



FAO LAND TENURE STUDIES

5

**Rural property tax
systems in Central
and Eastern Europe**

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Foreword

The present volume is part of a series of Land Tenure Studies produced by FAO's Land Tenure Service of the Rural Development Division. Land tenure plays a vital role in achieving sustainable rural development. Increasing technological change and economic integration are requiring policy makers, planners, development experts and rural producers to re-examine the institutional arrangements used to administer who has rights to what resources for which purposes, for how long, and under what conditions.

This volume is designed to support people who are involved with the development of rural property taxation systems in Central and Eastern Europe. Increasingly, countries are introducing policies to decentralize the provision of rural services. These policies are often not well-implemented because insufficient funds are provided to the local level to carry out the newly decentralized responsibilities. One approach to improving the capacity of local levels of governments to deliver services is to raise revenues through property taxes on rural land. We have therefore prepared this practical guide to assist people with the technical design and implementation of rural property taxation systems.

This guide forms part of the Land Tenure Service's programme designed in response to FAO's overall concern for food security and poverty alleviation. Sustainable agricultural and rural development is a critical area of activity, where improving access to land by the poor (especially women, minorities and other disadvantaged groups) who want to engage in agricultural pursuits is a key aspect which is often unrecognised and not well understood. This book, like others in the series, does not

seek to be exhaustive but rather reflects what FAO and its many international collaborators have discovered are “good practices” for a particular aspect of land administration. It is intended to be of use to technical officers of Member Nations, other senior authorities responsible for rural development, and FAO field officers. FAO’s Rural Development Division looks forward to continuing collaboration with its larger audience.

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1. Introduction

- 1.1 This guide reflects the increasing recognition that rural property taxes can play a significant part in promoting sustainable rural livelihoods in transition countries in Central and Eastern Europe. Governments are facing increasing public demands and expectations for public sector revenues. One factor of many is the ageing populations in European countries which is leading to increasing costs of pensions. At the same time, governments face limitations because tax systems must react to pressures of public acceptance and, increasingly, on the need to be internationally competitive.
- 1.2 One potential source of public revenue is property taxes. Property taxes have declined in importance as a source of revenue in many countries; for example, in OECD countries they have declined from an average of 8 percent of tax revenues in the mid-1960's, to about 5 percent today. Much of this decline has been caused by the increase in the relative importance of other taxes in the 20th century. There is thus scope for significantly increased revenues from better designed and more efficient property taxes in most countries.
- 1.3 Property tax is an annual tax imposed on real property usually by reference to an ad valorem tax base (i.e., the tax is calculated according to the value of the property). Such taxes have been in existence for millennia and their benefits are well known. They are transparent, cheap to administer, efficient to collect and well understood by the taxpaying public. They are administratively feasible in virtually any circumstances and, being locationally fixed, are particularly suitable as a source of locally generated revenue for local government. Although the very transparency of a property tax can make it unpopular, well administered property taxes have the potential to generate significant revenues and reduce opportunities for corruption.

- 1.4 The relevance of rural property taxes lies in their local importance and in their ability to allow local communities to provide for locally determined needs. This is particularly relevant in transition countries because central governments may find it increasingly difficult to respond to local rural needs. Rural livelihoods are inhibited without sound rural infrastructure. Property tax has an important role in helping to provide it.

- 1.5 This guide provides support to those who are involved with the technical design and implementation of rural property taxation systems in transition countries in Central and Eastern European, and to project officers in multi-lateral and bi-lateral agencies. It explains the relevant property tax issues with which they need to be concerned. It makes the reader aware of the political benefits and problems, the relation to other taxes, the organisational obstacles, and the timetable for reform or introduction. The guide identifies issues that should be considered in the design and implementation of rural property taxes. The overall message is that property tax in rural areas is technically feasible and will benefit the rural economy.

2. Why property tax is important

- 2.1 It is not possible to consider property tax on its own. No tax is an end in itself and it must be looked at in relation to other local and national taxes. The taxation system of a country is subservient to national social and economic aims. The detailed considerations required in the design or administration of any individual tax should not obscure a wider view, informed by a knowledge of history and international experience.
- 2.2 In historic terms taxes have tended to rise as percentages of gross Domestic Product (GDP). On average the ratios of tax to GDP (the tax ratio) have increased from 25.8 percent in 1965 to 37 percent in 1998 in OECD countries.¹ Although this increase has been halted or even reversed in recent years in some countries, the long-term trend has been clearly upwards. There are, however, great national variations. Generally there is a tendency for the developing economies to have lower tax to GDP ratios than the developed economies. Many developing countries have ratios of less than 20 percent. In contrast a number of countries in the OECD have ratios of over 45 percent, for example, Denmark, France, Italy and Sweden. On the other hand the world's two largest economies, United States and Japan, both have ratios of less than 30 percent.
- 2.3 It is reasonable to suppose that ratios will tend to increase or at least be maintained with increasing expectations and investment in medical services, prospects of greater longevity and larger proportions of pensioners in the population, and with requirements for improved education and skills to enable international competitiveness. With the general trend of decentralisation of public services, governments and people are also looking for more locally based and locally accountable taxes.
- 2.4 How will the extra revenues be raised? New taxes are not being invented and public sector revenues will come from the same sources tomorrow

as they do today. What are the major taxes? How do they compare? What are the long-term trends? For a long-term global view of taxation, this guide uses a conventional classification and simplification of taxes in the following broad groups:

- personal income tax
- company or corporation tax
- social security contributions
- consumption taxes
- property taxes

- 2.5 **Income tax** is not an easy tax to administer which is why it has been historically a comparative newcomer.² In the last two centuries income tax rates grew, particularly in times of war, until reaching historically high levels in the 1980s. Since then individual tax rates, particularly those relating to the top slices of income, have fallen. OECD figures show that the share of personal income tax as a proportion of tax revenue has fallen on average in member countries from 30 percent in 1975 to 27 percent in 1998. There are democratic and economic pressures that are likely to inhibit any significant change in the present situation.
- 2.6 **Corporation taxes** were once seen as an easy tax target. There were few votes to be lost if corporation taxes were increased. This has now changed as a consequence of the intense international competition to attract business to national or regional locations. Corporation tax rates are a significant factor in decisions by multilateral corporations of where to locate their businesses. This is therefore a major constraint preventing national governments from increasing corporation tax rates to previous levels.
- 2.7 **Social security contributions** have tended to rise in response to increasing social benefits and now constitute an average 25 percent share of taxation in OECD countries.
- 2.8 **Consumption taxes** as a source of revenue have remained on average constant in OECD countries in proportion to other taxes but the emphasis

is now on value added taxes. Most transition countries aspiring to join the EU are adopting value-added taxes in order to comply with EU rules. There are economic, competitive and democratic constraints that governments have to take into account when considering increasing consumption taxation rates.

2.9 **Property taxes** show a large variation in the ratio of property tax to total tax revenue. If wealth taxes and certain other taxes are included in the definition, property taxes account for more than 10 percent of the total in the UK, United States, Canada, Japan and Korea. Property taxes have, however, seen a long-term decline in relative importance. In 1998 property taxes represented an average 5 percent of tax revenues in OECD countries. In 1975 it was 6 percent while ten years previously it was about 8 percent. In previous centuries taxes on property almost certainly formed the most important source of tax revenue for both national and local taxes.³ The decline in relative importance of property tax and the need to find buoyant, reliable locally based sources of revenue to finance increasingly decentralised services suggest that there is scope for increasing yields.⁴ As globalisation has given multinational companies opportunities to avoid corporation taxes in a particular country, the importance of 'unavoidable' property taxes has increased.

2.10 To summarise:

- The demand for tax revenue is likely to grow, particularly in the case of local governments.
- Most major taxes are under pressure from international competition and the limits of public acceptance.
- Property tax yields can be increased in most countries.

