ACHIEVING SUCCESSFUL IMPLEMENTATION OF VALUE-BASED PROPERTY TAX REFORMS IN THE ECA REGION

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Abstract
The paper examines the factors that influence the success or otherwise of projects to introduce value-based recurrent property taxes. It is based on the results of a knowledge project in the Europe and Central Asia Region that the World Bank, FAO and the Centre of Registers of Lithuania have worked on since 2014. The project identifies good practice in mass valuation systems, valuation infrastructure, and property tax reforms within the framework of the Voluntary Guidelines on the Responsible Governance of Tenure. It uses material from nine case studies - Albania, Kazakhstan, Lithuania, Moldova, the Netherlands, Poland, Serbia, Slovenia, and Turkey - that range from countries with well-established systems of value-based property taxation to those which have been piloting mass valuation systems or considering their options. It examines the role of property taxes in a fiscal system. It identifies the preconditions, such as good quality price data, efficient tax administration, and a valuation infrastructure that meets internationally-recognised standards, needed for the successful introduction of value-based property taxes and the strategies that can be used to overcome obstacles.

Key Words: mass valuation (appraisal), valuation standards, value-based recurrent taxes on immobile assets
Background to the Project

Since 2014, the World Bank, F.A.O. and the Centre of Registers of Lithuania have worked on a knowledge project on property taxation and valuation in the Europe and Central Asia (ECA) Region. The initiative is financed by the World Bank ECA Region’s Programmatic Trust Fund for Public Finance Management and the World Bank-F.A.O. Co-operative Program. The intention is to identify and share good practices on the lessons learned from the establishment of mass valuation systems, valuation infrastructure, and property tax reforms within the framework of the Voluntary Guidelines on the Responsible Governance of Tenure (C.F.S. and F.A.O., 2012). Case studies drawn from nine countries in the ECA region - Albania, Kazakhstan, Lithuania, Moldova, the Netherlands, Poland, Serbia, Slovenia, and Turkey - were presented at a regional workshop in Vilnius from June 3 – 5, 2015 and have been published in a themed edition of the Land Tenure Journal (Issue 2, 2015). The findings are believed to be of relevance to other parts of the world looking to introduce value-based property taxation, mass valuation or to reform their valuation infrastructures, and are not confined to the ECA Region.

Since 1991, the World Bank has funded 42 land projects in 24 ECA countries in support of reforms in land, land administration, and land management, many in cooperation with F.A.O. Recently, the World Bank and FAO land administration teams have faced growing interest by ECA countries seeking to increase local revenues, enhance state land management practices, and define state asset values accurately. These experiences show that cross-sectoral knowledge needs to be consolidated in spatial (land) records, property valuation and taxation applications, tax policies, and municipal financing to provide best practice responses to this growing demand.

This paper presents some of the principal findings from the project and draws particularly on the aforementioned nine country case studies and the discussions that took place during the Vilnius workshop. It primarily focuses on value-based recurrent taxes on immovable property. These are taxes on land, buildings, premises, and other forms of real estate, though they usually also fall on fixed plant and machinery as well as infrastructure, such as steel mills, oil refineries, railways and pipelines. They do

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2 Valuation and taxation issues are addressed respectively in sections 18 and 19.
not tax business or personal property, though in some countries the recurrent property tax machinery is also used to collect taxes on these. Sporadic property taxes whose payment is triggered by an event such as the sale of the property or the death of its owner are not the primary focus, though it is recognised that improved systems of valuation and revenue collection for recurrent property taxes also have implications for sporadic taxes that fall on real estate, such as inheritance and gifts taxes, property transfer taxes, and capital gains tax. Many countries make use of recurrent property taxes but levy them according to the size of the property **rather than by value.** The problem with such taxes is that they are not imposed according to the value of the property and **do not necessarily reflect the ability of taxpayers to pay the tax** with the result that owners of property of identical value can be charged different rates of tax. Area-based property taxes can be unfair and inequitable. One of the central aims of the project is to improve ways in which value-based tax systems can be developed, which implies improving methods of valuation. As value-based property taxes are particularly used to finance local governments, improvements in their ability to levy fair and equitable taxes should enhance the quality of local governance. Moreover, strong valuation systems enable land value capture through instruments like impact fees, sale of development rights, special assessment zones, revaluations of recurrent value-based property taxes, and tax increment financing.

**Methodology**

The aim of the project is to improve the knowledge and understanding of value-based property taxation, mass valuation, and valuation systems and their impact on the distributional fairness with which property taxes are levied and revenue is collected, and thereby to enhance the quality of governance, particularly at a local level. The approach is to highlight regional best practices and to encourage their adoption on a wider scale.

Nine case studies were commissioned from Albania, Kazakhstan, Lithuania, Moldova, the Netherlands, Poland, Serbia, Slovenia and Turkey. Although those producing each case study were encouraged to develop the themes in the way that seemed most appropriate for their country, the case studies made use of a template that asked the authors to explain the property tax system in their country, the role of property taxation in the country’s public finances both at national and local levels, how property taxes are assessed, valuation standards adopted and the valuation infrastructure, the uses of mass valuation, data sources used in mass valuation and their reliability, the methods employed in mass valuation, and the lessons learned from property tax and mass valuation reforms. The case studies were drafted in the early part of 2015 and presented at the regional workshop in Vilnius from June 3 - 5, 2015 with the final
versions being produced and taken through a refereeing process for publication in the *Land Tenure Journal* between June and September 2015.

The aim with the case studies was to achieve a representative sample of countries. Such a sample cannot be random since the production of a complex case study requires substantial expertise and commitment from the person(s) producing it and their access to relevant data. The key constraint is to find a suitable expert or experts available to undertake this commitment. The implication is that a case study is likely to have to be produced by someone working within a governmental body responsible for property taxation or mass valuation, or a consultant who has worked in the country for its government, a body like the World Bank or F.A.O. or a donor organisation such as USAID, or is an expert valuer who researches and works in the country. The refereeing process and presentation before an informed audience at the regional workshop played an important part in ensuring that each case study maintained an appropriate degree of distance and objectivity.

