Property Valuation and Taxation for Fiscal Sustainability and Improved Local Governance in the ECA Region

Richard GROVER, United Kingdom; Mika-Petteri TÖRHÖNEN, United States; Paul MUNRO-FAURE, Italy and Aanchal ANAND, United States

SUMMARY

Many countries in the Europe and Central Asia region have made significant progress in developing property registration and cadastral systems. However, the development of valuation infrastructure has often lagged behind with many of the countries in the region needing to do further work on valuation standards, the quality and transparency of property market information, and the qualifications and professional standards expected of professional valuers. The valuation infrastructure impacts on a number of areas of an economy, including the stability of the banking system and secured lending, the reliability of company accounts, and compensation for compulsory purchase. One particularly important area that is affected by this is property taxation. Fair property taxes should be based upon the value of assets otherwise taxpayers pay significantly different percentages of the value of their properties. Regularly revalued annual property taxes enable governments to tap into rising property values resulting from economic growth and can enable the provision of infrastructure to support growth. Many of the countries in the region face fiscal stress and need new sources of tax revenue to overcome these. Often their tax systems are unbalanced with undue dependence on income, profits or sales taxes, which well-designed property taxes could help alleviate. This paper presents some initial findings from a study of the property tax systems of selected countries from the ECA region. The sample was chosen so as to produce a cross section of countries ranging from those who have mature systems to those who are just starting the process of developing value-based property taxes. The comparisons identify the factors that facilitate value-based property taxes, the challenges that have to be overcome, and the potential solutions that can enable countries to develop efficient and equitable property taxes.

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Richard GROVER
UK

Mika-Petteri TÖRHÖNEN
USA

Paul MUNRO-FAURE
Italy

Aanchal ANAND
USA

1. INTRODUCTION TO THE PROJECT

This paper presents some of the initial findings of a joint project between the World Bank, FAO, and the Lithuanian Centre of Registers into Property Valuation and Taxation for Improving Local Governance[1]. The initiative aims to improve understanding of property valuation and taxation systems in the Europe and Central Asia region, including the challenges, impact, and ability to improve municipal financing and local governance. Case studies on Lithuania, Moldova, Turkey, Serbia, Kazakhstan, Slovenia, Russia, and the Netherlands have been commissioned, representing the evolution of value-based property taxation systems from the stage of initial consideration (such as in Serbia), experiments in mass valuation (such as Turkey), to strong, well-established property valuation and taxation systems (such as in Lithuania). In addition, the Netherlands has been studied as a comparison. The case studies will be featured in a regional conference on June 3 – 6, 2015 in Vilnius Lithuania and it is expected that a number of them will be published in a thematic edition of the *Land Tenure Journal*[2]. The initiative will conclude with a best practice publication on property valuation and taxation due in the autumn of 2015.

The World Bank and the Food and Agriculture Organization of the United Nations (FAO) have supported land reform, land administration, and land management projects in the Europe and Central Asia region (ECA) since the early 1990s. The ending of communist regimes in Central and Eastern Europe after the fall of the Berlin Wall in 1989 and the dissolutions of the Soviet Union and Republic of Yugoslavia resulted in unprecedented political, economic, and social changes in ECA. The resulting economic transition launched a wave of massive reforms in economic systems – changing the countries from command to market-based economies - transforming institutions, processes, attitudes, and fundamental concepts of individual and organisational behaviour across the region. Both the privatisation of land and property assets and their efficient management and the mobilisation of credit markets have been at the centre of the transitional reforms to date. During this period, the World Bank has

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funded 42 land projects in 24 ECA countries in support of reforms - in land, land administration, and land management.

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. World Bank operations to enhance property valuation systems have been completed in Slovenia, Russia and Moldova; are on-going in varying forms in Azerbaijan, Turkey and Kazakhstan; and under preparation in Serbia, Albania and Uzbekistan. Property taxation reforms are being supported in Croatia and Kazakhstan. There is a need to consolidate cross-sectoral knowledge on spatial (land) records, property valuation and taxation applications, and taxation policies and municipal financing, and provide best practice responses to this growing demand.