3. What is property tax

- 3.1 Property tax is an annual tax on real property. It is usually, but not always, a local tax. It is most commonly founded on the concept of market value. The tax base may be the land only, the land and buildings, or various permutations of these factors. For the purposes of this guide, property tax is restricted to annual taxes and excludes one-off taxes on transfers, on realised capital gains or betterment, or on annual wealth taxes.
- 3.2 Property tax has been in existence for at least three millennia. It is common throughout the world and has often been the subject of political debate. The strengths and weaknesses of this type of tax are well known and possibly more widely understood than any other tax.
- 3.3 Several characteristics of property taxes have contributed to their declining relative importance in the 20th century. The maximum yield presently achievable appears on the basis of experience to be less than 12 percent of total national tax revenues, although the actual potential will vary according to the specific structure and incidence of taxation within any given jurisdiction. It is useful to understand these characteristics when designing a new tax or seeking to bring about improvements in existing systems. There is much to learn from the experiences of other countries.

ADVANTAGES

- 3.4 Advantages of the tax are clear and include:
- It is technically and administratively possible to introduce and/or maintain in almost any circumstances.
 - It is cheap to administer, and it is possible to aim for a cost yield ratio of 2 percent or less.
 - It is very difficult to avoid or evade, and collection success rates of 95 percent are readily achievable.
 - It is transparent.
 - The public understand the concept of market value (whether capital value or rental value) and therefore appreciate the basis of assessment.

- In general there is a good correlation between assessed value and the ability to pay.
- If designed correctly the tax can be marginally progressive.
- The revenue is predictable and buoyant.
- It is very well suited as a source of locally generated revenue for local governments.

DISADVANTAGES

- 3.5 The disadvantages of property tax are less clear than the advantages. The tax is not perfect and is often not popular; although it should be remembered that there are no perfect taxes and taxation is never popular.
- 3.6 Some of the advantages incorporate hidden disadvantages. The transparency of the tax reveals any inconsistencies which may become magnified in public perception. These inconsistencies will be both those of assessment (which are inevitable in a valuation list which may consist of thousands or hundreds of thousands of assessments) and those of ability to pay.⁵ Other taxes, such as income tax, are very much less consistent in practice but the public only know how the tax should work and not how it is actually applied in practice. Confidentiality hides the actual results. With property tax the public see the tax system working with all its imperfections. In a similar way the difficulty of avoiding or evading property tax may make it unpopular. This is particularly the case in societies where the rich and powerful are accustomed to manipulating the tax system for their own advantage. These persons tend to be the most articulate and politically influential and may effectively oppose or undermine the equitable operation of the tax at the political level.
- 3.7 There is also a more subtle and less well-understood shortcoming. The American war of independence was fuelled by the cry of “no taxation without representation”. In some circumstances property tax can provide “representation without taxation” for a large segment of the population. Universal suffrage means that not every voter will be a property tax payer. In some circumstances non-taxpayers may greatly outnumber taxpayers, which damages the democratic link between democracy and taxation at the

local level. There is no sanction on non-taxpayers voting for high tax policies. The adverse effects of this will be magnified if property tax forms the only part of total local revenue over which the local authority has control. In this case, a modest increase in total revenues may require large increases in individual property taxes because of the small number of tax payers.

- 3.8 There is also the problem of building “buoyancy” into property tax. In theory buoyancy is a function of two mechanisms. The first of these is the revaluation of properties at regular intervals. The second is the increase in the rate of tax to produce the needed revenue. Both are highly political. In theory either one or the other could provide buoyancy. It is technically possible to increase tax rates on an out-of-date valuation list. However, it is known from experience from many countries that the public do not understand and do not accept an out-of-date valuation list. Nonetheless there is always resistance to revaluations and the more out of date the list, the greater the resistance. The biggest factor behind declining yields for property taxes in OECD countries and others is the failure to carry out revaluations.
- 3.9 The difficulties of implementation should not be underestimated. Although the technical difficulties can be overcome, they can restrict progress, especially in the early stages of implementation. Such technical factors include:
- The system is dependent upon a pool of technical expertise (of which there is often a shortage) to create and maintain a valuation roll, and to establish and conduct the appeals process.
 - Parts of the process can be time-consuming and expensive, for example, compiling a comprehensive list of rateable properties (especially where records are poor or incomplete, or where there are a large number of legal status issues), outsourcing services to the private sector, establishing a valuation tribunal, and administrative and infrastructure support (such as dedicated information technology systems for both the valuation and the financial accounting system for the billing, collection, and enforcement procedures).

- While it is true that the public generally understands the concept of market value, confusion does arise in the relationship between ‘rateable value’ and setting the ‘rate’. This is particularly so where revaluations take place after a long interval, and/or where there has been political unwillingness to increase the rate. This often manifests itself in large numbers of ill-founded appeals.

USES OF PROPERTY TAXES

- 3.10 *A source of local revenues.* Throughout the world property taxes are commonly employed as the main source of locally generated revenue for the good reason that there is no other major source of taxation revenue that is exactly geographically defined. It is possible to use local income taxes and/or local sales taxes for generating local government revenue but both have difficult administrative problems. Local revenue may be generated from other sources, particularly rents from local government owned properties. In some cases, local income taxes are an important source of revenue. In many cases, however, property tax is the main source of revenue (and even when local income taxes exist, it may be easier for a local government to modify the property tax rate than to adjust the income tax rate).
- 3.11 As a primary source of revenue, property tax plays an important role in decentralisation and the autonomy of local government. Full decentralisation of government incorporates the power to raise revenue independently in addition to powers allowing local governments to use the funds as they see fit (in accordance with the limits of their legal powers). In practice, local government autonomy is always limited. The duties of local governments are almost invariably such that it is impossible to discharge them without central government grants which detract to a greater or lesser extent from their independence. Increasing independent powers of raising revenues through property taxes thus becomes important.
- 3.12 *Support for other functions.* ‘Valuation lists’ compiled for local government may be used by other bodies, particularly those that can be termed “single

function authorities” such as Water Boards. Water charges are commonly based on the assessed value in the valuation lists. Such procedures are very cost effective⁷ and may have a reasonable correlation with water usage in many circumstances (although cases do exist where commercial and industrial properties have low water consumption but have relatively high values). Drainage boards can also be funded by charges related to the valuation list, which has advantages over charges related only to the surface area of the property.

- 3.13 Valuation lists may be used in transitional economies for other purposes such to establish lease rates on government owned land. Where land markets are not yet developed, mass valuation results can also be used as a basis for establishing market values for properties. In addition, local bodies may have to take over functions previously controlled and administered centrally (such functions include local drainage boards,⁸ common grazing facilities, and consolidation bodies⁹). They are not able to rely on central government funding and have to raise their own revenue. Depending on the tax rates and cost of collection, valuation lists may provide a fair and cost effective basis for doing so.

RURAL PROPERTY TAXES

- 3.14 There are sound reasons for introducing or extending property tax into rural areas:
- Property tax provides a basis for local autonomy and facilitates decentralisation
 - It provides a revenue base for single function authorities
 - It encourages the economic use of land¹⁰
 - It tends to reduce land and property prices thus facilitating access to land
- Apart from agricultural land and buildings, rural property tax may be applied to commercial, industrial and residential properties located in rural areas.
- 3.15 Almost invariably the benefits of rural property tax will be local rather than national. It will be apparent in almost every country, including those in

transition, that the extension of the property tax net into rural areas will have limited impact on the total national tax revenue. The rural tax base is very much smaller than the tax base constituted by the urban economy. Frequently a national capital city and two or three other major cities produce a major part of the GDP. The relative size of the regional GDP gives a good indication of the magnitude of the tax base. Thus if for instance an improved property tax covering the entire country has a potential to produce 10 percent of total tax revenues, the proportion arising from rural areas is unlikely to be more than 20 percent of this. Even in such circumstances the rural property tax base will constitute only 2 percent of the national tax total and be more proportionately expensive to administer.¹¹

- 3.16 In most instances the above illustrative figures will overstate the potential yield from rural areas. However, this does not diminish the importance of a rural property tax. It is a vital part of decentralisation. It is not so much its size relative to the national tax base but its magnitude in relation to local revenues especially those locally generated revenues. This is why it is a vital instrument in improving rural livelihoods.
- 3.17 In most transition countries the issue of property tax in rural areas will be linked with agriculture. First, there tends to be a carry-over from the socialist period of the emphasis on primary industries. Many will tend to believe that agriculture is more important in the national economy than is the case. Second, there may be a belief that exempting agriculture from tax will reduce food prices although there is little evidence that it has ever done so. Economic theory suggests that the exemption tends to increase the price of land relative to other assets and there is evidence that this is the case. Third, there can be an erroneous belief that access to land is facilitated by exemption from tax. In practice, tax relief causes the price of agricultural land to rise and makes it more difficult for newcomers to gain access to farms.
- 3.18 There are few, if any, sound reasons for exempting agriculture from property tax. Most of those commonly proposed do not bring about the desired result.

