

Property Taxation and Land Policy in France

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The interaction between real estate taxation and land policy is often confusing because of the different objectives of these public policies. A brief examination of the main property taxation devices now applied in France (yearly taxation, wealth tax, development taxes, and exactions) evidences the gap between fiscal objectives (proceeds, social justice, economic incentives) and land policy objectives (land supply, betterment recoupment). The recent 1985–1990 property boom makes it necessary to introduce a financial mechanism to mitigate its exclusionary consequences.

Introduction

Land taxation can be traced back as far as the Egyptian empire (3500–2200 B.C.), when public budgets were financed by a single tax on land. The assessment of land values was based at that time on both the market value of the capital and the income provided by its use. Since that time, land has been used as a tax base in most countries, but its share in the overall taxation system is declining in most of them as evidenced by the recent Organisation for Economic Co-operation and Development (OECD) reports (1990).

Many discussions about the interaction between property taxation and land policy can be confusing because they mix different purposes that can be pursued by any taxation device:

- providing money for public authorities (proceeds)
- social justice (distribution)
- economic incentive (allocation)

These objectives are to some extent contradictory: the maximization of proceeds can be inconsistent with social justice, an efficient taxation in terms of land supply will bring about only limited proceeds, and so on.

A large number of taxation devices have been used around the world, but many of them still have to be analyzed and evaluated carefully. The "Georgian" site value taxation mechanism, implemented *inter alia* in Australia and Denmark, seems to be the most promising device, but it requires a set of conditions—accuracy of assessments, fresh updating, stability of zoning—that prevails in only a limited number of countries.

In France, property taxation was introduced in 1790 during the French Revolution, and can be characterized by the many taxes, local rates, and subsidiary levies based on property. Property taxation is an issue that has been repeatedly discussed by politicians since the end of World War II and has produced many laws and regulations, parliamentary reports, decrees, or circulars. This accumulation has not yet proven very satisfactory when related to the three objectives that have been defined.

This paper first describes the "traditional" yearly property taxes (local taxes on raw land and on improved property) and the 1991–92 general reassessment, as well as the "wealth tax" introduced in 1982.

Then the paper describes and analyzes different taxes on transfers of property and on development levied at the time of sale, change of use, or construction, especially the "legal density ceiling" and the various types of exactions. A special device, similar to "linkage" in the United States, is included in the town planning law of July 19, 1991.

The paper concludes with comments on the present trend of deregulation, its consequences in terms of segregation, and the possible influence of property taxation.

This paper does not intend to provide a thorough analysis of property taxation and its interaction with land policy. This would require the analysis of the entire taxation system because many taxes, for instance, income tax, value added tax, or professional tax, are based to some extent on the value of properties or on incomes derived from property and have some influence on land and property markets.

This is, rather, a selective description and analysis of the main taxation devices directly related to land ownership and land development, whose effects on the land market can be analyzed and commented on, to make comparison with different property taxation systems easier.

Yearly Property Taxation

During the French Revolution, when the property tax was introduced in France, the idea was to create a state taxation that would be unified, rational, and simple, based on the then major source of wealth: land. The tax base was (and still is) the rental value of land. Then in the mid-nine-

teenth century, a tax on buildings, also considered as a source of income for owners, based on the rental value appeared.

Later, as the economy grew and the fiscal machinery developed (income tax in 1917, value added tax after World War II), property taxes were increasingly transferred to local governments, especially municipalities. Through a 1949 act, property taxation became entirely the responsibility of local authorities.

The present system of property taxation was defined by a statute of January 1959 and includes three local taxes based on property.

- the tax on raw land (*taxe foncière sur les propriétés non bâties*), paid by the landowner, based on the rental value of land (with a 20 percent allowance)
- the tax on built property (*taxe foncière sur les propriétés bâties*) paid by the owner, based on the rental value of the buildings, with an allowance of 50 percent
- the housing tax (*taxe d'habitation*), paid by the occupiers of the dwelling, based on rental values, with rebates depending on the size of the family.