2. PROPERTY TAX CONCEPTS

The central focus of the study is value-based recurrent annual taxes on immovable property and the role that mass valuation can play in the development of these taxes. Market-based taxes (often called *ad valorem* taxes) are levied on the market value of the property. This is the estimated price at which a property would be transferred between a willing buyer and a willing seller in arm's length transaction on a given date after proper marketing and where the parties acted knowledgeably, prudently and without compulsion (IVSC, 2013). Alternatively, the assessment could be on the basis of the market rent that would result from an agreement between a willing landlord and a willing tenant if the tax base is to be the annual or rental value rather than the capital or sales value. Pragmatically, in countries in which there is a high level of owner occupation in the residential sector, evidence of the market rents of housing is difficult to obtain and may be unrepresentative, favouring the use of capital or sales values as the tax base. By contrast, evidence of sales prices for non-residential property (such as shops, offices, factories, and workshops) is often difficult to obtain as businesses typically rent the premises they need rather than buy them. This may favour the use of rental or annual values as the tax base or else their capitalisation to produce capital values.

Value-based property taxes can be distinguished from specific taxes which are levied per unit, in the case of property, per square metre or hectare. Usually specific property taxes are adjusted by coefficients to allow for differences in characteristics, for example, between zones, types of construction, or land use. In Kazakhstan, for example, the tax on agricultural land is adjusted by coefficients according to whether the land is steppe or desert, semi-desert or uplands, and within each category according to the quality points awarded. In populated areas the land tax rate varies according to whether the land is occupied by housing or not and the settlement in which the land is located. With specific taxes there is no attempt to reconcile the resulting assessments with the market value. The coefficients may represent factors that

influence value but may also exclude other important characteristics. Whether the coefficients influence of the market price to the extent implied by their use is not empirically verified.

Property taxes based on value are inherently fairer than specific taxes since with value-based taxes what the taxpayer is required to pay reflects his or her wealth or the value of the assets occupied and the benefits that flow from these. With specific taxes, it is likely that properties that have the same value, but are of different size, will be subject to different rates of tax. Properties which are of similar size but of different value are likely to be charged the same amount of tax. The use of value-based taxes improves governance through a more equitable distribution of the tax burden.

Recurrent or annual property taxes are levied yearly by governments, though they may be payable instalments by the taxpayer. They have the advantage of their income being relatively predictable and stable. By contrast sporadic property taxes are ones triggered by a specific event, such as the sale of a property, inheritance, or gift, and result in a one-off payment. The income from these can vary significantly from one year to another. For example, in a buoyant market, there are many sales of property so that the income from sales or transfer taxes is higher than when the market is depressed. Typically, but not in all situations, recurrent pr operty taxes are levied by local governments. They are likely to set the rate of tax, often within limits set by central government, collect the tax, and may have responsibility for assessment, though in other cases valuations are untaken by a central body or else locally-based valuations are subject to oversight by a central body. Sporadic taxes tend to be levied by central government, though there may be revenue sharing arrangements with local governments.

There are important links between recurrent and sporadic taxes in which improvements in the efficiency of one type of tax can have an impact on the other. Value-based taxes can be levied only if there is good evidence of the market prices for comparable properties. A good source of this evidence can be the prices declared for sporadic taxes, such as the prices sellers claim to have received when paying property transfer taxes or what buyers claim to have paid when paying land registration fees. If there is evasion of sporadic taxes due to under-declaration of sales prices, this erodes the tax yield from them and undermines the ability to levy value-based recurrent taxes. However, improved valuation methods for recurrent taxes make it more difficult for taxpayers to get away with a false declaration of price resulting in improved yields from sporadic taxes. Improving the accuracy of valuations for recurrent and sporadic property taxes may be mutually reinforcing, with beneficial impacts on the tax yields from both types of tax and the fairness with which the taxes are levied. Tax evasion and avoidance are unfair to those who actually pay their taxes.

Traditionally value-based property taxes were the result of valuations made of each property

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by a skilled valuer. There are two particular problems with this approach. It is expensive and in many countries there is a shortage of skilled valuers. Internationally accepted best practice is that qualified valuers should have degree-level education. In the ECA region education systems are well developed Communist system did not accept the validity of private ownership of property rights or of property markets. Consequently universities in the transition countries did not offer programmes in market-based valuations. The method of valuation taught was based upon the labour theory of value in which the value of a building was its depreciated replacement cost. Thus, valuation was something that to be carried out by engineers or architects because of their understanding of construction but not by those with a background in economics or finance. Ministries of education in the region have generally been slow to accept courses in market-based valuation into the list of approved degree programmes and subject specialisations.

A potential solution to the problems of cost and skill shortages is to make use of mass valuation systems. Mass valuations are valuations of large numbers of properties at the same time using computer-based statistical models. The computer models seek to replicate what human valuers do but statistically on an industrial rather than bespoke basis. The definition of value is identical for mass valuations and traditional ones. Mass valuation uses statistical decision rules rather than the subjective judgements of individual valuers. The costs of mass valuation are significantly lower than using traditional methods. In Lithuania the cost per valuation using mass valuation is one euro compared with approximately 100 euro for an individual valuation. The scarce skilled human valuation resources can be used where they are most needed, namely in the design of the mass valuation system, updating the models, and handling appeals against assessments.