Furthermore by exempting agriculture damage is done to perceptions of the role of the tax as a fair way of apportioning local expenditure. It also renders it of little use for raising revenue for single function authorities.

BOX 1

REVIEWING PROPERTY TAXES

Factors listed below may lead to governments reviewing the scope for introduction of property tax where it does not exist, or considering the scope for increasing taxation rates where it does, and examining the administrative machinery with the purpose of making it more efficient.

Scope for increased yields: While many taxes are now bumping up against ceilings created by economic factors, or international competition, or public acceptance, in most countries property taxes could yield more.

Probable ceiling: Although there is often scope to increase the yield from property taxes there are few if any examples of property tax accounting for more than about 12 percent of total tax revenue and this may represent a limit of public acceptance. Property tax in most countries is much less than this theoretical ceiling.

The relatively small size of the rural tax base: The rural tax base will always be comparatively small in comparison with the urban tax base. The importance of property tax in rural areas is of local significance. The benefits to the national economy are indirect.

Importance beyond its relative size: The importance of a property tax covering rural areas is greater in political terms than might be supposed from the absolute size of the property tax yield. As the foundation of local government autonomy, and as a means of financing some single function authorities, there is sound justification for the introduction of the tax.

Administrative feasibility of property tax: The wide application of property tax and its long history shows that, if there is sufficient political will, there are no insuperable technical or administrative problems to the introduction of property tax.

Political will: All taxes require political determination and public acceptance. The openness and transparency of property tax mean that it is impossible to introduce the tax by stealth. Political determination is therefore essential. If there are political doubts do not waste time and money considering the introduction of property tax.

4. Rural property tax in transition countries

4.1 Several factors inhibit making useful detailed recommendations about property tax in specific countries in Central and Eastern Europe:

- It is too large and varied a region for such oversimplification. The geographical and economic conditions vary enormously. The different countries, and different regions within those countries, have developed their cultures over millennia. These distinctive characteristics remain in many cases despite their 40 or 70 years of socialist experience.
- The general principles identified in relation to taxation and property tax apply in the large majority of these countries. The particular circumstances of a country form the basis for the application of these general principles on which it is very probable that a modern ad valorem property tax can be introduced. Only complete breakdown of systems of law and order presents an insurmountable obstacle to the implementation of property tax.
- Detailed recommendations are also of limited use because most of the countries start with some sort of property tax in existence already although these are generally not true ad valorem taxes. Many countries are in the process of revising their systems and so any specific comments would soon be out of date. The following general considerations relevant to property tax in rural areas, therefore, may or may not be applicable in specific countries.

AGRICULTURAL CONDITIONS

4.2 Agriculture is in a state of transition throughout Central and Eastern Europe. A prime concern of every transition country is access to the markets of the EU countries, particularly for their agricultural produce. At present there are factors that make it difficult for the agricultural industry of most countries in transition to compete. The former state farms are inefficient and short of capital, and encumbered with infrastructures they

can neither afford to maintain nor replace. Many are not being run at a profit, or would not be considered to be doing so if depreciation is taken into account. Privatisation has created many small uneconomic badly sited holdings. Even those countries (such as Poland and the former Yugoslavia) which retained large areas under private ownership have many farms that are too small and too scattered to be economic. However, there is no reason to doubt that the agricultural sectors in these countries will be able to compete in the future. They will adapt to the circumstances.

- 4.3 None of these factors prevent the application of an ad valorem tax, although the assessment of small-scattered holdings entails more work and will be more costly. Coupled with low agricultural values, this suggests less favourable tax/cost yields. However, a modern system of property tax should be less complicated and cheaper to administer than some of the cadastral systems presently in use.
- 4.4 It is reasonable to anticipate a period of rapid change as countries adapt and compete. It is likely that the structure of holdings will change. Land values will probably increase. Regular property tax revaluations will be necessary to pick up these changes.
- 4.5 A broad indication of the magnitude of the potential tax base attributable to agriculture may be estimated from the relative size of agriculture in the economy. There are large variations. Those where agriculture is over 25 percent of GDP include Albania, Armenia, Georgia and Moldova. Those least dependant on agriculture are Czech Republic, Poland, Slovakia and Slovenia (4 percent); Estonia and Hungary (6 percent); and Russia (7 percent). The capacity of the agricultural populations in these countries to absorb increased tax liabilities is conditioned by the fact that agriculture supports a typically disproportionately large percentage of the population. Of course, the ability of rural people to pay the tax is an important factor.

LAND TENURE AND LAND ADMINISTRATION

- 4.6 *Restitution and privatisation.* The process of privatisation in almost

every country was driven by political urgency. The resulting pattern of ownership is frequently uneconomic and has left problems that are relevant to property taxation which could pose difficulties in defining the property and valuation.

- In many countries there are small restored parcels of agricultural land which now have no proper relation to the services installed to serve large collective farms during the socialist era.
- There remain doubts about the legal status of many parcels.
- The unclear legal status of certain communally managed properties will cause difficulties of valuation and enforcement of collection.
- The unclear legal status of certain communally managed properties will cause difficulties of valuation and enforcement of collection.

4.7 **Cadastrés.** In many transition countries, ‘cadastrés’ have existed for a century or more. They vary in character but tend to incorporate a detailed classification of soil type and permitted land use. They are frequently maintained in a labour intensive manner faithfully preserving the original character of the document. It is also generally the case that the uses to which the cadastrés are put do not warrant the time and expense applied to their maintenance.

4.8 It is worth considering whether, and if so how, these cadastrés can be adapted to form a modern valuation list. It should in theory be possible because the cadastrés are in fact ‘valuation lists’ that have become fossilised. When originally prepared they were remarkable documents, well adapted to their purpose and generally of a high professional standard. The purpose was to raise revenue and they correctly addressed the main economic base of the period: agricultural land. The quality of the soil was then relatively much more important than it is today. In the last century agricultural technology and mechanisation has lessened the relative importance of soil quality. For instance, wetland can often be drained at an affordable cost. Heavy land can be cultivated more easily

with powerful machinery. Acidity is readily corrected by liming. Artificial fertiliser is applied to correct deficiencies on hungry land. Nor is it only soil quality that is important in agriculture. For many enterprises agricultural buildings are essential. In fact the pattern of agriculture has changed remarkably in the latter half of the last century and the methods of valuation and assessment must change with it. In summary there are two defects of most present day cadastres. First, they do not include the non-agricultural properties in the tax base. Second, they do not reflect present day agricultural values.

4.9 Nevertheless cadastres can form useful material from which a modern valuation list can be created. Many of the skills required to maintain a cadastre are relevant, with adaptation, to the assessment process.

4.10 **Land registration.** The subject of land registration has received much attention in most of transition countries but, in many, the situation remains less than completely satisfactory. Some of the underlying reasons are relevant to the design of property tax.

- Land registration is a service to the public. The test of success is whether the public use the system to record property transactions accurately. This simple concept with its simple test of success is still not fully understood by many of the public servants administering the registration systems who still see it as part of a government control system.
- There is often a multiplication of registers. Land ownership can be recorded in two registers: the cadastre and the land book. Building details are often in a completely separate register. Land and property owned by the public sector will probably be recorded separately with each ministry and local authority keeping their own records. Much land and property will continue to be held from the public sector (in one form or other) and this tenure will account for a large proportion of the country.

As a result, valuers cannot rely on the information in the registers and have to make their own researches at an additional cost.

- 4.11 **Valuation.** There is a shortage of valuation skills in the transitional economies of Central and Eastern Europe. The public service competes with the private sector, and the property tax administration with other public sector users of these skills.