The range of countries and their balance was far from being opportunistic and conformed to a pre-set plan. Although the intention was to focus on the experiences of countries in the ECA Region who have received World Bank funding, it was recognised that a control was needed from outside this group in the form of a country with a mature property markets and a developed mass valuation system for property taxation. This role was performed by the Netherlands. Whilst other countries from Western Europe could have fulfilled this role, the choice of the Netherlands had certain advantages. Property tax assessment is undertaken by municipalities, of which there are 393 in the Netherlands, and the resulting valuations are used by all levels of government and for a variety of non-tax functions as well as for the range of property taxes. This has necessitated the development of a quality assurance system to ensure the reliability of assessments produced by a highly devolved system. Almy (2014) found in a survey to which 100 countries responded that central government was responsible for valuation in 43 cases, regional or local governments in 30 instances, and 27 had a mixed pattern. In a number of ECA countries, local governments are responsible for property taxes and they are often relatively small. For instance, Albania has reformed its local government so that there are 61 rather than the previous 373 local authorities (Gjika, 2015); Serbia has 168 (Rašković, et.al., 2015); Poland has 2,479 municipalities (Walacik, 2015); and Turkey has 1,396 municipalities able to levy a property tax, though there are also 30 metropolitan cities which do not have this power (Güneş and Yildiz, 2015). The Dutch experience is likely to be of more relevance than that of a country where property tax valuation is centralised. In 2007 the Netherlands adopted annual revaluations for property taxation, replacing the previous system of revaluations every four years. The system of mass valuation has had to develop efficient processes to accommodate the compressed timescale for each revaluation. Annual revaluation has the advantage of ensuring that
valuations are relatively up-to-date and can therefore be used in a range of applications. In countries with limited valuation capacity, the ability to use the product of mass valuations in multiple ways is advantageous.

The remaining eight countries were selected to provide a variety of experiences of mass valuation for property taxation ranging from countries with developed systems to those who were just beginning to experiment with mass valuation. Lithuania has a well-developed system and the factors that aided its development can help to identify the pre-conditions needed for successful implementation. It also has a highly centralised system of valuation and property tax collection which provides an interesting contrast to that of the Netherlands. Moldova, Poland and Slovenia have also developed mass valuation systems but for different reasons the planned systems are not yet fully implemented. Their experiences help shed light on the impediments that can be encountered in gaining acceptance of well-designed mass valuation systems and in moving property taxation from being area-based to value-based. Albania, Kazakhstan, Serbia, and Turkey are at much earlier stages in developing value-based property taxes and the mass valuation systems needed to support them. All have undertaken some work on mass valuation, though not necessarily for tax purposes. Their experiences highlight the necessary preparatory work needed to develop mass valuation for value-based property taxation and the pre-conditions necessary for success.

Seven of the eight countries are transition countries, including three former constituent parts of the U.S.S.R. (Kazakhstan, Lithuania, and Moldova) and two from Yugoslavia (Serbia and Slovenia). Turkey, by contrast, is not. Its experiences enable a distinction to be drawn between the issues encountered in developing value-based property tax systems that are associated with the transition process and the development of property markets in former centrally planned economies and those which reflect the level of development.

**The Role of Property Taxes in a Fiscal System**

Property taxes can play an important role in a fiscal system. As these taxes fall on immobile assets they are a suitable tax for local governments since the tax base lies within a defined jurisdiction (Norregaard, 2013). In this respect they have significant advantages over many other forms of tax where the revenues can leak across jurisdictional boundaries. For instance local sales taxes can be avoided through purchases made in other localities or over the internet. Local income taxes can be avoided by households living in other areas and commuting to work or businesses being registered in lower tax areas. Encouraging local governments to make full use of property taxes is a policy option that can reduce their dependency on
inter-governmental fiscal transfers and thereby the need for central government to increase its borrowing to facilitate higher expenditure by local governments. For instance, in Moldova the property tax provided 8 percent of local government revenues whilst central government grants accounted for 44 percent (Buzu, 2015); in Lithuania taxes on property provided 10 percent of local revenues but 60 percent was from central government (Almy, 2015); whilst in Slovenia local governments’ share of personal income tax accounted for 80 percent of their budgets (Žibrik, 2015). Reducing dependency on inter-governmental fiscal transfers is important if national governments are faced with problem of unsustainable budgetary deficits or high levels of national debt relative to the country’s Gross Domestic Product (GDP). For instance, the budgetary deficit in Serbia in 2014 was 6.6 percent of GDP (Rašković et. al., 2015) and public debt in Albania is 71 per cent of GDP (Gjika, 2015).

Recurrent property taxes can help improve responsiveness to local needs and the quality of governance by linking tax revenues to local service provision and the resolution of local issues (F.A.O., 2007). If local governments become more reliant on their own revenues, this can increase their accountability to their citizens due the link between expenditure on local public services and taxation being made more explicit. In countries with rapidly growing urban populations, such as Albania and Turkey, value-based property taxes enable local governments to share in the increase in land values resulting from this growth and to use the proceeds to fund infrastructure that the growing urban areas need. Metropolitan municipalities in Turkey are not able to levy property taxes but are responsible for strategic plans, major roads and other infrastructure (Güneş and Yildiz, 2015). Instead they are dependent on government grants, fees and charges, and sales of land. In some countries local revenues are dependent on tax sharing arrangements between central and local government over taxes like personal income tax. As the IMF (2013) has noted in relation to Serbia, such arrangements can disincentivise local governments to maximise their “own” revenue streams or discipline their expenditure.