3. THE ROLE OF RECURRENT PROPERTY TAXES

Countries make varying use of recurrent property taxes. They tend to fall into two main groups as Figures 1 and 2 illustrates. There are a minority of countries which raise significant amounts in recurrent property taxes as a proportion of their gross domestic products. In the majority the yield from recurrent taxes is relatively low. As Figure 1 shows, the average proportion of GDP raised through recurrent property taxes amongst the OECD countries is 1.1% but 20 of the 34 countries produce less than this. In just seven countries do recurrent property taxes yield 2% or more of GDP whilst in 12 countries they generated 0.5% or less of GDP. The transition countries, with the exception of Poland, generated proportions of GDP from recurrent property taxes that were below the OECD average. Figure 2 presents similar data from a range of middle and low income countries. The average proportion of GDP raised from recurrent property taxes by this group is just 0.4%. Only Russia exceeds the average achieved by the OECD countries. An important issue for this study, therefore, is whether the low yield from recurrent property taxes matters and, if so, what are the reasons for it and

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whether and how they can be addressed.

Figure 1 Recurrent Taxes on Immovable Property as a Percentage of theGross Domestic Product in OECD Countries, 2012
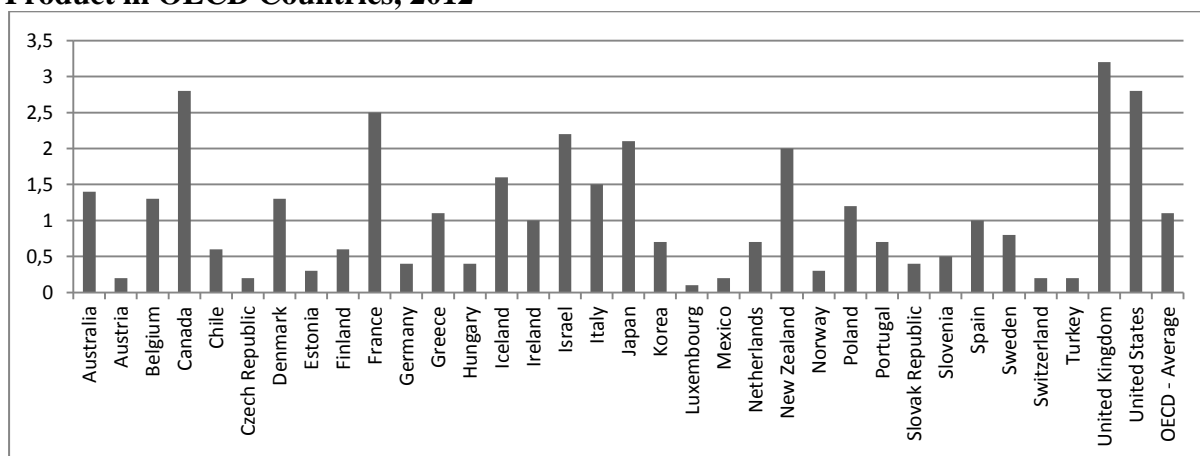
Source: OECD (2015) Dataset Revenue Statistics – Comparative tables, 4100 Recurrent taxes on immovable property, http://stats.oecd.org/viewhtml.aspx?datasetcode=REV&lang=en (accessed on March 5, 2015)