PROPERTY MARKETS

- 4.12 It is sometimes suggested that rural property markets are too thin to provide a basis for a value based property tax. This is most unlikely to be the case. The activity in property markets is usually underestimated particularly in transition countries. It can be difficult for nationals to understand their own local property markets if they are not professionally involved in those markets. It is even more difficult for foreigners, especially if they have never been professionally involved in their own country, to recognize and understand property markets, particularly if they imagine that markets can be detected from official sources. A safe default assumption in almost any circumstances is that properties do change hands¹² and there exists sufficient evidence for a skilled valuer to create a valuation list. The evidence may not appear in the official records but this matters little.¹³
- 4.13 At the start of the 1990s most transition countries considered that property markets were insufficiently developed to form the basis for an ad valorem property tax. However, it is most unlikely that the current state of property market development will prevent the introduction of an ad valorem tax system. There are factors that the design of the tax must take into account:
- Development has been much faster in urban areas than it has in rural areas. Evidence of value is therefore more difficult to find in rural areas.
 - In agricultural areas changes in occupation through leases and renting are much more common than sales. This is particularly so for agricultural land. Many of the leasing arrangements are informal and effected verbally.
 - Much of the market activity does not appear in the registers.

- The price or consideration stated in official records cannot be relied on as being correct. It is frequently mis-stated.
- The concept of market value is not yet firmly established. The lack of transparency of the market inhibits progress.
- Foreign ownership of real property is often not permitted, and there are often strong feelings against foreign ownership of agricultural land.
- Agricultural land values are often much lower than is the norm in EU countries. There are often large differences on either side of the EU border.

TRANSPARENCY

4.14 In several transition countries there is clearly an intention to move from a 'flat rate system'¹⁴ to a true ad valorem system of property tax. The fiscal and economic advantages are recognised by many in those countries. One of the unspoken factors inhibiting this move is a fear of a new system that seems to depend more on individual judgement than it does on fixed rules. The belief is often that this will leave even more scope for corrupt officials to extract irregular payments. Understandable though this belief might be, it is incorrect. In fact the reverse is generally the case. The underlying reasons are probably related to the lack of transparency of a flat rate system. Certainly it is known from examples elsewhere in the world that flat rate taxes do not stop corruption. This may also be the case in some transition countries where the flat rate and the lack of opportunities to appeal against the officially determined value increase the opportunities for corruption in official hands.

4.15 Instead, it is more probable that a change to an ad valorem system actually will lessen the opportunities for corruption provided that it is based on up-to-date values, that the entire valuation list is open for public inspection,¹⁵ and that there is ready access to a judicial appeal system that is free to the taxpayer. When the system works well, the basis of comparability means that the freedom for officials to reduce values is

reduced because a) they can not afford to undermine their own list by individual injudicious reductions and b) it will be cheaper for the taxpayer to go to appeal than to pay a bribe. The practice of mass valuation of properties for taxation purposes leaves very little room for corruption practices as all properties are handled simultaneously without paying special attention to any particular property.

- 4.16 The way in which transparency is introduced will depend on the particular circumstances of each country. Where there are concerns of corruption at the local level of government, methodologies for mass valuation should be developed at the national level. The responsibility for setting tax rates should be assigned to local elected councils, assemblies or parliaments, and should not be left to local administrators. Local legislators should also be given the right to set the time of the next revaluation.

5. Implementing a property tax

- 5.1 The details of administration should be designed in accordance with the underlying philosophy of the tax. For what purpose is a property tax required? How does it fit into the present or proposed government structure? Is it part of a decentralisation strategy? How will it fit with other existing taxes? What will be the social and economic effects of introducing a property tax or modifying an existing one? The detailed design of the tax depends on the answers to these questions.
- 5.2 There are some important political decisions to be made. The legal drafter and those who have the task of instructing them can draw on examples of law from all over the world. It is known what works. Maybe more importantly it is also known what has not worked. The following section lists the separate but interrelated issues for which rules should be provided in the legal code. (This can be done either directly in the law or through powers devolved to ministers under the law.) It is a checklist and is not exhaustive.

PRACTICAL DETAILS: A CHECKLIST

- 5.3 *Jurisdiction of tax.* The law must specify the jurisdiction and extent of the tax. What bodies can impose the tax? What areas does it cover?
- 5.4 *Administrative benefits and responsibility.* Administration of property tax falls into various stages:
- The legal initiation of the tax, commonly the responsibility of the central government minister.
 - The assessment and the choice of where the responsibility for this task should be assigned.
 - The responsibility of setting the percentage rate which can be specified in the law or fall to the local government body, possibly within limits set by central government.

- The law must specify the duty of collection.
- The law must specify which body receives the benefit of the revenue.

It is possible for every one of these functions to fall to the local government body but generally this situation is unusual and rarely is central government willing to give local governments a free hand.

- 5.5 ***The basis of assessment.*** The basis of assessment is of course important and forms the core of the taxation process. Unfortunately public and political discussion of the options is often misled by those with an over enthusiastic attitude to one basis or another, and frequently fuelled by unrealistic expectation of the economic benefit that their preferred option will bring with it. The enthusiasts are seldom those with practical experience of administering taxes. Tax professionals have first hand experience of the imperfections of tax systems in practice.
- 5.6 If change is considered to be necessary, of course a public debate is needed. If that debate is not to become bogged down by ill informed prejudice the ground needs to be carefully prepared with a well researched discussion paper setting out the pros and cons of the different options available in the local circumstances.
- 5.7 The final result is not as important as might be supposed. In most situations there are at least three options that would work almost equally well. No solution will have the monopoly of benefits. There are always disadvantages. There are a number of different choices. Table 1 illustrates the permutations available.
- 5.8 The selection of an appropriate tax base must accord with the general philosophy underlying the tax and fit with other administrative provisions. For instance, is it intended as tax on ownership or on occupation? The underlying philosophy probably determines the best option(s) for the basis of assessment. It is also fundamental to the legal provisions relating to many of the items listed in this section. There can be other considerations relating to

TABLE 1
Comparison of bases of assessment

	A - Valuation assumption: Value restricted to existing use only.	B - Valuation assumption: Valuations taking into account the 'highest and best use' of the property.
1. Capital value. The price that the property would sell for in the open market.	1A: Common and well-tried basis of assessment, based on the value of the property in its present state. Probably the most used globally. Easy to understand. Potential value from redevelopment is ignored unlike 1B.	1B: Well known and well tried. Thought to have economic advantages in encouraging best use of the property. It requires a clear physical planning legal code so that the highest and best use is clearly apparent. Not as easy to collect as bases 1A & 2A.
2. Rental value. The price at which the property could be let from year to year.	2A: Well-tried basis of assessment. Works in almost any circumstances. Many fiscal advantages. The easiest tax option to collect. Less well understood than 1A in situations where there is a limited or statutorily controlled market.	2B: Not an easy option to apply in practice and rarely worth considering. Not realistic to take into account potential value from redevelopment in relation to an annual value.
3. Site value. ¹⁶ The value of the land only. The price that the property would sell for without buildings and other improvements.	3A: Well-tried basis of assessment that often works well. It can have administrative advantages and be a cheap system to run. Less easy to understand than 1A or 1B which may affect ease of collection. Correlates less well with ability to pay than 1A or 1B.	3B: Realistic option in some circumstances. The different uses that may be considered are only those permitted by physical planning or zoning classes.

how property is held or used.¹⁷ The selection of an appropriate tax base for an ad valorem system should also take into account the preponderance of available evidence of value. If most properties are rented, a rental basis of valuation would be sensible. If most properties are bought and sold on the basis of their market capital value, this will provide a more credible basis.

- 5.9 There are advantages of adopting one of the ad valorem tax bases above. Generally they are well understood by the taxpaying public, particularly where the basis is natural rather than artificial, and where it reflects the prevalence of market evidence that will be known and available to the public. They encourage the better use of property and have some

correlation with ability to pay. Usually the potential yield from ad valorem taxes is higher than from the other options. However, they are not the only choice. Several of the countries to which this paper is addressed use what might be termed 'flat rate property taxes' which are less dependant on valuation skills and are often a quick and easy option. An attractive option, particularly where valuation skills are in limited supply, is to adopt a system of "banding" of values to provide a reasonable degree of equity in liability without being too demanding in terms of data and professional level skills.