The appraisal of the tax base is done in each municipality by an ad hoc "municipal committee for direct taxation," including elected officials and representatives of property owners.

Land is classified into thirteen categories (for instance, category 2: "meadows, grassland, pastures," or category 6: "moorland, heathland, marshland"). The committee then chooses a standard parcel that characterizes each category, appraises its value, and assigns any parcel to one of the thirteen categories.

The appraisal of the ratable value of buildings follows similar lines: houses and flats are classified into eight categories (from luxury to slums) and each category is provided with a reference dwelling and ratable value per square meter. Some adaptations take into account the size of the dwelling, degree of comfort, quality of location.

This local taxation system is usually considered unsatisfactory. The calculation of the tax is rather obscure to the taxpayer, the management is complex, and the general reassessment of values has been repeatedly postponed. Up to 1989, the last general direct assessment of land values had taken place in 1961 (land) and 1971 (buildings). Since then, the assessments were simply updated through lump sum coefficients to keep up with inflation.

As a whole, these taxes apply to 97 million land parcels and 37 million units of dwelling, office space, and industrial premises. These numbers help explain why the costly process of reassessment has been so delayed. Eventually, a 1989 statute ordered a general reassessment of the tax base, including some changes in the valuation principles:

- Land parcels will be classified in seven categories (instead of thirteen), divided into subgroups.
- In any group, the Ministry of Finance will make an assessment of the rental value of a typical parcel for every "homogeneous area," possibly including several municipalities. The rate of the tax is decided by the municipality, within some limits on increases and on ratios to other local taxes.
- A major change, optional for municipalities, concerns the appraisal of land classified as building land in the local plan. Assessment will be based in the future on market values instead of rental values, and this could result in much higher taxes on such land, thus providing an incentive to land supply.

This last point is controversial, especially in areas with development pressure and rapid land price increases, where the implementation of this mechanism would raise considerably the amount of the land tax.

As a whole, the general revision of the property tax base in France that began in July 1990 is a heavy task, extending over two years with a cost of about \$200 million (US). The revised values will probably apply for the property tax levied in 1994.

A general evaluation of the annual land tax leads to some unimpressive results in relation to the three criteria:

- *proceeds*: The amount to be raised is not very important (7.3 billion FF, that is, 5.5 percent of total local taxes) and is in steady decline, but the management cost is high.
- *equity*: The land tax, important for small municipalities in which agriculture is important, is negligible in major cities. The effective rate of the tax is 0.4 percent for agricultural land but usually under 0.1 percent for urban land.
- *incentive*: The undertaxation of urban land will probably stimulate "land hoarding" in developing areas.

These conclusions obviously raise the question of a deeper reform than the one envisaged in the general reassessment process. Given its importance in the overall taxation system, some advocate its suppression and replacement by grants from the national government (it would suffice to raise the VAT rate by 0.4 percent). Others suggest using market value for all properties as a tax base, thus increasing proceeds in cities. But the Ministry of Finance is not enthusiastic about a drastic reform of the land tax that is still postponed.

The Wealth Tax

The taxation of the global wealth of households at a progressive rate was introduced in 1982 by the socialist government, with a large set of ex-

emptions (art and antiquities, firms when the taxpayer owns more than 25 percent of the capital, woods, and other items). Suppressed by the right wing government in 1986–88, the wealth tax was reintroduced by the finance law for 1989, with slight changes in the rates, exemptions, and so on.

The tax now includes a "circuit-breaker" mechanism: the wealth tax plus the income tax must not exceed 70 percent of taxable income (the maximum rate of income tax is 58 percent). Rates of the wealth tax are shown in table 1. About 160,000 taxpayers are now subjected to the wealth tax, with proceeds at slightly over 5 billion FF.