As property taxes fall on immobile assets, this makes them a valuable counter to tax avoidance of corporate and personal income taxes by multi-national companies and high net wealth individuals. Their property can be taxed even if they are domiciled in other countries. Much “international” trade takes place within groups of companies, enabling them to use transfer pricing to ensure that profits are booked to subsidiaries in low tax countries and that those in higher tax economies have to pay royalties on intellectual property rights “owned” by subsidiaries in lower tax ones or interest charges on loans “borrowed” from them. Similarly high net wealth individuals have the opportunity to organise their affairs so that their income and wealth is in tax havens. Property taxes can help offset the erosion of the national tax base by globalisation as they are amongst the least-affected taxes (Johansson et. al., 2008).
There is a case on grounds of economic efficiency for levying recurrent value-based property taxes in order to reduce a tax system’s reliance on income and profits taxes, which have potentially distorting effects due to disincentives for work, investment and enterprise (Johansson et al, 2008; Slack and Bird, 2014). Recurrent property taxes are relatively neutral in their impact; “the fact that the property tax, to the degree it is a tax on accumulated wealth, does not alter future behaviour” (Norregaard, 2013, p.14). Sales taxes, such as value added tax and excise duties, tend to be regressive in their impact by falling more heavily on those with lower incomes who tend to spend a higher proportion of their incomes. Property taxes can help to equalize the burden as they tend to fall more heavily on the more wealthy sections of society. In Lithuania property taxes generate 0.5 percent of GDP but sales taxes 8 percent, social insurance contributions 11 percent, and income tax 5 percent (Almy, 2015). In Moldova property taxes amount to 1 percent of national tax revenues, sales taxes to 49 percent, social insurance contributions to 24 percent, and income tax to 13 percent (Buzu, 2015). Property taxes can help secure greater equity in taxation between those whose main asset is their ability to generate income through work and those with wealth. Value-based taxes can also encourage the productive use of land to generate income to pay the taxes (Malme and Youngman, 2001).

Although recurrent property taxes can be shown to have a number of advantages, they are relatively lightly used by most countries. The arithmetic average percentage of GDP raised by recurrent property taxes for the EU is 0.8 percent and that for the middle and low-income countries 0.4 percent (Grover et. al., 2015; Norregaard, 2013). Both of these are far below what is achieved by the UK (3.4 percent), France (2.4 percent) or Denmark (2.1 percent). Figure 1 examines the burden of recurrent property taxes as a percentage of incomes from capital and land in the EU using a methodology developed by Walters (2013). The incomes were derived by taking the gross value added (total output less that part used for intermediate consumption) and deducting employee compensation (wages and salaries plus employers’ social contributions). The arithmetic average for the EU is 1.9 percent but the UK raises 8.4 percent of non-employment incomes in recurrent taxes on immovable property, France 6.2 per cent and Denmark 6 per cent. This raises the question of why, in spite of the benefits from making these a significant part of a tax system, such taxes are not more widely used, what the barriers to their use are and how these might best be overcome. There is some evidence to suggest that income level is a factor in determining the use of property taxes, as is the extent of urbanisation, the openness of the economy, the legal heritage, and the degree to which there is decentralisation of government (Norregaard, 2013; de Cesare, 2012). However, none of these factors can be argued to prevent the use of property taxes even if they may account for some of the differences in their current use.
Although the revenue raised from recurrent property taxes tends to be relatively low as a proportion of the GDP or gross value added, such taxes are quite widely used. However, they are often levied on an area basis rather than being value-based. For instance, the property tax in Kazakhstan is based on the area adjusted for depreciation and location (McCluskey, 2015). The main barriers to the greater use of property taxes are really ones concerning the use of value-based taxes rather than to property taxes as such. Area-based taxes, even if modified by coefficients that reflect attributes of properties such as location, age of the building, or fertility of the soil, do not fully reflect the market value of properties and are therefore inequitable. They can result in large properties of low value paying more in tax than small properties of much higher value with governments having little awareness of the effective rates of area-based property taxes.

The absence of effective value-based recurrent property taxes to support local governments can result in the use of alternative taxes and charges, particularly on businesses. These can be less supportive of economic development than property taxes or be unsustainable in the longer term. In Serbia these alternative means of raising revenue included approximately 15 communal fees, such as charges on business signage, though since 2012 they have been reduced, and quasi-property taxes in the form of the urban land use charge, which until its abolition in 2014 was payable by companies whose buildings were on state land (the land not having been privatised when the businesses were), and the development fee payable on new construction and development (Rašković et al., 2015). The urban land use charge probably raised a similar amount of revenue as the annual property tax and the development fee made a similar financial contribution in Belgrade and other urban centres, though much less elsewhere (World Bank, 2012). Infrastructure charges are a legitimate way of obliging developers to contribute to the costs their developments necessitate but the question arises as to whether the fees are related to these developments or are really just a tax. In Slovenia more than 80 percent of the property tax revenues raised by municipalities come from the urban land use charge (Žibrič, 2015). In Albania the tax on small businesses produced 40 percent of local governments’ own revenues in 2004, though this fell to 13 percent in 2013. A consequence of the decline is that at 1.9 percent of GDP, local governments’ own revenue sources in Albania are the lowest in South East Europe (Gjika, 2015). Although Turkey raised 1.4 percent of GDP in property taxes in 2013, only 0.2 percent of GDP was produced by recurrent property taxes, the remainder coming from sporadic taxes, which are a less consistent source of income generation. These can undermine the transparency and efficiency of the property market if they result in false declarations of transaction prices in order to evade sporadic taxes, something for which there is
evidence in Turkey (Güneş and Yildiz, 2015). A case can be made for value-based property taxes to avoid the use of less desirable means of raising revenue by local governments.

The countries that have successfully introduced value-based recurrent property taxes have had to overcome two main types of barriers. There are technical obstacles concerned with how to levy an efficient value-based tax. There are also what might be termed political or governance barriers. Three of the case study countries – Moldova, Poland and Slovenia – created well-thought out value-based property tax systems that have either never been implemented or whose implementation has not been completed. In these cases the technical issues have been resolved but not the governance ones.