- 5.10 **Definition of the separately assessed property.** What should constitute a single assessment? It is by no means self evident in all circumstances. For instance, in the context of areas where farms are held in many scattered non-contiguous fields, the question is whether each field is a separate assessment or the farmer's entire holding a single assessment. The definition of the holding must accord with other aspects of tax. For instance if it is a tax on ownership, a single apartment block might have one assessment. This is not possible if the tax is one on occupation, in which case each apartment must be separately assessed.
- 5.11 **The taxpayer: who pays?** The choice is broadly between the owner and the occupier.¹⁸ There are fiscal advantages to the occupier being the taxpayer especially where registers are incomplete. The occupier is much easier to find and identify and there is probably also a greater correlation with ability to pay. However, it is politically easier to persuade the public of the merits a property tax with the owner as a tax payer. To the uninformed it sounds fairer for the owner, who may be a landlord of rented property, to be the one liable for property tax. In reality in many instances it will matter little and either may be feasible. In any case the ultimate burden will lie with the land owner (although of course, the land owner may try to pass the tax on to the consumer of produce or goods generated from the land). A tenant can only afford a certain amount in rent and property tax. If tenants, as occupiers, are liable for property tax they must, on a new lease, reduce the market rental value they can afford to bid.

- 5.12 There is an important caveat if the owner is to be specified as the taxpayer. The definition should not be too closely tied to registration because failures in the registration system may cause properties to go unassessed. Moreover, where registration triggers annual property tax liability, this creates serious disincentives to registration and undermines the effectiveness of investment in registration systems. In systems of property taxation in which the primary liability is on the owner there are known legal formulae which allow the assessment of the occupier in cases of doubt with legal protection for the occupier to pass on this liability to land owner where this can be done. Where the owner has primary liability it is also common in countries with large amounts of property owned by the public sector and let to private individuals or companies, for the law to put the tax burden on the person holding from the public sector.
- 5.13 **Revaluations.** The law must stipulate how often revaluation must be carried out. Commonly this is required under the law every five years. There are considerable disadvantages if the interval is greater. The more often the revaluations are carried out, the better the tax base value reflects the current market and the better it is understood by the tax paying public. Information technology (IT) allows the possibility of annual revaluations (as typically in the USA). There are good reasons to introduce the concept of annual revaluations into any revisions of property tax where there is sufficient IT capacity to do so reasonably inexpensively. Revaluations can be politically difficult to handle if they result in large changes in values and tax liabilities. Such large charges, and the associated need for sensitive political decisions, can be avoided by introducing annual revaluations.
- 5.14 **Setting the rate.** There are several possible approaches. In one approach the rate is fixed annually by local government taking into account the budgeted needs of the authority. The setting of the rate is a political act, which will give rise to local debate. In another approach the law fixes the rate in primary legislation and the tax revenues will vary according to changes in market values and regular revaluations. In a third approach, the central government fixes the property tax rate annually taking into

account the needs of local government and reflecting the extent of intergovernmental transfers from central to local government.

- 5.15 Although in the longer term the general picture will tend to be of buoyant revenues, in situations with declining property values revenues will decline. This could also be a problem for some Central and Eastern European countries where populations are forecast to decline significantly. The yield of the tax in these circumstances is not within the control of local politicians. One of the main strengths of the locally set tax rate for property tax is that it allows decentralised accountability. This accountability is reduced if the local government is not in control of the rate.
- 5.16 It is also possible to have differential rates depending on the value of property and/or the amount of property held by any taxpayer. Thus it is possible to introduce a policy where the greater the assessed value of the taxpayer's properties the higher the rate of tax. In theory it makes the tax more progressive and it sounds attractive at first sight. There are, however, many technical reasons to avoid this and adopt a single tax rate. It leads to artificial splitting of properties to avoid the higher rates. The approach makes the total yield of the tax less predictable and therefore complicates local government budgets. It makes the tax a degree less transparent. The greater complexity decreases the level of accountability achievable from the administrative staff and can lead to corruption.
- 5.17 **Exemptions.** In general it is the case that the fewer the exemptions, the easier and cheaper it is to administer a property tax. Exemptions seldom bring with them any lasting political popularity and rarely have the expected beneficial economic and social consequences. As noted above, the case for exempting agriculture is weak. It is advisable to minimise the number of exemptions. There are specific classes to be considered by the designer of property tax:
- One type of exemption universally found throughout the world is that for churches, mosques, etc., with associated burial grounds. It would be wise to exempt such buildings.

- Roads, public parks and some other public amenities are also usually exempt. The occupations and ownerships are often difficult to define and therefore to tax. The same consideration may apply to common amenities in rural locations such as common grazing areas. However even if such valuable amenities are not included in valuation lists the benefit is not lost to the tax base. The value is reflected in the increased value of the properties that benefit from that amenity.
- There is usually little point in assessing land used for commercial forestry. As a rule the value of forestry land, if the value of standing timber is excluded, is very low. Moreover the ability to pay is restricted by the periodic cash flow pattern of forestry yields that does not fit an annual tax.

5.18 Government property and property tax. Commonly government and local government property is exempt. At first sight this appears sensible. Taxation of property owned and occupied by the public sector would seem to be an unnecessary bureaucratic exercise of taking money from one public sector pocket to another. On closer analysis it may be seen that there are very good reasons for public sector properties to be subject to property tax in the normal way:

- Such taxation is a method of apportioning liability between the different layers of government. A central government establishment uses local facilities and there is no reason why central government should not contribute to the cost through property tax in the normal way. Taxation of central government property may be very important for those local governments in which a relatively large number of central government properties are located.
- Throughout the world it is generally the case that the public sector is not a careful user of land and property. The reasons for this include the lack of financial sanction: they have the public purse at their disposal. Also for most public sector departments land management is not their core function and land and property are held incidentally to this. There are a number of ways that the administration of the public

sector estate can be improved. The liability of public sector properties to property tax is one step towards better management, because then holding land and property are no longer cost free. It is an encouragement to use land and property less wastefully. It is a step towards proper accountability by public sector departments for the property holdings. As the public sector is almost always a very large owner and occupier of property the question is important. This is commonly the case in Eastern Europe.

- 5.19 **Exemption for small properties.** An analysis of most valuation lists prepared on an ad valorem basis typically reveals that 40 percent or more of the total assessed value derives from less than 10 percent of the most valuable properties. On the other hand about half the population live in less valuable properties that account for less than 10 percent of the total value.¹⁹ Furthermore, because of the higher cost/yield of assessing these less valuable properties and greater difficulties of collection, it would in fiscal terms be possible to exempt them from tax with little loss of revenue. It appears politically attractive to exempt so many poorer people from tax and to pay so small a price in loss of revenue. There are sound reasons why this is rarely done. First, it diminishes the configuration of the tax as a channel of local accountability because a smaller proportion of the population are taxpayers. Second, it can lead to artificial division of properties for avoidance purposes. Third, it creates dissatisfaction at the margins, and those property owners just into the tax threshold feel aggrieved.
- 5.20 **Rules for payment.** The law must specify how and when payment must be demanded and made.
- 5.21 **Enforcement.** The law must provide powers of enforcement in cases of non-payment. Typical remedies include distraint on goods (i.e., the removal of goods for sale to make the payment), seizure of rents and profits, fines and interest on late payment exceeding the commercial rate, forfeiture of the property and imprisonment.

- 5.22 **Settlement of disputes.** Experience throughout the world shows the advantage of having a system of tribunals or local courts that are local, accessible without professional representation, speedy and cheap. It is important to ensure that tribunals used to settle property tax appeals are seen to be independent from both the body responsible for the property tax assessments and the responsibility for collecting the property tax.
- 5.23 Many of the disputes relating to property tax will turn on matters of fact and valuation. The typical composition of such tribunals (at least three persons, chaired by a lawyer) will reflect this. The non-legal members are typically informed and respected local persons and/or non-legal professionals such as valuers and accountants. The dispute resolution system is very important to the smooth administration of the tax and is also an important safety valve. The law must of course specify how and when appeals can be made.
- 5.24 **Relation to other taxes.** The main point on which a political decision must be made is whether property tax is an expense allowable against income tax and corporation tax, and if so, in what circumstances. It is normal for property tax to be an allowable expense against corporation tax and for individual tax in businesses.

