements, schools, libraries, etc.). Small villages with a lot of agricultural land cannot lose substantial revenue source from the agricultural land. And almost every investment in the territory of the municipality means higher costs for the municipality.

Researching the reasons for the immovable property tax exemptions, it is obvious that primarily the State is performing its policy, stating the exemptions. In most cases, the exemptions are clever, useful, and reasoned, especially in the group of public benefit exemptions (highways, roads, railroads, parks, sport grounds, cultural heritage, church property, property owned by generally beneficial subjects and foundations, schools, universities and research institutes, museums and galleries, libraries, public archives, hospitals, social services providers).

There is no reason to exempt ports, airports, railways and bus stations. Such a property has high value,³ and it is used for business purposes, to generate profit – and high tax revenues. There is competition between the operators, especially in case of airports, bus terminals, and river ports. This competition is usually at the national level, but concerning airports, it is even international. Ultimately, the State provides public support for the operators.

The public ownership exemptions are to be changed, as well. There is no reason to exempt property owned by the State, even though one can argue that exemptions for state property are the compensations for the immovable property tax administration provided and paid by the State (and not by the municipality who is the immovable property tax beneficiary). The State owns in individual municipalities a different amount of property and then such an exemption is not fair. There is no reason to exempt property owned by regions, too. On the other hand, the exemptions of the municipal

² Compare Art. 14(2) of the Local Charges Act.

³ E.g. Heathrow airport has a rental value of 319 million pounds. McCluskey, 2018.

(if the property is located in the territory of this municipality), diplomatic and military property seems to be clever.

Most of the ecological aspects in the immovable property tax exemptions are reasonable (water areas excluding ponds, woodland excluding commercial forests, specially protected land and 1st zones of natural parks, land to protect animals in the fields and grass growths, etc.). However, there are several issues to be solved. Especially property used for waste management and water management including irrigation facilities should not be exempted because such a property is used primarily for business purposes. The same arguments apply for all the power plants (water, wind, and biogas), “ecological” facilities (geothermal, biomass), and the land used for heat and energy distribution (from the group of incentive exemptions). There are always some stimulation programmes for more ecological heating systems and it is not necessary to support them with the tax exemptions. The same applies to woodland and agricultural land cultivations. Moreover, the property tax saved is marginal, compared to the total costs of a new heating system or a cultivation.

A very low immovable property tax might be an argument to abolish socially reasoned and investment incentive exemptions, as well. The historical experience from municipalities is evident: only several municipalities were able to find (mostly only political) reasons to exempt agricultural land (arable land, hop-gardens, vineyards, orchards and land under permanent grass) and properties in special industrial zones. Concerning the family houses, flats and summer houses (cottages) owned by disabled persons, I would prefer to cancel these exemptions because there is no fixed link between the disability and ability to pay the immovable property tax. If the tax is higher, we may think about the exemptions for the first dwelling, but there is no reason to exempt the second houses including summer houses.

3 Conclusion

There are many problems in the immovable property taxation in the Czech Republic, and the reduction of exemptions is strictly connected with the other structural components of the immovable property tax. I have tried to introduce a new classification of the immovable property tax exemptions by defining five criteria: public ownership, public benefit, ecological aspects, (investment) incentives, and social reasons. From the critical analyses of contemporary exemptions, it is obvious that there are many problematic issues and many exemptions that should be cancelled.

Primarily, it is necessary to abolish the group of property not liable to tax and to state that all the property is liable to tax. Then it is possible to define exemptions. The basic exemption should respect the principle of only one tax on each piece of land (i.e. an exemption for the land within the ground plans of a building and an exemption for apartment block buildings, in respect of which the tax is payable on the apartments/flats and associated non-residential premises). For the duty to file the tax return for

the exempted property, it seems to be necessary to analyse every exemption and decide whether there is any other possibility to get the information for the exemption without an announcement by the taxpayer.

The research shows that there are too many immovable property tax exemptions and the powers of municipalities as tax beneficiaries are limited. The reflections presented in this paper confirm the hypothesis that the Immoveable Property Tax Act enables the implementation of the tax policy of only the central government; however, for the local governments the same hypothesis is disproved. Popławski states that: *“Introduced statutory exemptions in local taxes should be accompanied by an obligation of the state introducing compensation for the lost incomes of the municipality”* (Popławski, 2018). Because of different conditions in Poland, I really do not think that the Czech Republic should be inspired by the Polish regulation. The most important difference is the tax administrator: while in Poland property taxes are administered by the municipality, in the Czech Republic it is the task of the State.

My suggestion is to define basic exemptions on the state level. Besides the exemption mentioned above, which is based on the principle “one piece of land – one tax”, the State should set only a limited number of exemptions to promote its interests. The group of statutory exemptions should include diplomatic and military property, water areas excluding ponds, specially protected land, natural parks, cultural heritage, roads and highways, railroads. This would allow the State to implement its tax policy adequately and sufficiently. All the other exemptions should be up to the municipality as a beneficiary of the immovable property tax. The Immoveable Property Tax Act should give municipalities the same powers as they have in the Local Charges Act, i.e. they should be allowed to set exemptions in the local bylaw – a generally binding ordinance. This would enable the implementation of the tax policy as well as the local (municipal) level.

Every municipality should than adopt such exemptions, those are useful and adequate for local circumstances, to get sufficient revenues. They should be aware of all three basic functions of the tax: fiscal, stimulating and regulatory. Municipalities should take into account possible public support introducing the exemptions, especially (with regard to the contemporary regulation) in the area of public transportation, “green” energy and heat and energy distribution, waste and water management, etc. Without any doubts, the exemption will always be influenced by political motivations, but the representatives of the municipalities should try to avoid these exemptions. They should also take into account the administrative burden and administrative costs related to the exemptions, especially if the amount of the immovable property tax remains the same, i.e. extremely low. Due to the number of small municipalities in the Czech Republic, tax administration will remain on the national tax authorities. That is another reason for the very limited number of exemption on both state and local level.

Any regulation of immovable property tax exemptions *de lege ferenda* is strictly connected with the amendments of other structural components of the immovable property tax. As the role of the immovable property tax in the Czech Republic is marginal, it is necessary to think about essential amendments. An *ad valorem* tax base

is not a solution: it is expensive to establish, administratively demanding and time-consuming. My proposal is to set one maximum tax rate in the Act for every type of property. Municipalities should have the right to introduce their own specific tax rates below that level. As there are more than 6,250 municipalities in the Czech Republic and many of them are extremely small with a very low number of inhabitants, there should be another rate (standard rate) in the Act for those municipalities that do not set their own specific tax rates.

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