The Quality of Tax Administration

Recurrent property taxes are particularly dependent on the quality of their administrations (Slack and Bird, 2014). As the assets taxed are immobile they ought to be difficult to conceal and the tax due hard to avoid. However, this does depend upon the comprehensiveness of land registration and cadastre and whether these can be relied upon to produce accurate tax rolls. Informal land occupancy and construction make it difficult to maintain tax rolls. Cadastres need to record buildings and three-dimensional rights and not just land parcels or the footprints of buildings. For example, a cadastre recording a shopping centre or mall needs to identify each retail unit; in an office block it needs to identify who occupies each floor and how the floors may be sub-divided between occupiers; and in apartment blocks, the various housing units they contain and which residences have ancillary space such as parking bays, garages and bin stores.

In some countries there are significant gaps in registration and as to how comprehensive the tax rolls are. Serbia’s cadastre records parcels but does not contain a comprehensive record of buildings or three-dimensional occupancy. It has been estimated that 14 percent of apartments, 22 percent of family homes, and 15 percent of commercial premises are unregistered, and 37 percent of municipalities put the level of unregistered properties at between 20 and 40 percent (Arsić et.al., 2012, pp. 9, 40). A study by the World Bank in Arandelovac found 21,000 electricity consumers but only 9,500 property taxpayers (World Bank, 2012). In Indija the number of taxable properties was increased from 16,000 to 26,000 by cross-checking utilities and land use databases (Rašković et. al., 2015).

In Albania the Immovable Property Register Office (IPRO) does not register properties until all claims have been resolved, which presents problems where there are outstanding disputes and with the legalisation of informal settlements (Gjika, 2015). The IPRO estimates that it has records for some 60–70
percent of all properties and has completed first registration for 83 percent of rural cadastral zones but only 25 percent of urban cadastral zones. The result is that most properties in urban areas remain unregistered (World Bank, 2011). Some local governments have created their own databases. In this way Tirana was able to increase the number of commercial properties taxed by 15 percent and the tax billed by 60 percent. Fier was able to increase its revenues by 189 percent (Gjika, 2015). A further problem in Albania is the lack of a comprehensive and accurate address system. A link is needed between the property and the person who should be billed for the tax. Registers not only have to be created but also to be maintained. In Kazakhstan it is mandatory to register all land leases and private land conveyances that have transferred land rights from the state to legal or private persons but registration of immovable property rights is not mandatory (McCluskey, 2015).

Reliable systems are also needed for the billing and collection of taxes. This requires the development of collection-led strategies, including making it easy for taxpayers to make payments and to pay in installments to reduce illiquidity problems (N.A.L.A.S., 2009; Kelly, 2013). Effective enforcement strategies are also needed including the seizure of assets belonging to delinquent taxpayers (De Cesare, 2012). In Serbia collection rates for billed taxes are 85 percent for legal entities and 75 percent for natural persons (Arsić et al., 2012) and in Albania average collection rate is below 50% in largest urban areas and reflects the effort put into collection (Gjika, 2015). Arrears of taxes may only be collected when a document is requested, which can be withheld until payment is received. Utility companies can be appointed as tax agents to collect property taxes but this strategy only works if they also do not have problems with collecting their charges (Rašković et al., 2015). Weak collection and accounting systems and lack of capacity, including poor equipment and premises, undermine collection rates (Rašković et al., 2015). By contrast, in Moldova collection rates for the land tax are 99 percent for that payable by individuals and 96 percent for legal entities and for the value-based assessments 95 percent for individuals and 90 percent for legal entities (Buzu, 2015). Taxes on businesses can be easier to collect if businesses are registered and households are not (Gjika, 2015), but care needs to be taken not to undermine the economic activities that generate tax revenues. Less effort needs to be put into collecting a given amount of revenue from businesses as each business tends to pay a larger amount in tax than a household and there is less political fallout as businesses do not have votes. Taxes on residential property are some of the least distorting of economic activity (Johansson et al, 2008).

As Gjika (2015) has argued in relation to Albania, “there is a need to overcome the social and cultural views that influence tax evasion,” including through campaigns to focus attention on why property tax needs to be paid and how this facilitates better local services. Central governments can link grants to
property tax collection or distribute grants in way that assume that local governments will generate a given level of revenue. There is some evidence that collection rates are higher where there is a belief that the local elites cannot avoid paying their dues (Monkam and Moore, 2015, p.10). Tax compliance is inversely correlated with corruption (Torgler, 2011) and countries that are most successful in controlling corruption are able to raise significantly higher revenues from property taxes (Walters, 2011). Wider initiatives on public administration and governance and to improve the legitimacy of governments may also be required along with increased transparency in public finances if the public are to be persuaded that taxes are being levied for their benefit and are not being wasted or rewarding corruption (Kelly, 2013). The Bertelsmann Transformation Index (Bertelsmann Stiftung, 2014) reported that in 69 of the 129 developing and emerging countries surveyed, officeholders who break the law and engage in corruption are not prosecuted adequately. Transparency International (2009) reported that the land sector is the third highest one (after the police and judiciary) in which people reported paying bribes in the previous twelve months. In many countries, transparency could be improved over the way tax rates are set, how assessments are undertaken, who is granted exemptions, and in demonstrating that no-one can get away without paying their dues.

A recognised problem with recurrent property taxes is that some taxpayers have problems in paying them because of the illiquidity of their assets. They may own or occupy properties whose value is relatively high compared with their current incomes and are asset-rich but cash-poor. This is a particular problem for individual taxpayers as, in principle, there is no reason why legal entities faced with this problem should not relocate to premises that are more affordable and, in most cases, should be incentivised to do so to enable their property assets to be put to more efficient use. In transition countries there is a specific problem that has arisen from the policies of privatising housing at nominal prices so that its occupiers became owners and from restitution policies (N.A.L.A.S., 2009). For instance, in Slovenia households were able to acquire housing at about 10 percent of its market price (Žibrik, N. (2015). These can result in households occupying dwellings whose value bears little relationship to their lifetime earnings and who could not meet recurrent property taxes if levied at realistic rates. These assets are not income producing (Malme and Youngman, 2001). Some reliefs are likely to be required to mitigate the liquidity problem they face and there are a variety of possible approaches (Haveman and Sexton, 2008).