After severe criticism in the early 1980s, this tax is now accepted, and no candidate in the 1988 presidential election campaigned on the suppression of the wealth tax. As opposed to the property tax, the wealth tax is based on the market value, declared by the taxpayer. Given the random location of the properties affected by the tax, it is obviously difficult to assess its effects on property markets and the behavior of property owners.

Taxes on Property Sales and Property Development

The approach is very different for these two types of taxes. The taxation of property transfers is an ancient concept: as soon as a property changes hands, whether through sale or inheritance, the state takes advantage of the obligatory registration to extract a portion of the value. The rationale is to cover the administrative cost of registration, but this relationship has become loose, and transfers of property are a practical base for taxation.

On the other hand, it can be argued that high transfer taxes can reduce the fluidity of the market by raising the transaction cost, thus disturbing the optimum market equilibrium. This point is often argued in France where the basic rate of transfer tax is 13.8 percent, very high compared with other countries. But it can be emphasized that most transactions (agricultural land, owner-occupied dwellings, social housing, recent dwellings, and so on) are subject to much lower rates, for instance 2.6 percent

TABLE 1
Wealth Tax Rates

Wealth (million FF)	Rate of the tax
< 4,13	0
4,13 to 6,71	0,5 %
6,71 to 13,22	0,7 %
13,22 to 20,66	0,9 %
20,66 to 40	1,2 %
> 40	1,5 %

for an owner-occupied dwelling. The level of transfer taxes nevertheless remains high in France compared to other European countries and should be decreased in the perspective of the unification of the common market in 1993.

On the other hand, the taxation of land at the time it is developed has given rise to several mechanisms that mix two related objectives: recouping value increases and providing money to finance infrastructure. Both are closely connected, since the increase in land prices results to a large extent from the creation of infrastructure networks by public authorities. But the link is not automatic.

We shall focus here on three different mechanisms for coping with this problem: the legal density ceiling (1975), development fees and exactions, and the present project of a tax on new housing to finance development of land for affordable housing.

The Legal Density Ceiling (*Plafond Légal de Densité*)

The 1975 Town and Country Planning Act instituted the legal density ceiling (PLD), whereby limits are set to a landowner's development rights, independently of other constraints resulting from regulations. That is, the developer, when he gets a building permit with a floor area ratio greater than the ceiling, has to "buy" from the authority the development rights in excess of the ceiling. Initially, the PLD was fixed at one square meter of floor area per square meter of land, except in Paris where it was 1.5. When regulations allow a higher floor area ratio, the developer may build at a density higher than the PLD, on condition that he pays a fee equivalent to the market price of the area of extra land that would be needed in order not to exceed the PLD.

The PLD was aimed at reducing the increases in land values from which centrally located plots with high density benefited. The idea was to discourage high density schemes by fiscal means that also brought extra resources to the local councils, thus providing at the same time some recoupment of "windfall gains" resulting from zoning.

The mechanism has been changed to be more flexible. After 1983, the municipalities with more than 50,000 inhabitants were allowed to increase the level of the PLD to between one and two, and the city of Paris has increased it to three. A 1986 statute has made it optional for municipalities, and the upper limit has been removed, thus reducing its real impact.

The PLD device is not as commonly used as it used to be, but it is still an important source of income for local councils, especially in areas undergoing a boom in office building (for instance in the western suburbs of Paris). About 2,000 municipalities have kept this mechanism.

Planning, Development and Servicing Costs

The increased flexibility in the planning framework has modified the relationship between developers and builders on one side, and the municipalities on the other, regarding the decision-making process for issuing a building permit, as well as the financing of the servicing cost. Development fees and exactions are an important part of the property taxation system and have an obvious influence on the land markets.

From the Local Plan to the Building Permit. The "Brave New World" of techno-planning supposed a one-to-one relationship between zoning regulations included in a local plan and the characteristics and conditions of a building permit. But, negotiation is now a major part of the process, and it can be worth looking more precisely at the different types of development processes that can occur.