Figure 2 Recurrent Taxes on Immovable Property as a Percentage of the Gross Domestic Product in Middle- and Low-Income Countries, 2010
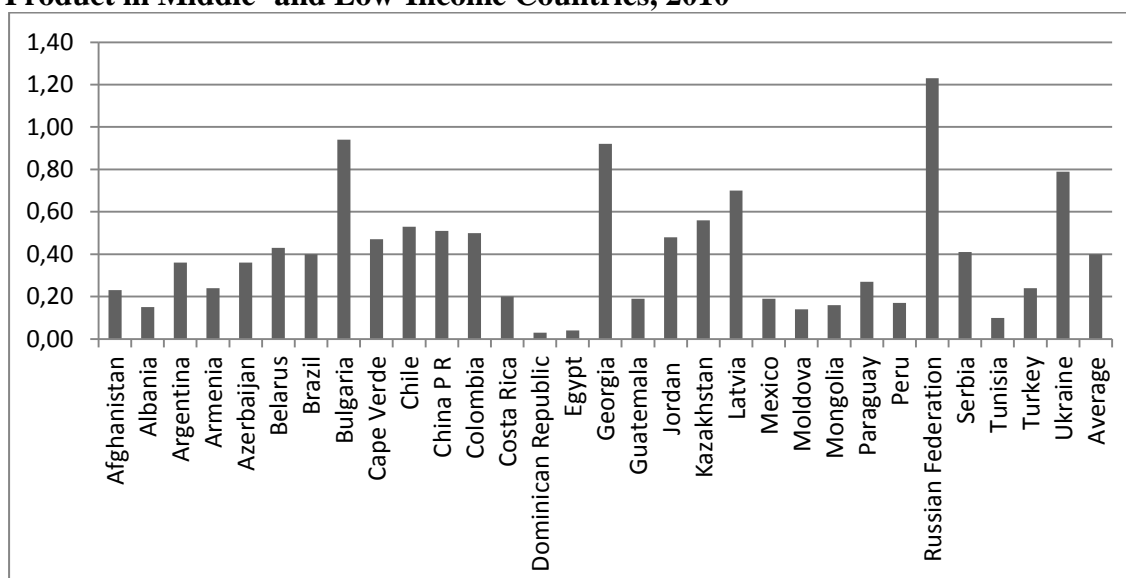
Source: Norregaard (2013), p. 39.

Property taxes are often regarded as being particularly suitable for local taxation as they fall

on immobile assets that cannot be moved to another jurisdiction. Local income, business and sales taxes potentially suffer from leakages of tax revenues to other jurisdictions, particularly in countries where towns are within easy travelling distance of each other. It can be argued that the assets they fall on indicate ability to pay, though there can be liquidity problems for asset-rich cash-poor taxpayers in raising funds to pay the taxes when they fall due. The liquidity issue is of particular concern in the transition countries since many households acquired the housing they occupy through privatisation at nominal prices or through restitution. The value of the properties they occupy may therefore bear little relationship to their current or past incomes. Property taxes can form a major part of the revenue that local governments are capable of generating from their own resources and are potentially a more sustainable resource than fees, charges and asset sales.

Many public services, for example, education and healthcare, have to be delivered locally to their beneficiaries This does not necessarily require there to be effective local taxes since the delivery of such services by local government can be financed through grants from central government or by revenue sharing of national taxes. Examples can also be found whereby central government provides local services through organisations responsible to it that have a local presence. Central government provision of local services can mean that they are less responsive to local needs. An important element of good governance is subsidiarity, namely that service provision and the resolution of issues should be dealt with at the most local level consistent with efficient and cost-effective delivery (FAO, 2007; Voluntary Guidelines, 2012, 19.2). This requires that local governments have the necessary financial resources to do so and recurrent property taxes are an effective means of achieving this. If local governments are not responsible for at least some of the revenue required for the provision of local public services, this can raise issues of accountability. Weaknesses in local taxation therefore raise questions about governance. They reduce the scope for local determination of expenditure priorities and can weaken the link between public expenditure and the burden of taxation.

If the ability to raise local tax revenues from property is not exploited to its full potential, then local governments become reliant on inter-governmental fiscal transfers. This can undermine the stability of a country's finances. The development of value-based property taxes can enhance fiscal sustainability. For example, in Moldova the property tax provided 8% of local government revenues in 2013 whilst central government grants accounted for 44%. In Lithuania taxes on property provide 10% of local tax revenues but 55% of revenue is in the form of grants from central government. In Turkey annual property taxes provide 15% of the revenue for district and town municipalities, 5% for cities and nothing for metropolitan municipalities compared with 40%, 50% and 68% respectively coming in the form of fiscal transfers from central government. In Albania central government transfers finance 80% of local government expenditure, though this is only 7.5% of public expenditure.

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Inter-governmental fiscal transfers mean that the deficits and debts of the various parts of the public sector are linked as central government may have to increase its borrowing to facilitate higher expenditure by local governments. If the government needs to reduce a fiscal deficit or an unsustainable level of public borrowing, one tactic for doing so is to reduce inter-governmental fiscal transfers and to encourage local governments to meet more of their expenditure from their own resources. Several of the countries in our sample are faced with a need to reduce a budgetary deficit or the level of national debt. For example Serbia's fiscal deficit in 2014 was an unsustainable 6.6% of GDP and the gross government debt in 2013 was 63% of GDP (World Bank, 2015). Serbia has decentralised the revenue from key national taxes, including personal income tax from real estate and business and 80% of that from wages, inheritance tax and property transfer tax. The IMF has argued that decentralisation is associated with weaker expenditure discipline at the local level and has advocated measures to boost local governments' "own" revenues through property taxation and service fees (IMF, 2013, p.22). The implication is that failure to exploit the potential for raising revenue through property taxes has implications for the stability of national finances.

