



TAXES ON WEALTH AND PROPERTY

Chapter 20

Presentation prepared by Seuren Williams to teach Economics
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Questions For Discussion (1 of 3)

Suppose the market value of a property is \$500,000 before considering future tax payments. However, both the buyer and seller know there will be a tax of \$15,000 at the date of purchase, and \$10,000 and \$7,500 the next year. The risk-free interest rate is 10%. Taking into account the capitalization of taxes, how much would a prospective buyer be willing to pay for the property?

Key Points – Question 1

- $\$500,000 - \$15,000 - \$10,000/1.1 - \$7,500/(1.1)^2 = \$469,710.74$

Questions For Discussion (2 of 3)

The City of Calgary opened a new airport runway in 2014. To avoid having to close direct road access to the airport from the city's northeast, the city plans to build a tunnel under the new runway. The cost of the tunnel is about \$300 million and is to be financed mainly by an increase in property tax rates in Calgary. Discuss the incidence and efficiency effects of the tunnel project from a capital tax view and a user fee view of the property tax. Which view of the property tax do you think is more appropriate for the tunnel project? Explain your reasoning.

Key Points – Question 2

- From a capital tax point of view:
 - The increase in property taxes might cause mobile factors of production (people and capital investments) to move to places with lower taxes
 - This would create an excess burden, since a tax on capital distorts markets
 - Landowners might bear a high share of the tax, since land is an immobile factor
- From a user fee point of view:
 - The tax is equivalent to paying for the benefit of the tunnel
 - The tax would not induce an exit of people or capital
 - There is no excess burden, since in this view the tax is seen as a fee (and not a tax)
- Since the tunnel would likely be mainly used by residents in one part of the city (the northeast), the capital tax view is probably more appropriate

Questions For Discussion (3 of 3)

Heal (2001, p. 1) notes that when Frederick Law Olmsted, the developer of New York City's Central Park, was asked how the city would pay for the park, "he responded that its presence would raise property values and the extra tax revenues would easily repay the construction costs. History shows that he was correct." This episode illustrates best which of the three views of the nature of the local property tax?

Key Points – Question 3

- This sentiment reflects the view of property tax as a user fee for public service