Complex development schemes, possibly including hundreds of dwellings, office space, shopping centers, and so on, are being developed through a specific legal process, the comprehensive development area (or ZAC, *zone d'aménagement concerté*).

Some are directly or indirectly managed by public authorities, often a municipality or a public-private company (*société d'économie mixte*). But a majority of ZACs enable an authority to negotiate the conditions of a development scheme with a private developer. The coherence of the scheme is established by a program and a plan which together are meant to assess the cost of the public works to be included, and the approval of the contract specifies the proportion of the required servicing costs to be financed by the public authority and by the developer, respectively. Once approved, the ZAC plan is included in the local plan.

This tool of negotiated urban development, introduced in a 1967 statute, had decreased to low levels in the late seventies, but it has increased rapidly in the eighties. Today, about 40 percent of all new development uses this process. Sometimes it includes some cross-subsidization in order to provide affordable housing, and comprehensive development areas are well adapted to major development schemes, insofar as the public partner has a competent staff of planners, as in most major cities.

When this is not the case, it happens that some large developer-builders can dominate the bargaining process, with a possible sliding from fair public-private partnership to some kind of "public cost/private benefits" scheme. The bargaining power is then a crucial element for assessing the efficiency-equity balance in planning implementation.

The same comment applies, albeit in a different way, for the subdivision procedure. There a developer (*lotisseur*) buys and assembles various neighboring plots of land, then services the whole area and subdivides it into a number of plots of usually 300 to 800 square meters ready to be built, with the guarantee that the buyer will get a building permit. This

usual procedure (more than 80,000 single-family dwellings are built yearly through this procedure) involves of course prior negotiation between the original landowner and the developer.

But the planning context has changed. In the former centralized over-regulated system, developers usually looked for adequately zoned areas classified as development areas in local plans. The flexibility of planning has modified the process to a certain extent: developers often negotiate with landowners to buy pieces of land not yet classified as development land, obtain an option (*promesse de vente*), get in touch with the municipality to obtain a rezoning of the area, and then conclude the purchase and get the building permit.

As a result, a "floating value" phenomenon occurs whereby the increment of land prices resulting from development rights, instead of being restricted to "well-zoned" areas, is spreading over larger and larger parts of agricultural or other natural areas. The growth of the market of options is usually considered by economists to favor economic efficiency, but in the case of urban development, it can be a threat to any physical planning insofar as zoning is more determined by the price of options, that is, the hope value of rezoning, than by urban, social, and environmental factors.

Public or Private Supply of Public Services. Urban development requires the provision of various facilities (such as roads, sewerage, and various networks) which can be financed by a public authority or by the developer, that is, the household who buys. The sharing of the cost (Alterman 1988) between public and private partners and the way it is determined (negotiated or preset) is a key element to understanding the precise content of "public-private partnership." In France, after two decades of wavering between a systematic fiscal device (local development tax calculated as a percentage of a preset lump-sum price of the to-be-built floor area) and case-by-case negotiated agreements between developers and municipalities, such as it is practiced in comprehensive development areas, a new tool situated half-way between has been introduced in 1985 as "special exaction areas" (*programmes d'aménagement d'ensemble* [PAE]).

The municipal council delineates the geographical area within which developers who have secured a building permit will have to pay all or part of the costs of the public infrastructure required by present and future residents of the area. The amount of the exaction is not preset; the statute only says that the amount cannot exceed 100 percent of the real cost of infrastructure. The municipality must establish the nature of these public facilities (roads, sewerage, parks, schools, and so on), their cost, schedule for building, as well as the developer's share (per square meter of floor area to be built) of the total cost and how it will be apportioned among the various building types. The exaction can be in-kind or monetary.