The approach that is often adopted is to grant extensive exemptions. It should be recognised that this is not a cost-free approach since exemptions increase the tax burden on those who do not benefit from them. For instance, granting exemptions or reliefs for pensioners implies a redistribution of income from families with higher incomes who may possess less wealth and who may as a result find access to family
homes is made more difficult. Complex exemption systems are expensive to operate. In Moldova exemptions from the real property tax amount to 27 percent of the maximum tax revenue on individuals and 55 percent of that on entities. The loss of income is made worse by a discount of 15 percent if taxpayers pay at least six weeks before the payment deadline for the first half of their tax bill (Buzu, 2015). In many countries there are exemptions for the public sector, which can crowd out access to the property market by the private sector, which does not enjoy this benefit.

The Quality of Data

Levying value-based property taxes involves taking a sample of properties for which the market price is known and applying these prices to comparable properties for which no recent transaction has taken place in order to produce an estimate of their value after appropriate adjustments have been made to reflect differences between the properties. Typically a mass valuation system is used for this sample to estimate the **statistical relationship between the market price and various attributes of the properties that are believed to determine it**. The credibility of value-based taxes depends on the quality of the data used, both of the market prices used and the attributes or characteristics of properties. The implication is that value-based property taxation requires data of adequate reliability on transaction prices and property attributes. There must be a functioning and transparent property market that generates reliable transaction prices. This implies that the capital market functions reasonably well to finance purchases; there are an adequate number and quality of supporting trades, such as valuers and estate agents, and media through which buyers and sellers can be informed about market conditions; property rights and titles are well-defined, documented and marketable; and there are enough market transactions for all classes of property in all locations to reliably establish what the true market value is (Walters, 2011). The prices collected must reflect the way in which the property market functions. If the normal access to property is by buying it, then **sales prices** are needed; if households or businesses normally access property by renting it, then **rental values** need to be collected. It is likely that different types of transaction price will be needed for different types of property, for instance sales prices for residential property and rentals for commercial. The valuation models used need reflect how the property market functions so, for instance, a **sales comparison model** would be appropriate for a residential market where access to property is by purchasing it, whereas an **income capitalisation** approach would be better suited if access to commercial property was through renting it. Well-developed property tax systems utilise a variety of valuation models so that those most suited for a particular type of property are used (Almy, 2015; Buzu, 2015; Žibrik, 2015).
A problem in levying value-based property taxes is that functioning markets may not exist outside major urban areas or may not exist for all types of property because so few transactions actually take place. Access to some types of property may not normally be by renting or buying it but by some other means, such as inheritance. Even in developed markets, periods of recession can result in insufficient transactions to enable market prices to be estimated adequately for all types of property. The tenure system should encourage and require transparency in transactions and the accurate recording of prices. The most obvious sources of data about transaction prices are the **land registry or sales contracts where these have to be notarised or registered**. The quality of this data can be undermined if there are incentives to conceal the true price in order to evade taxes or other property transfer charges and enforcement mechanisms are weak.

In Moldova property sales contracts are thought to understate true prices in 90 percent of cases. This appears to be the result of a capital gains tax which is levied at a rate of 18 percent on the difference between the sales price and that produced by the mass valuation. Since the assessed values have not been revalued, there can be a substantial discrepancy between them and transaction prices with the mass valuation assessment being declared as the sales price. For example, apartments in Chisinau were assessed in 2004 and assessment values are estimated to be 44 percent of current market prices and those for residential houses (assessed in 2005) to be 48 percent.

In Turkey there is a land registry fee of 4 percent of the transaction price and this is also thought to result in under-declaration of the true price. The land registry can be asked to register a mortgage on a property that is significantly greater than the supposed sales price. The results from mass valuation pilot studies in two areas indicated that under-reporting means that the estimated annual property tax yields should be 2.94 and 1.88 times the sums actually raised (Güneş, and Yildiz, 2015). By contrast, declared prices in Lithuania are believed to be relatively accurate because low taxes, notary and registration fees at 0.8 percent of value and the use of mortgages in purchases provide little incentive or opportunity to make a false declaration and a capital gains tax on sales made within five years discourages purchasers from being party to under-declarations since they this could result in higher tax liabilities for them when they come to sell. Declarative taxes, as opposed to value-based taxes, can also result in attributes of properties being understated. In Albania where registration has not been completed, tax values are based on property characteristics as reported by the holders or owners. In most cases these are not accurate even in terms of the surface area (Gjika, 2015).

In the absence of reliable transaction prices other approaches may be needed, such as the development of sales price, rental and mortgage valuation registers, but the key priority is to generate transparency in the
property market. In Turkey mortgage valuations are regulated by the Capital Markets Board and only licensed valuers can carry out mortgage valuations. Valuers are required to join the Türkiye Değerleme Uzmanları Birliği (TDUB) and to share their mortgage valuations with it (Güneş, and Yıldız, 2015). Slovenia and Serbia have developed sales price registers (Žibrik, 2015; Rašković et. al., 2015). In Serbia the reliability of prices is enhanced by the activities of the Tax Authority in collecting the property transfer tax and of notaries in registering sales contracts. By contrast, the Government of Serbia is addressing weaknesses in the mortgage valuation system with a new valuation law, encouraged by the I.M.F. (I.M.F., 2015). In Moldova prices from sales contracts were supplemented by asking prices, data obtained from realtors and valuers, and information from auctions. The methods used to address price data problems do depend on the institutional strengths and weaknesses in a country and it is unlikely that universal solutions are viable.

The Valuation Infrastructure

The countries which have successfully adopted value-based property taxes are those that have adopted valuation standards that are consistent with internationally-recognised valuation standards. These include valuation methodologies, the qualifications and professional education required to be a valuer, and setting ethical and standards of professional conduct to be followed in valuation and tax assessment.