ADMINISTRATIVE MACHINERY

- 5.25 **Essential Features of Property Tax Administration.** There are important and sometimes unique features of property tax administration which it is necessary to understand when planning the implementation of the tax or a revaluation:
- Chain of functions: The successful implementation of property tax requires the completion of a number of different functions each of which is essential to the success of the whole process. They are links in the chain and the absence or failure of any one link causes complete failure.
 - Completion of the valuation list: Property tax requires that every taxable property should be included in the valuation list. If a list is incomplete, not all possible revenues are being collected. Inclusion of

all properties is also important from an equity principle as it ensures that the tax burden is placed fairly on all eligible taxpayers. Every property must be assessed within the planned time schedule.

- **Schedule:** The time taken to implement the system will depend on the scale of the task and the resources available. It will take at least two years to implement a new valuation list from scratch, and often takes longer. The time can be reduced in subsequent years if the list has been well maintained and if the computer systems are well designed. Policy makers need to take this into account.
- **Yearly modules:** It is usual for a new valuation list to come into effect at the beginning of a financial year. The timetable should take this into account. If the valuation list is not complete at the beginning of the financial year in which it is scheduled this is likely to cause a full year's delay.

5.26 There are therefore several factors that can give rise to failure. There are probably no other taxes for which there is such a stark gulf between success and failure. Furthermore the abortive work done for failed valuation lists may well be completely wasted. Most of the data has a comparatively short useful life. The effect of this is that property tax administration must be carefully planned and executed with considerable determination.

5.27 ***People and professional skills.*** In the developed market economies, the number of people working in valuation and property management in the private sector is usually 3-4 times that working in the public sector. In every country with established annual property taxes, the assessment process is organised in ways that minimise the number of fully qualified valuers used. Using computer-assisted mass appraisal techniques, much of the work can be carried out by people with appropriate IT and statistical skills and valuation technicians.

5.28 Valuation knowledge and skills are still in short supply in transition countries. Moreover, the specific skills necessary for rural valuations

require appropriately trained valuers with experience and standing in the valuation districts. This shortage has been considered a factor limiting the implementation of an ad valorem tax. The property tax skills requirements in the public sector have to compete with the private sector and the other functions in the public sector which use valuation and property management skills. In some countries, property market valuation skills are developing more rapidly in the private sector than in the public sector. There may often therefore be private valuers but few if any in the public sector. In other countries, the private sector has not developed to the stage in which it can be used reliably in valuation for taxation purposes. Private sector companies have found it difficult to train their personnel and invest in IT technology needed for mass appraisal.

- 5.29 Particularly when introducing an ad valorem based property tax, countries will need to consider training and education for valuers, property advisors and property managers. The shortage of professionally qualified valuers will remain a challenge for most transitional economies for the time being and the public sector will find it difficult to secure and retain these scarce skills. Strategies for combating this difficulty will include support for development of university capacity in training and research in this area, the in-house training of technicians and the use of the private sector. Strategies must also address the fact that training and education for valuers and assessors generally includes no instruction on the organisation of a property tax office or the planning and execution of a revaluation.
- 5.30 **Institutions.** The location of the different property tax functions within the government administration is not straightforward and may make the difference between success and failure. There are several different sub-functions which can be located in different ministries or at different levels of government. Table 2 illustrates possible choices.
- 5.31 When considering the assignment of responsibility for the assessment function there are often entrenched interests to be taken into account. Property records that could be relevant to assessment may be divided and

TABLE 2
Choices for locating responsibilities

Function	Possible location
1. Overall responsibility	Ministry of Finance, Ministry of Financial Planning, Ministry of Local Government, Ministry of the Environment, Ministry of Agriculture, and/or whichever ministry controls the surveying and cadastral functions
2. Assessment	Ministry of Finance, Ministry of Local Government, Ministry of Agriculture, Ministry of the Environment, and/or whichever ministry controls the surveying and cadastral functions if not one of the above, Local government Subcontracting to the private sector by any of the above
3. Collection	Local government Central government on behalf of local government Subcontracting to the private sector by any of the above

located in several ministries. Agriculture holds records of soil classification and farm units. Land ownership records may be with the cadastral department and records of buildings may be held separately. The shortage of professional valuation skills in the countries of Central and Eastern Europe suggests that in most cases it is probably not an option to devolve the assessment function to the beneficiary local governments who will not have the professional in-house capability. There is the option of contracting with the private sector to carry out the work.

- 5.32 There are good reasons for separating the collection function from that of assessment and in many cases local government carries out the collection function while central government retains control of assessments.
- 5.33 **Technical considerations.** Valuation lists of high quality have been compiled for several millennia without the benefit of modern technology and long before computers were invented. It is worth bearing this in mind when deciding on the level of sophistication of information technology (IT) to be used:

- IT has no effect on the quality of the final product
- IT does not produce a substitute for valuation skills
- IT does not produce organisational skills
- Greater spending on IT will not necessarily produce better results

However, the careful and well-planned use of IT may well reduce costs, should increase accuracy and consistency of the data, and will certainly save time. A valuation list is a very large database and IT allows the data therein to be reproduced in several different formats. Fortunately IT skills are generally available in the transition countries. There is a wealth of experience (the successes and the failures) of computerising property tax from throughout the world from which to learn. It is important to get the strategy right.

PUTTING IT INTO PRACTICE: A CHRONOLOGICAL CHECKLIST

- 5.34 The purpose of this section is to demonstrate the chronological order of the actions and the interrelation between them. The sequence of events illustrated in Table 3 indicates the steps that must take place from conception to collection for introducing or reforming property tax. It is intended to help plan the process in individual countries and to assist identifying the critical path in each individual case. The sequence is also intended to emphasise the unity of the process. All parts of the process must be in place to succeed. The malfunction of any one process will cause failure of the whole. This guide cannot do more than indicate the functions. It does not discuss the detail of how they are implemented as this will vary from case to case.
- 5.35 **Policy planning.** It is obvious that policy makers must decide the direction in which they wish to go. It is clearly impossible to start the detailed design before this has taken place. One initiative that is not included in the chart is the preparation of public opinion.
- 5.36 **Legislation.** The legislative process must be complete by the time the tax is to come into effect. If the government is certain that it can get the legislation through by that time this step can proceed during the preparation

TABLE 3
Sequence of events

Action and responsibility	Time in years relative to the tax coming into operation					
	-3	-2	-1	+1	+2	continuing
1. Policy planning (Central government)	-----					
2. Public information	-----					
3. Legislation (Central government)	-----					
4. Establishing the valuation office (Central government)	-----					
5. The assessment process (Valuation office)		-----				
6. Depositing the legal valuation list (Valuation office)				-----		
7. Setting the rate (Local government)			-----			
8. Dealing with objections and appeals (Valuation office)				-----		
9. Setting up collection office (Central government)		-----				
10. Collection (Collection office)				-----		
11. Enforcement (Collection office)					-----	
12. Maintenance of the valuation list (Valuation office)					-----	

of the valuation list. In the table it is suggested that the legislative process should be complete before this. This may be advisable. There is a risk in setting up a valuation office if the changes in the legislation may fail. There is also a need for the valuers to have legal powers to enter properties and to obtain information necessary for their task.

5.37 ***Establishing the valuation office.*** Although the assessment process is only one of the functions, it is the one that is most technically and organizationally demanding. There must be an office capable of carrying out this step completely, punctually and to the required quality standards. It requires technical valuation skills, organizational skills and computer skills.

5.38 ***Establishing the collection office.*** There must be an entity to collect the tax. It requires fewer technical skills and fewer people than the assessment process but as much determination.