In the latter case, if the local government does not carry out the infrastructure program on schedule, the developer can claim reimbursement

for exactions paid. This legal framework is flexible, consistent with the principles of decentralization implemented in France since 1982. The only constraint for municipalities is that the schedule for providing facilities must be decided when the special exaction area is approved, independent of the real timing of the development. As yet, this has not caused problems for municipalities, although many will probably establish long-term infrastructure construction schedules to avoid reimbursement claims.

Special exaction areas are too recent to be evaluated thoroughly. Compared to the former practice of informal, and often illegal, case-by-case exactions, however, the new procedure has improved the system by clarifying the statutory basis of exactions. Moreover, it has been observed that the announcement of the program, by displaying the servicing costs, could have some influence on the supply curve, being an incentive for landowners to lower their supply price for a given level of the demand curve. This cannot be demonstrated statistically but seems to result from a set of convergent observations (Vilmin 1990).

As a whole, this mechanism of "special exaction areas" seems to be an interesting adaptation of public-private partnership, providing at the same time some flexibility in the management of the development process and a sufficient picture of the future to allow developers and builders to plan their investments.

Flexible Planning, Land Prices, and Exclusionary Zoning. A constant argument in supply-side land economics is that an overregulated, tightly zoned system of planning, by reducing the areas where development is authorized, is a major factor behind the increase in land prices. On the other hand, deregulation and flexibility in planning should improve the situation by lowering land prices.

This line of reasoning looks sound and simple but it has not yet been confirmed by statistical observations, for instance in the United Kingdom between 1982 and 1986 or in France between 1986 and 1989.

Table 2 describes the evolution of land prices in the Paris region after 1986, where a clear-cut land supply policy has been implemented (deregulation, selling of public lands, and so on). The sharp increase in land prices occurred at the same time as an increase in the number of trans-

TABLE 2
Changes in Land Prices in the Paris Region

Average price of development of land	1986	1989	Increase (per-cent)
75—Paris	6.876 F/m ²	22.587 F/m ²	+ 228
92—Hauts de Seine	1.741 F/m ²	4.457 F/m ²	+ 156
94—Val de Marne	770 F/m ²	1.289 F/m ²	+ 67
93—Seine St-Denis	609 F/m ²	781 F/m ²	+ 28

actions, thus challenging the classical supply-demand relationship. Another point to be noted is the increasing discrepancy between land prices in already gentrified parts of the region (Paris, Hauts de Seine) and in less attractive areas (Val de Marne, Seine Saint-Denis).

Various factors can be set forth to explain this last observation. First of all, other things being equal, a land-supply policy does not necessarily increase the willingness of landowners to sell. To the contrary, it can persuade them that the most economically rational behavior is to wait until some land shortage is announced. In the absence of strong financial or fiscal incentives or obligatory measures to develop land, such a policy can thus increase "land-hoarding" by landowners.

Sales of unused or underused land owned by public authorities are often part of "land-supply" policies. It is clearly a reasonable objective to use public land in an efficient way—socially and economically.

But some comments can be derived from the experiences in the eighties in the United States, Great Britain, or France. First, public authorities in many countries are facing financial difficulties, and it can be attractive for them to sell to private developers at the highest price their best located properties. Instead of stabilizing land prices, this behaviour can fuel the land price boom.

Moreover, any policy concerning public land ownership must correspond to some long-term vision in which public land reserves can be used as an open-market mechanism to regularize the evolution of land prices, instead of using them as pocket-money when exhausted public budgets require it. The experience of northern European countries such as The Netherlands, Denmark, or Sweden can be helpful to understanding what a sound public-private partnership can be.

Deregulation and Exclusionary Zoning

It has been observed that deregulation could lead to an increased differentiation in land prices between areas. This is a simple consequence of market mechanisms, and their increased role in a more deregulated framework leads, as can be observed in various European countries (for instance, Spain, France, or Great Britain), to a spatial specialization of land use and social segregation.