In Lithuania privatisation and restitution programmes began to function in 1991 and gave rise of a demand for more developed valuation methods. The Lithuanian Association of Property Valuers (L.A.P.V. – Lietuvos turto vertintojų asociacija) was established in 1994 and was instrumental in developing educational materials, professional qualifications and standards. The General Property Valuation Principles, approved by the Government in 1995, provided a framework for specifying the skills required of licensed valuers and the Law on Fundamentals of Valuation of Property and Business, 1999, provided definitions and valuation procedures. The Ministry of Finance began certifying valuers in 1998. By the time that mass valuation was started in 2000, a valuation infrastructure was already established (Almy, 2015).

Valuations in Moldova are regulated by the Law on Valuation Activities, 2002. Other than for tax purposes, valuations may only be undertaken by licensed valuation companies, who must have at least one licensed valuer. Standards are based on European Valuation Standards. A valuation infrastructure therefore existed by the time that mass valuation was started in 2004 (Buzu, 2015). The implication is that mass valuation and the development of value-based property taxes is aided by the prior establishment of a valuation infrastructure that is consistent with international valuation standards.
Mass Valuation

No modern recurrent property tax system can function in the absence of a strong mass valuation system. It is unrealistic to send out armies of valuers to carry out valuations of each individual property. A Federal Land Cadastre Service of Russia survey of mass valuation systems for taxation in Europe in 2001 and found that 72 percent of respondents had mass valuation systems but that only 45 percent of these were aimed at producing market-based valuations (U.N.E.C.E., 2001). It is a different matter with sporadic taxes where taxpayers in self-assessment systems can be required to submit valuation certificates with their declarations for taxes such as property transfer, inheritance, and capital gains taxes. However, this does depend upon the existence of efficient valuation infrastructures so that valuations can be produced by qualified valuers operating to internationally-recognised standards and within appropriate codes of professional practice.

Mass valuation uses standardised procedures, common data, and statistical testing of the models (Goudemans and Almy, 2011). Rather than individual valuers carrying out valuations, mass valuation uses teamwork with groups of people collecting data and analysing it. The sizes of the databases used, the merging of data from different sources, often compiled and maintained by different agencies, the number of properties being valued at any one time, the relatively short timescale for carrying out the amount of work, and the use of geo-referenced data mean that mass valuation tends to use high-powered statistical packages.

The principal reason for using mass valuation is economic, that the costs per valuation are lower than for single property valuations. For Lithuania the difference is between €1 and €100 for each single property valuation (Almy, 2015). In Moldova the costs per valuation were put at €0.36 per apartment (2004) and €1.4 per residential block (2005) (Buzu, 2015). In the Netherlands the cost per assessment was reduced from €23 in 1997 to €17 in 2014 (Kuijper and Kathmann, 2015). It is not entirely clear how the costs have been worked out particularly as mass valuations tend to be part of property attribute systems like cadastres from which much of the data they use is drawn. However the costs of single property valuations are many times those of each assessment carried out by mass valuation and annual valuations can bring down costs over time. the Netherlands changed from revaluations every four years to annual revaluations in 2007 resulting in the annual costs of valuation falling from €190 million in 1997 to €150 million in 2014 as work processes were improved (Kuijper and Kathmann, 2015). The main economy results from reducing the input from expensive skilled valuers through the use of cheaper automated processes and unskilled clerical workers collecting standardised data. Automated remote data capture can also be used.
Mass valuations are not a cheap solution. Typically costs of setting up such a system run into the tens of millions of euro even for a relatively small country. This is because they have very significant fixed costs, such as the costs of maintaining tax rolls, collecting data on the attributes of each property, developing statistical models, and applying them to each property. As is noted later, the results of mass valuation can have a range of uses across government, which means that the fixed costs of setting up the system can be shared. The marginal cost of each additional valuation is only a fraction of that of each additional single property valuation because of economies of scale. But this means that if only a small number of properties are to be valued, single property valuation can result in a lower total cost than creating a mass valuation system. The costs of creating and maintaining a mass valuation system are only economically justifiable if it is used to generate a minimum level of tax revenue, otherwise the costs could exceed the revenue generated. Almy (2014) has suggested that high quality mass valuation systems are easily justified as being economic only when effective tax rates reach at least one percent and are completely uneconomic with rates as low as 0.01 per cent. Low tax systems therefore need to be less ambitious as to how assessments are produced.

The timescale over which tax assessments have to be produced also favours the use of mass valuations. Usually only a limited period of time - often only a few months – is allowed between the valuation date, the publication of new assessments and the new assessments being used to collect the tax. Where there is a requirement for annual revaluations, the timescale is particularly compressed. All the valuations have to be undertaken as at one particular date in order to avoid inequalities between taxpayers. Market prices can rise and fall so that the valuations need to be made using the market conditions that prevailed on that date. Annual revaluations help to ensure that the assessments largely reflect the current values of properties, though these can result in fiscal problems for the governments levying them if there is a substantial fall in values, such as happened after the 2008 crisis. Annual assessments can reduce taxpayer objections and increase acceptance of the tax. In the Netherlands the proportion of assessments to which taxpayers objected declined from 8 percent in 2001 to 1.3 percent in 2015 following the introduction of annual revaluations in 2007 (Kuijper and Kathmann, 2015).

Mass valuation can help to overcome limited valuation capacity in a country. The number of valuers may be limited in supply because the higher education system is not geared up to producing a sufficient quantity or opportunities for graduates to gain the necessary supervised work experience are limited. Capacity could also be limited in terms of the quality of the valuers. A limited pool of valuers can be used effectively where they are most needed. This includes advising on statistical models, setting standards for data cleaning, carrying out valuations of those types of properties for which it is difficult to develop statistical models, making judgments when there is insufficient market evidence, and hearing appeals. The
use of standard rules and procedures enable mass valuation systems achieve a great degree of consistency between valuers than might happen in a market in which standards for valuation are underdeveloped and there is limited data about market prices.

