



Extract from the report to the
Public Accounts Committee on
illegal collection of property taxes

October
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I. Introduction and conclusion

1. This report is about illegal collection of property taxes. Since 2005, a large number of Danish landowners have been overcharged on their property tax bill as a result of an illegal practice. According to a preliminary estimate from May 2011, the affected landowners have been overcharged approximately DKK 1.2 billion in property taxes.

The Ministry of Interior and Health and the Ministry of Taxation have referred to the overcharge as being illegal in their briefings to the Danish Folketing (parliament), and Rigsrevisionen is therefore also using the term "illegal" in this report.

2. At its meeting on 26 January 2011, the Public Accounts Committee asked the auditor general to prepare a memorandum on the organisation of a major examination of illegally collected property taxes. Rigsrevisionen outlined the contents of such an examination in a memorandum of 15 February 2011, which was endorsed by the Public Accounts Committee on 23 February 2011.

3. The official property valuation from January 2002 increased land values considerably and the government therefore wished to limit the increase in property taxes imposed on landowners. This should be achieved by capping increases in property taxes from one year to the next. The so-called land tax cap was introduced through an amendment of the municipal Property Tax Act (in the following referred to as the Property Tax Act). The Ministry of Interior and Health, which is responsible for the Property Tax Act, formulated the required amendments to the act with the assistance of the Ministry of Taxation, and the land tax cap was introduced in law no. 1047 of 17 December 2002 and took effect in January 2003. Subsequently, it became apparent that section 1(5) of the Property Tax Act had the unintended effect that some landowners, for instance those whose tax allowance for land developments had been increased, largely escaped paying property taxes.

In December 2004, SKAT (Danish tax and customs administration) was made aware of the potential problem, as property taxes imposed on certain landowners were considerably reduced when their tax allowance for land developments was increased by SKAT, in its capacity as official property valuator. SKAT then changed the IT system that calculates the land tax cap to ensure that this was not recalculated to reflect increases in land development tax allowances. As a result, subsequent calculations of the land tax cap came into conflict with the Property Tax Act.

In the period 2007 to 2009, SKAT received several warnings from internal as well as external sources that the practice established when the IT system was changed could cause severe problems. Yet, SKAT did not acknowledge that the new administrative practice could be in conflict with the Property Tax Act before a property valuation appeals board in 2009 overruled SKAT in a case concerning recalculation of the land tax cap. Not till March 2010, when Kammeradvokaten (the legal adviser to the government) prepared a statement on the issue, did SKAT recognize that the practice was de facto illegal. SKAT's practice was legalised in a new act that was passed in December 2010.

Land development tax allowances are generally related to activities that increase the value of the land. The landowner may deduct expenses related to the installation of water, electricity and gas mains, sewerage work and road building. The tax allowance reflects the increase in land value – without exceeding the actually incurred costs - and can be claimed for 30 years after completion of the land development activities.

In cooperation with representatives of the Ministry of Taxation, the Ministry of Finance and KL (Local Government Denmark - an interest organisation for Danish municipalities), the Ministry of Interior and Health took the initiative to determine how the overcharged property tax could be repaid to the affected landowners. The efforts to identify the problems relating to section 1 (5) of the Property Tax Act raised questions concerning the administration of other parts of the act too. These issues are also being addressed by the task force.

4. The overall objective of the report is to examine the causes of the administrative practice that was in conflict with the regulations of the Property Tax Act, and to assess the ministries' handling of the case. The report answers the following questions:

- Were responsibilities and competences concerning property valuation and property tax clearly distributed?
- Was the preparation of the act on the land tax cap handled in a satisfactory manner?
- Was SKAT's decision to change the practice concerning recalculation of the land tax cap made on a sound basis?
- Did SKAT respond to the warnings received in a satisfactory manner?
- Are the initiatives launched by the ministries to terminate the illegal administrative practice satisfactory?

MAIN CONCLUSION

In 2005 SKAT decided to change its practice for calculation of property tax which brought the administrative practice into conflict with the Property Tax Act. As a consequence of SKAT's decision, the municipalities are now, according to provisional estimates, required to repay approximately DKK 1.2 billion to the affected landowners.

Rigsrevisionen is of the opinion that several factors contributed to the unlawful administrative practice. The Ministry of Interior and Health, the Ministry of Taxation and in particular SKAT's administration of the area has been characterised by passiveness, errors and shortcomings. That several years passed after 2007 before SKAT addressed the problems can also partly be ascribed to inappropriate administrative practices pursued by SKAT.