In France, this phenomenon has occurred in the Paris region simultaneously with booming of land prices and a growing differentiation (urban, social, financial, environmental) between well-off western and poorer northeastern suburbs. This Hydra of urban management raises at the same time a problem of social justice and economic efficiency. It is admitted in most countries that any housing policy must include some subsidization mechanism in order to provide housing affordable to low-income

people. The question is to know where the required money must come from.

An answer, under the generic name of "linkage," has been given in the United States. Linkage is a system of having developers or builders, especially of office space (cf. San Francisco and Boston), contribute, in kind or through a financial contribution, to the development of affordable housing. Alterman (1989) recently assessed linkage:

the reasonable approach is to recognize the inherent appeal of linkage in the short run, but to look for more sound alternatives for the long run.... The forces that have propelled linkage are indicators of a potential new direction in American public policy: willingness to consider recapture of the windfall—the unearned increment—in land values and real estate development.

Such a mechanism (*Loi d'orientation pour la Ville*) has been introduced in a 1991 statute. The mechanism will allow the possibility of applying a special exaction called "*participation à la diversité de l'habitat*," through which a builder must provide up to 15 percent of the area, or the equivalent financial amount, to provide rental dwellings affordable to low-income households.

This topic is controversial in France. Besides the technical difficulties of carrying it out, linkage raises a basic question: provided that housing is a social need and that low-income people must be subsidized for it, will the required amounts be taken out of the most profitable parts of the development market, or will they be provided by public budgets: local, regional, and national?

A theoretical examination of this problem, illuminated by an analysis of the link between land prices and property prices, is now needed to understand better the operations of land and property markets as well as to design and assess public policies.

Land Policy and Property Taxation in the Nineties

The theories of land rent have provided a huge literature during some centuries, but have not yet succeeded in establishing a theoretical framework that enables forecasting of the evolution of land prices in a market economy.

Tokyo, where skyrocketing land prices now reach \$300,000 (US) per square meter in top locations, is a good example of the side effects of capital mobility through the "bubble" phenomenon, whereby large amounts of money are invested in land not for its use but for the capital gains that can be obtained.

This phenomenon has two consequences: without any connection to land use, an investment in land can make land planning inefficient since the yearly return on land use is of small importance compared to capital gains. And this can be aggravated by tax mechanisms that favor investment in land, as can be seen for instance in Japan.

Moreover, the "bubble" phenomenon increases the volatility in land markets and enlarges the gap between the timetable of financial investors, who shift rapidly from one type of asset to another according to immediate profitability, and of developers and property investors whose timetable usually extends over five to ten years, sometimes more. For instance, the very large development of office space in La Defense, west of Paris, became (very) profitable fifteen years after its beginning in 1963. Property taxation must take into account this increased volatility.

If it was possible to define an unequivocal "fair price" of a piece of land, the land taxation problem would be simple to solve. This is possible with "pure" agricultural land whose "fair price," its use value, is determined downside by the market price of its production.

Economic mechanisms are very different for urban land as soon as the price of land is primarily determined by the development rights that are attached to it. The legal constraints of zoning are then the main factor in the determination of land prices, and the taxation framework must be determined according to zoning.

There appears another difficulty arising from the crisis of physical planning, for example in western European countries, where physical planning became much more flexible and negotiated: with a stable zoning system, a satisfactory device for public authorities to recoup a part of the betterment is to tax a part of the difference in market value when zoning changes. A good example of that is Denmark, where 60 percent of the difference in market price is collected by the municipality when a piece of land passes from "agriculture" to "development."

Such a mechanism is becoming more and more difficult, especially in southern European countries insofar as the zoning plan is very flexible and becomes negotiable.

The "zoning game," at least in the western European countries, has changed to a large extent during the eighties, and so must the property taxation system in order to reach its goals. At a time when Eastern European countries are changing their economic systems, abruptly or progressively, it could be very helpful for them to have a firm assessment of market failures in the land markets and the possibilities of land and property taxes to help to correct them.

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