Mass valuations have been used in a variety of circumstances but the principal reason for developing them is usually to levy recurrent annual taxes on immovable assets on the basis of their market value, though in Albania mass valuation has been developed for restitution and compensation rather than taxation (Gjika, 2015). The resulting values can also be used to generate valuations for sporadic taxes. Other applications of mass valuation include compulsory purchase, valuing state land, restitution compensation, land consolidation programmes, assessing charges for flood protection and irrigation systems, and evaluating the risks the banking system faces from its mortgage portfolio.

In the Netherlands a common definition of real estate property value was established by the Special Act for Real Estate Assessment (Wet Waardering Onroerende Zaken or Wet WOZ), 1995. Valuations are produced annually by local governments and their use is mandatory in all tax calculations, irrespective of the level of government levying the tax. As well as the annual property tax, they are also used for the tax on the imputed rent owner occupiers of residential properties pay themselves as their own landlords (which is part of income tax), the tax on landlords with ten or more residential properties, the tax on residential properties not permanently occupied by the owner, inheritance tax, and the water system charges levied by polderboards. They are the basis for setting maximum rents for social housing and are also used by notaries, banks and insurance companies for the prevention of mortgage and real estate fraud (Kuijper and Kathmann, 2015).

In Slovenia the Generalized Market Value produced by mass valuation is also in sporadic taxes as well as to provide assessments for the annual property tax. Additional uses include determining whether a family’s real estate assets exceed the level per family member for social security support, compulsory purchase for infrastructure purposes, to determine mortgage collateral, and to assess the capital adequacy of banks under the Basel II agreement, which requires periodic reviews of bank solvency (Žibrik, 2015).

Multiple uses of the valuations generated by mass valuation enables the cost of the system to be spread over a number of applications and enables governments to avoid multiple valuations. Their use outside of taxation can also encourage confidence in property taxes and the fairness with which they are assessed if the public is able to make use of them for their own purposes, such as deciding on asking prices when they sell housing or offer prices when purchasing. However, multiple use of such valuations does come with two important caveat. All valuations are an opinion of the market price on a particular day. Unless
there are regular revaluations, those produced by mass valuation cease to be current. It is notable that the Dutch system with its multiple uses of the valuations produced is one in which there is annual revaluations. Secondly, each valuation contains assumptions about the basis of value. Typically in property taxation the base is the market value in current use or the highest and best use assuming that possible redevelopment is that permitted in development plans. Usually there are also other assumptions such as occupancy is by a tenant on standard lease terms. These assumptions may not be valid for an individual property, whose market value might be significantly higher or lower than that produced by the mass valuation as a result. Whilst such potential individual errors may be acceptable when examining the collateral behind the mortgage book of a bank, the risk of error is probably too high to base an offer price for a property one is buying on a mass valuation. In such cases the real value may only be determined by inspection by a skilled valuer. The application where the use of generic valuations is most problematic is in compulsory purchase where the intention is to ensure that persons deprived of their property in the public interest are compensated for their loss and are not made worse off as a result. The danger is that mass valuation could result in some individuals receiving compensation that is lower than the real value of their property so that they are unable to buy an equivalent replacement.

**Overcoming Resistance to Property Taxes**

Although a strong case can be made for the use of value-based recurrent property taxes, they are a sensitive issue that produces significant reactions from the population. They are highly visible in ways that other taxes often are not and their unavoidable nature can make them unpopular. In three of the countries in the sample – Moldova, Poland and Slovenia – mass valuation systems to levy value-based recurrent property taxes have not been fully implemented although a great deal of work has been done on them and the systems are well thought out. In Moldova mass valuation started in 2004 and it was intended that all properties would be valued within five years. The plan was to value an additional type of property each year so that the new system would be applied in stages. In the event, the programme has not been completed.

The new approach has been applied to residential properties in urban areas, commercial and industrial property, and agricultural land which has structures on it used for business. The types of properties that have not been valued under the new system include agricultural land, rural housing, property in public ownership, infrastructure systems and networks, and those used for specific purposes such as power plants and airports. The old system of area-based values for agricultural land, inventory value for housing,
and book value for non-residential properties remains in use. As Moldova is predominantly a rural country, it means that mass valuation has been applied to just 12.5 percent of all properties, though these do include many of the most valuable properties (Buzu, 2015). Inventory values are likely to be significantly below market values and local governments in rural areas are faced with budgetary problems as a result of not being able to move their taxation on to the new system. The main reason for this situation is problems with property registration. Mass first registration, which has to precede mass valuation, is funded by the national government whereas the revenue from property tax goes to local governments. Central government has not allocated funding to complete the process although it could reduce inter-governmental fiscal transfers if local governments had better sources of own revenue. Approximately 450,000 houses in rural areas have not been registered and the registration of properties in public ownership and special purpose facilities is incomplete. The latter two categories also raise issues about the efficient management of state property. However, by taxing commercial properties and urban housing the Government of Moldova has targeted the more valuable properties.

Slovenia’s mass valuation began in 2006. The initial development and calibration of the valuation models took place between 2008 and 2009 and notices of valuations sent out to owners in 2010. The valuation models were approved by the government in 2012 and the Generalized Market Values came into use. However in 2013 the new system became locked into a constitutional dispute. There were substantial differences between the effective tax rates between municipalities that made harmonisation of the system difficult and major differences between the effective rates of tax on residential and non-residential properties. The Government wanted to increase tax rates mainly on residential properties to bring them closer to those on non-residential properties and retain part of the revenue for central government use. The proposals were challenged in the Constitutional Court which ruled against the Government. Although the Government has put forward revised proposals to address the Court’s ruling, municipalities are opposed and favour the continuation of the previous system. The future development of the property tax is uncertain (Žibrik, 2015). Opposition from municipalities who stood to lose some of their powers and residential taxpayers faced with higher tax rates have proved to be an obstacle to the implementation of the tax.