In 2002 the Ministry of Interior and Health, in close cooperation with the Ministry of Taxation, drafted a bill on the land tax cap with the purpose of limiting the increase in property tax for the individual landowner. The wording of the bill was not entirely in compliance with the purpose of the bill, and had the unintended effect that the property tax imposed on certain landowners was considerably reduced.

In 2004, a municipality brought it to the attention of SKAT that certain landowners largely escaped paying property tax because their tax allowance for land development had been increased. SKAT was of the opinion that the problem was caused by an IT error and changed the IT system in 2005. Thereby SKAT also changed the practice concerning recalculation of the land tax cap. The change in practice was in conflict with the Property Tax Act. Due to inappropriate administration in SKAT, the decision to change practice was made on an inadequate basis without a legal assessment and without consulting the Ministry of Interior and Health, which is responsible for the Property Tax Act, and the municipalities.

In the period 2007 to 2009, SKAT received several warnings from its own staff and from external partners that the practice it had established in 2005 was problematic. SKAT's processing of the warnings took much longer than necessary and were assessed on an inadequate basis due to inappropriate administrative practices.

In June 2009, it became clear to SKAT that the administrative practice pursued involved great risk. In the opinion of Rigsrevisionen, SKAT allowed the illegal practice to continue for too long before it took steps to resolve the matter. Not till the legal adviser to the government submitted his statement in March 2010, did SKAT recognize that the current practice was in conflict with the act. SKAT should also have involved the Ministry of Taxation and the Ministry of Interior and Health in the case much earlier.

Rigsrevisionen has noted that an amendment of the law in December 2010 legalised the practice pursued by SKAT.

In the course of Rigsrevisionen's examination it became clear that the administration of other parts of the Property Tax Act is also problematic and questionable. Rigsrevisionen finds it imperative that the ministries seek to resolve these problems as soon as possible to ensure that property taxes are collected correctly, and illegally collected property taxes are repaid to the affected landowners.

The main conclusion is based on the following findings:

Were responsibilities and competences concerning property valuation and property tax clearly distributed?

- The overall distribution of responsibilities and competences between the Ministry of Interior and Health and the Ministry of Taxation concerning property valuation and property tax is well defined, but calls for on-going collaboration between the two ministries. In the opinion of Rigsrevisionen, the Ministry of Interior and Health and the Ministry of Taxation should have cooperated on monitoring, coordination and knowledge sharing in the area, because the administration of the Property Valuation Act and the Property Tax Act are closely integrated.

Was the preparation of the act on the land tax cap handled in a satisfactory manner?

- Rigsrevisionen is of the opinion that the ministries' preparations concerning the legislation were not entirely satisfactory, as the ministries did not exercise due care when they elaborated section 1(5) of the Property Tax Act. The intent of the act was not reflected in the text, and as a result of the concrete wording of the provision the property tax ended up being lower than intended, and certain landowners largely escaped paying property tax.

Was SKAT's decision to change the practice concerning recalculation of the land tax cap made on a sound basis?

- According to Rigsrevisionen's assessment, SKAT did not make the decision to change practice on a sound basis. The decision was made without the support of a legal assessment, including a comparison of the changed practice with the act and legislative basis. Moreover, SKAT did not consult the Ministry of Interior and Health and the municipalities which are responsible for the Property Tax Act and the collection of property taxes, respectively.

Did SKAT respond to the warnings received in a satisfactory manner?

- Rigsrevisionen does not find SKAT's handling of the warnings satisfactory. The processing of the warnings took much longer than necessary and they were not discussed on an informed basis. Rigsrevisionen has established that SKAT in October 2008 was aware of the inappropriate elements of the Property Tax Act, and SKAT should at this point have contacted the Ministry of Interior and Health.

Are the initiatives launched by the ministries to terminate the illegal administrative practice adequate?

- Rigsrevisionen finds it satisfactory that the Ministry of Interior and Health and the Ministry of Taxation have taken steps to terminate the illegal practice. Rigsrevisionen is also of the opinion that SKAT's examination of the illegal administrative practice took too long. In the course of Rigsrevisionen's examination it became clear that the administration of other parts of the Property Tax Act is also problematic and questionable. Rigsrevisionen finds it imperative that the ministries seek to resolve these problems as soon as possible to ensure that property taxes are collected correctly, and illegally collected property taxes are repaid to the affected landowners.