- 5.39 ***The assessment process.*** This is the big time consuming function. It will certainly be on the critical path. There are many sub-functions within this step. These include:
- collection and assembly of data on market transactions
 - market analysis
 - devising of mass valuation benchmarks
 - identification of taxable land parcels and the relevant characteristics
 - field inspections
 - valuations
 - compiling the list
- 5.40 In order to assist in updating the lists, the assessing body should establish links with other land administration agencies such as the land registry and cadastre (for information on characteristics of the land parcels, transfers and selling prices) and the planning authority (for information on new buildings, etc.) The mass assembly of relevant data on land parcels for property taxation purposes is a major initial and ongoing task that requires careful planning and budgeting of resources.
- 5.41 Setting the rate. In some systems the rate is set in the law. Otherwise this step is essentially the taking of a decision. However, it is a politically charged decision and will be preceded by political debate. Steps include:
- Depositing the legal valuation list. This is the culmination of the assessment process.
 - Dealing with objections and appeals. The assessment process does not end with the deposition of the list. In any transparent and sustainable system there must be an appeal system.
 - Collection. The collection process follows an annual cycle.
 - Enforcement. Collection will not be complete without enforcement.
 - Maintenance of the Valuation List. Properties and the tax base are always changing. These must be tracked and recorded. The process must roll on continuously.

6. Valuation approaches and techniques

- 6.1 Although the administration of property tax is a complex process in its entirety, there is no single element that cannot be explained in simple terms and judged by commonsense standards. Policy makers and taxpayers are entitled to understand property tax issues. Half a century ago professionals of all types were not expected to explain their professional judgements but nowadays citizens expect to be able to understand those issues that directly affect them. The public are increasingly intolerant of professionals hiding behind professional jargon so it is important to keep the public well informed throughout and for the terms used to be clearly explained.

VALUATION METHODS AND STANDARDS

- 6.2 Valuation method” means the calculations and techniques used to arrive at the value. Valuers and non-valuers and policy makers should keep in mind that there is only one simple test of a method. *Does it work?* Does it correctly predict the selling price before the event in a market situation? Non-valuers are interested in the end result and not in the finer points of the techniques. In the case of valuations made for property tax the test is whether the resulting figures are acceptable to most taxpayers and defensible in court on appeal.
- 6.3 In fact the starting point is not the valuation method but the method of analysis. The method of analysis, if successful, will be reflected in the method of valuation. For instance dwelling houses are normally analysed and valued by reference to the floor area. It is known from analysis of sales evidence that size, quality and location are significant factors and so values are determined using those factors. If someone devises an alternative method that works better it will be used instead.
- 6.4 In property tax the most contentious problems of valuation arise when there is no sales evidence of that class of property. For the small number

of properties where this is the case there are conventional methods by which market values are approximated.

- 6.5 Valuations for property tax are defined by legislation of the country which identifies what must be taken into account in such valuations.
- 6.6 Valuation standards define the matters to be taken into account in valuation practice primarily when dealing with valuations for private sector activities such as mortgages, investment and accounting. Such standards are increasingly international in character reflecting the growing awareness of the strong links between valuation standards and financial markets, and globalisation.

COMPUTER ASSISTED MASS APPRAISAL (CAMA)

- 6.7 Mass appraisal is the process of valuing a large number of properties at the same time using standardized procedures. It is the only way to complete a valuation list and predates the practice of ‘mass production’ by many centuries. When one person (the valuation officer) has responsibility for assessing perhaps 100,000 properties for property tax within a two-year period, the officer can accomplish this only by organisation and delegation. The valuation officer can personally value no more than 1000 properties in this period. The work must be done by valuers and valuation technicians working for the valuation officer but in accordance with established guidelines. Thus for instance agricultural land of category x within a specified location is valued at \$y per hectare. Perhaps detached houses of a certain category in a defined suburb are valued at \$z per square meter of floor area. Of course the guidelines will become intricate because the resulting figure must be the market value as defined in the law. These mass appraisal methods are not new. There is evidence that the Romans used methods just as careful and complex.
- 6.8 How does “mass appraisal” become “computer assisted mass appraisal”? If failure is to be avoided the answer is that it must evolve in stages. The first stage in computerisation is the handling of the data in the valuation

list as a database. The next major priority will probably be the computerisation of the collection process. Only when these applications are well established should attention turn to the computerisation of the valuation process. It will be apparent from the description of the mass appraisal process above that many of the processes are very suitable for computer assistance. The guidelines can be computerised and the valuations automatically generated.

- 6.9 This approach works well but there are caveats. The guidelines, whether computerised or not, will not cover every case. For perhaps a maximum of 80 percent of the properties the guidelines will work without modification. The remaining properties will be atypical and require varying degrees of special attention. When handled manually the valuer or technician soon recognises when the guidelines are producing a wrong figure. It is more difficult when using computers and the design must reflect this. It must also be remembered that computers do not assist directly with the capture of information in the field which is a major part of the work. However, the use of simple inspection checklists that act as automated input forms, and palm-top and lap-top computers, can be extremely helpful in the assessment process.
- 6.10 There is an essential stage in the mass appraisal process, which has not been examined in detail in this paper. Before the valuation officer can compile the valuation guidelines there must be an analysis of the market information. For instance, how many sales of agricultural land have there been? How much is agricultural land of category B selling for on the open market per hectare? What are the valuation significant factors?
- 6.11 One analysis technique which can allow the valuer to make sense of market information is regression analysis which is particularly useful for handling large amounts of data. It helps identify the significance of different factors and identify trends. IT makes it simple and readily available. Regression analysis is also a key phase when the various applications above are linked to form an automated loop. Sales

information is fed into the market information database and analysed directly through regression analysis. Alterations of value are detected and feed into the valuation guidelines from which in turn new valuations are generated. This is used particularly in USA and allows very efficient annual revaluations. The complete loop is unlikely to be feasible in transition countries in the medium term because it relies on the vigorous operation of a property market and the complete and accurate reporting by the parties of the true consideration for the transaction.

- 6.12 Regression analysis is not new. It is a well-established and widely used technique. It does not over-ride common sense. People make judgements everyday about the value of things – whether a kilogram of potatoes, a second-hand car or the house next door – without using regression analysis. In fact in the case of an individual valuation there are probably fewer than 10 comparable open market transactions and regression analysis is neither necessary nor helpful. However, regression analysis is a very useful and powerful technique in the right circumstances and particularly in the context of mass valuations for property taxation purposes.

7. Final comments

- 7.1 It is widely recognised that the incidence of taxation on land and property can have profoundly distorting effects on property markets. Many taxes impinge on property and the design of each has the potential to affect the market in different unintended and undesirable ways. But there may also be ways in which the tax system encourages beneficial consequences. Table 4 illustrates the complexity and scope of the issues although it is not comprehensive or applicable in all circumstances.
- 7.2 Clearly any review of the effect of taxes on property as an investment or how tax affects access to land and property must have regard to many other wider factors: the wider economy, the existing pattern of taxation and the incidence of taxation on investments other than land and property. Taxation is of course primarily about raising revenue and is therefore an issue that goes well beyond the property market and land administration.
- 7.3 The first action is to review the incidence of taxation on land and property and identify any distortions caused by taxation. Remedies can only be devised in the light of the larger economy, the need to raise revenue, the national capacity to implement new taxes and political realities.
- 7.4 In the final analysis, property taxes can play an important role in developing sustainable rural livelihoods and communities. The tax is transparent, cheap to administer, efficient to collect and well understood by the taxpaying public. It is administratively feasible in virtually any circumstances.
- 7.5 It is particularly suitable as a source of locally generated revenue for local government. It enables local communities to provide for locally determined needs. This is important in transition countries because central governments may find it increasingly difficult to respond to local rural needs. Rural livelihoods will be inhibited without sound rural infrastructure. Property tax has an important part in providing it.

TABLE 4
Consequences of taxation

Taxes on Land and Property	Consequences for Property Markets
Property taxes using market values as a basis of assessment.	A system that uses up-to-date market values (capital or rental) as a basis does not distort the market provided the categories of exemption are those conventionally used. It will tend to reduce the market value and may thus make property more accessible.
Capital Gains Taxes	Capital Gains Tax and its design is likely to be a factor considered by those investing in property. In most countries houses used as primary residences are exempt. This does distort the market in favour of owner-occupation of residential properties, but this is regarded as a benign result in most countries. This tax need not affect the operation of the land market or the operation of property tax.
Transfer taxes or Stamp Duties	If the total cost, including tax, of officially transferring property becomes too great the market will not use the official systems thus leading to a less secure and less transparent market.
Capital or Wealth Taxes	If applied evenly and with few exemptions the distorting effects are few. The incidence of the tax can have some relevance to property tax. Both taxes impinge on the same target.
Income tax	The income tax system affects the property market in a number of ways. The treatment of capital allowances (how capital investments in property may be written off against income) will affect the decisions of investors. Arrangements can be made to assist farmers but unintended effects may occur: concessions often result in increasing land prices and impeding access to land. Applying property tax to rural property will tend to correct this distortion.
Taxes on inheritance	This tax can have a beneficial effect. Its redistributive nature can cause more land to come on the market.
Value added taxes and the effect on sales and building costs	The design of the tax, categories of exemptions and zero rating and level of tax payable are all factors relevant to property as an investment and the market.