Work on reforming Poland’s property taxation started early in its transition with the Unit for the Reform of the Tax System being created in 1993. This drew up detailed plans with the Council of Ministers approving a comprehensive reform of real estate records for fiscal purposes in 1994 and the creation of a Department of Local Taxes and Cadastre within the Ministry of Finance to implement property tax reform in 1998 and legislation in 1997 and 2005. Although much preparatory work for a new system has been
undertaken, no legislation has yet been adopted to specify the commencement and completion date for the new system or to identify a source of funding. The municipalities must pass resolutions on the costs to be borne by communities and the technical guidelines have to be adopted. There appears to be no political will to bring the new system into existence and there is little public support for it, with the over-riding belief being that any change to the property tax system would result in an increased tax burden (Walacik, 2015).

With mass valuation there is a potential conflict between the ease of carrying out the programme from a technical point of view and what may be easier to persuade the public to accept. The easiest category of properties on which to carry out mass valuation is residential property. There are large numbers of properties with relatively similar characteristics and usually a number of transactions to use in developing mass valuation models. However, governments are likely to encounter less resistance if value-based recurrent taxes are first levied on commercial and industrial properties. Businesses can afford lobbyists but do not have votes. The revenue raised can help to provide local public services that can help persuade the population of the merits of property tax reform. Yet modeling their values is more difficult so that mass valuation often starts with residential properties. In Lithuania the government has not attempted to extend the buildings tax to include ordinary residential properties, though in 2013 a tax was introduced on luxury residences and residential properties are liable to the land tax (Almy, 2015). This could be a contributory factor behind the acceptance of the new system.

Property taxes are highly visible in ways that sales taxes (often hidden in the price of the goods bought) and income taxes (which may be deducted at source) are not. Not only are property taxes visible but so too is the quality of the local services they are supposed to finance (Slack and Bird, 2014). Visibility, accountability, enhancement of local economic management and the potential to support local democracy are all potential positives from property taxes, “…but that does not make it popular, and the unavoidable and uncompromising nature of property tax has led to it being neglected globally” (Monkam and Moore, 2015, p.4). The impact property taxes have on citizens and businesses make their imposition a sensitive issue that produces significant reactions from the population. Opposition can be expected from those who are likely to pay more tax as a result of property tax reforms but often goes far beyond this.

Property taxes may lack effective advocates. They can be outside the technical competencies of typical ministries of finance (as the lead ministry for taxation), with the result that value-based recurrent property taxes may lack effective champions in government. Few governments have formally adopted the idea that the public sector, including municipalities, is a single entity with what happens in one area affecting
others. Consequently, the impact of property taxes, which are usually the responsibility of local governments, on national finances and the performance of the economy as a whole may not be appreciated. Part of the answer may be because of the perceived technical demands and costs of developing value-based property tax systems. Property taxes require different administrative systems and skill sets from most other taxes. This runs counter to the trend towards creating “one-stop shops” for taxes on businesses that can deal with sales and profits taxes and the role of businesses in collecting income tax and social security contributions from their employees on behalf of the government. The technical demands of property taxes may be outside the comfort zone of Ministries of Finance more accustomed to administering income, sales and profits taxes. Cadastres, which are well used to dealing with property data, tend to lack the financial and valuation skills needed to levy taxes. Property taxation requires the coming together of many agencies of government, including national cadastres and land registries, tax authorities, municipalities, and national banks (as the regulators of mortgage markets). Each country needs to address the best way to achieve cooperation between these bodies, particularly if there are histories of distrust and inter-agency rivalries.

There is a need for a tax system that the population recognises as being fair. Property taxes can be part of a policy to produce a more progressive tax system by taxing the wealthy on their wealth. In any tax reform there are inevitably winners and losers. It is important to determine who these are and to recognise that the losers are likely to articulate their potential losses and lobby to have these mitigated, whereas the potential winners may be unorganised, less vocal or not understand the implications of the change. Property taxes are wealth taxes. Implicit here are questions as to whether there is willingness by governments to challenge powerful and well-resourced groups in the national interest by imposing property taxes on them. There is a need to educate the public on the balance between taxation and public expenditure, in particular that higher levels of public expenditure necessitate increases in taxation. The case needs to be made in the transition economies of the ECA region where citizens are now faced with explicit taxes to fund public expenditure whereas under central planning the way in which public expenditure was financed was not transparent, often taking the form of levies on state enterprises.

**Conclusions**

The development of effective and efficient value-based property taxation is a long-term goal. Several iterations may be required to achieve well-developed systems that are acceptable in approach to the majority of taxpayers. The countries that have made the most effective use of property taxes took time to develop their systems, and these are still evolving. They also follow a variety of approaches rather than a
universal model. Countries introducing value-based property taxation need to develop a roadmap of the steps required and to adopt realistic timescales. One does not need to start with a fully functioning property tax system from the outset but, rather, to look towards developing one in stages over time.

“There is no fixed formula for successful property tax reform that applies to all jurisdictions in all countries at all times, there are nevertheless common challenges and general lessons from past attempts to improve property taxation around the world…[n]o matter how well a property tax is designed and implemented, it probably remains the tax everyone loves to hate.” (Rosengard, 2013, p.184).

It would be sensible to focus attention initially on the most valuable properties, such as international grade offices, shopping malls, big industry and luxury villas and not to worry initially about how to tax small farmers and the residences of the urban poor. Work may needed to make tax rolls comprehensive in their coverage properties, to ensure that billing systems function effectively, to put in place an efficient valuation infrastructure with appropriate internationally-recognised technical and ethical standards, valuer education and qualifications, and for there to be a transparent property market with effective systems for reporting transactions and prices. A one-time uplift in revenues can be obtained by more comprehensive registration of properties for tax purposes and improved billing and collection methods but sustained growth in revenues requires value-based property taxes with regular revaluations to prevent assessments getting out of step with market values and to enable society to capture part of any value increases resulting from economic or urban growth. A well-functioning value-based property tax system indicates that the whole property market and the systems necessary for its efficient functioning are working well.

The Case Studies


References


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**Figure 1 Recurrent Taxes on Immovable Property in the EU as a Percentage of Gross Value Added Less Employee Compensation**

Source: Eurostat with calculations by the authors