7.6 Many of the countries of Central and Eastern Europe have introduced a property tax in some form or other. Generally the advantages of property tax as a means of generating local revenue are understood. In many instances the tax in force is not yet on a true ad valorem basis due to perceived difficulties in assessment. There is a concern about the lack of valuation expertise. In some cases it is thought there is not a sufficiently strong

property market. It is considered that this is not now the case even in rural areas. Well administered transparent property taxes have the potential to generate a greater revenue and reduce the opportunities for corruption.

- 7.7 Most tax reforms take time and property tax is no exception. The longest and most unpredictable phase is the public debate and policy planning. Only when this stage is complete can the execution begin. Thereafter there are a number of interrelated steps which will take not less than two years. Thus time from initiation of the policy debate to the flow of tax revenue is likely to be about five years. Time is thus an important element. The single most complex step is the assessment process which must be completed within a certain period (say a maximum of three years) because the information captured becomes out of date and undermines the credibility of the tax. The most important step is setting the tax rate. If the tax rate is set too high, there will be widespread resistance. If the tax rate is set too low, the system will not be cost-effective. The aim should be to set the tax rate at a level high enough to generate sufficient revenue to make it worthwhile but not so high that it becomes impossible to collect the taxes because of an 'inability to pay'.
- 7.8 Property tax is an ancient and very well understood tax. There is plenty of experience from countries all over the world and it is well known what works, and what does not. There are probably no circumstances in which property tax cannot be introduced if there is the political will to do so. The overall message is that property tax in rural areas is technically feasible and will benefit the rural economy.

Notes

¹ These figures include social security contributions.

² The first income tax is often said to have been introduced into Britain in 1799. However there had been many previous taxes that did attempt to tax income. In Britain these attempts to tax income include the Land Tax of the 18th century in which the tax base incorporated stipends in addition to property based revenues. Also note the Taille in pre-revolutionary France which was an income tax in character, although defective in that the richest were exempt.

³ This is certainly the case if church taxes (such as tithes or dimes) and papal taxes (such as 'Peter's pence') are included in the definition of property taxes. It should not be assumed that property tax was the most important source of tax revenue by choice. It was more often that real property was the most visible form of wealth and the only tax base available.

⁴ This simple conclusion needs qualification and should be used with caution. If the average yields of property taxes are considered as a percentage of GDP, rather than in relation to tax revenues, it is seen that there has been remarkable stability. The OECD average property tax receipts as a percentage of GDP was 1.9 percent in 1965 and exactly the same in 1998.

⁵ Although in general people and business occupy properties that are consistent with their ability to pay the tax there will be exceptions. A common case found throughout the world, and one, which always causes sympathy, is the widow in the family house. Sentiment and circumstance may make it difficult to move but assessed property tax may be difficult to pay with her present income. The public is always sympathetic to widows who are always assumed to be poor.

⁶ Property tax designers tend to have in their minds a vision of perfectly matching democracy and taxation. The elected representatives of the local community decide the local needs and calculate the resulting local revenue required. The necessary rate is then set. This vision of local democracy is sometimes encouraged by notions of the democracies of ancient Greece or newly independent America. However in both those cases there was not universal suffrage. Only property owners (and therefore taxpayers) had the vote.

⁷ The alternative is charging by the amount of water used as assessed by water meters. The installation, maintenance and reading of meters is expensive. Meters may save water: it was about 11 percent in one study in the UK. The decision on whether to install meters can be made by calculating the cost of supplying the additional water and comparing that with the cost of meters.

⁸ It is not only the low-lying marsh areas in which drainage boards might operate. There is also a widespread problem relating to systems of under-soil drainage and privatisation.

During the socialist period extensive systems of under soil drainage were installed on collective and state farms. In many countries the restitution to the former owners takes no account of the pattern of drainage which will now have to be maintained communally if whole systems are not going to silt up and fall into decay.

⁹ An up to date valuation list will assist only in the first stages of a process of consolidating scattered holdings. A much more accurate and painstaking valuation will be required to satisfy the landowners before final apportionment of the land under a new layout.

¹⁰ This general condition has little application at present in most countries in transition where agricultural land prices are low, in sharp contrast to the sometimes adjacent EU countries.

¹¹ The cost yield ratios for rural areas tend to be less favourable. The unit costs of assessment will be the similar in both rural and urban areas. However the average yields in rural areas will be much lower.

¹² Properties must change hands because the human condition is same throughout the world whatever the social regime. People die, get married, have children, start businesses, change jobs, get old, get divorced, etc all of which may require a move from one property to another. A market will develop to accommodate these needs in some form or other. The greater the regularity and transparency of the property market the better it will be for the economy.

¹³ It is up to the valuers to find the evidence whether it is in the official domain or not. It is what valuers are trained to do and that is an integral part of their professional task. Of course evidence of value obtained from non-official sources are somewhat harder to prove on appeal but this is not an insurmountable difficulty.

¹⁴ This takes the form of rates per square meter set by law or regulation for various different types of property in different locations. Usually these flat rates are meant to reflect market values. The tables from which they are derived are often elaborate and the result of much work.

¹⁵ It is important that the whole list is available for inspection at no cost by any member of the public and not only taxpayers. The law should incorporate this right. Officials should not obstruct it.

¹⁶ A site valuation basis for valuation usually suffers from there being very little evidence of site values. This can seriously detract from the credibility of the assessments produced. In any consideration of the options for bases of assessment for property tax it is likely that there will, at some point, be reference to the works of the charismatic 19th century economist Henry George. A key element in his prolific work was his advocacy of a single tax levied at 100 percent of the annual value of land (but not the buildings and improvements thereon). This single tax would be a substitute for all other taxes. Although the single tax is central to his theories it is part of a larger vision. It is not an uncomplicated advocacy of site value taxation and it does not do justice to his work to view

it so narrowly. In his utopian vision he believed that “ in a simple change in the method of taxation lies the fundamental cure of pauperism and low wages and all the social difficulties which afflict the modern society”. He also said “it is not necessary to confiscate land, it is only necessary to confiscate rent”. This confiscation of land value was also an important and deliberate part of his scheme.

Few now believe in the practicality of this theory although the fervour that he engendered in his lifetime still exists for some.

¹⁷ There used to be a particular problem associated with bases of assessment that applied to rental values. It concerned the inter-relation with legal rent control provisions. The question was whether the rental value was the rent payable in accordance with rent control laws or the open market rent that would be payable if those laws did not exist. In the UK the courts determined that it was the full unrestricted open market rental value. In India the courts said it was the restricted value, and by doing so the whole rating system was considerably curtailed. The different opinions of the two national courts were understandable if the different underlying philosophies of the taxes in the two countries are considered. In the UK rates were a tax on occupation and the occupier pays the rates. The value of his occupation is not affected by rent control. In India the tax is on ownership and the owner pays the property tax even though it is assessed by reference to the rental value. Rent control affects the value of his ownership and this should be reflected in his assessment.

It would not be difficult to rectify this defect. Rent control in effect transfers an element of value to the tenant. If the law provides for a tenant to be assessed for a partial ‘ownership’ where rent control exists, this element of value is partially picked up in the tax net.

Rent control has not disappeared but is now much less common in the world. It is therefore much less likely to be a problem with which a property tax legal code will have to cope.

¹⁸ There are jurisdictions where both the owner and the occupier are severally liable for property tax. This is an option in most circumstances. However there may be administrative disadvantages. It may cost more because there will be more separate assessments to value and list and administer.

¹⁹ These figures are based on the author’s experience.

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