A particular issue arises in those countries, like Turkey and Albania, which have experienced rapid urban growth. Turkey has one of the lowest levels of sub-national government expenditure as a proportion of GDP in Europe as education, healthcare, and social protection are funded by central government. However, Turkey is faced with rapid urbanisation, which requires investment in infrastructure in anticipation of urban growth. An effective property tax could provide the means by which borrowings to finance this could be serviced out of taxes that capture the rising value of land resulting from urban growth. The increase in land values is primarily the result of economic and demographic growth rather than investment by the property owners and so can be regarded as unearned income. Taxing the increase in value requires value-based property taxes to be revalued periodically. Metropolitan municipalities in Turkey do not have the power to impose property taxes but rely instead on revenues from enterprises, and the sale and renting of land and buildings (World Bank, 2014). Developing a sustainable local tax base for these would be desirable.

A case can also be made for making greater use of property taxes for reasons of fiscal efficiency. Every country is faced with the problem of multinational companies and high net wealth individuals lawfully exploiting differences in company and income tax rates between countries to minimise their tax bills. Multinational companies can achieve this through transfer pricing, whereby a subsidiary in a high tax country buys goods and services, including management services from a subsidiary in a low cost one, thereby transferring revenue to a low tax regime. Subsidiaries in high tax countries can borrow funds and pay interest to ones located in tax havens. High net wealth individuals can be domiciled for tax

purposes in low tax countries whilst still running businesses in high tax ones. Property taxes enable governments to recoup some of these tax losses by taxing the immovable property assets owned or used by multinational companies and individuals. Taxes on assets enable those income and company taxes to be reduced, which can reduce disincentives on work, investment and enterprise. They can help secure greater equity in taxation between those whose main asset is their ability to generate income through work and those with wealth.

The case can therefore be made for increasing the proportion of tax revenues raised from property taxes, particularly recurrent annual taxes, to improve fiscal efficiency and governance. For reasons of equity, this can only be done through value-based taxes. The case studies make it possible to identify the circumstances which facilitate doing this, the constraints that exist and how these might be overcome.

4. THE CASE STUDIES

The case studies are of a cross section of countries at different stages of maturity in terms of their property valuation and taxation systems.

4.1 Lithuania

Lithuania has the most developed value-based recurrent property taxation system of the countries in our sample. Restitution and privatisation programmes began in 1992 and mortgages first became available in 1994. The banking crisis of 1996 was a major stimulus for change, particularly in valuation standards. By 2000, 1.1 million citizens owned property out of a population of approximately three million. Alongside the development of private ownership of property and a property market, a property valuation profession also developed, with the Lithuanian Association of Property Valuers being formed in 1994, General Property Valuation Principles that provided a framework for specifying the skills required of valuers being approved by the government in 1995, and the certifying of valuers by the Ministry of Finance's Property Valuation Oversight Agency.

Lithuania has separate taxes on land and buildings, first introduced in 1990 and 1995 respectively. The long-standing goal of a unified real estate tax based on market values has not yet been realised (the current plan is to unify the taxes in 2016). The land tax was initially levied on privately-owned agricultural land but not forests. Liability was based on the cadastral value, which reflected the productivity of the soil and production costs. The former Soviet Union, of which Lithuania (and Moldova) had been part, had a system of paying agricultural producers different prices for their product according to the fertility of the land so that the more fertile areas received higher prices than less favourable ones. The notion of an implicit land rent based on the productivity of the land was therefore embodied in the Soviet

central planning system (Nove, 1980). Urban land was brought into the tax base in 1992. As urban land had a low agricultural value and would consequently have received a low cadastral valuation, the cadastral values were adjusted to reflect infrastructure and municipal population. The tax was set at 1.5% of the cadastral value and produced 0.2% of government revenues. Administrative costs per taxpayer exceeded average revenues. In 2013 land began to be valued on its market value with revaluations every five years and a transitional arrangement by which the higher values are to be phased in over a four-year period. Municipalities can determine the rates to be applied based on land use and location.

The tax on buildings and immovable property, introduced in 1995, was initially on property owned by enterprises. It was assessed on the book values of property of enterprises belonging to legal persons and on the Soviet-era inventory values where the enterprises belonged to physical persons. Changes in 2002 resulted in assessments being based on estimated replacement costs with adjustments for location, the aim being to bring average assessed values into line with average sales prices. In 2006 the buildings and immovable property owned by persons became taxable, though with exemptions, particularly for dwellings. The basis became the market value derived from mass valuation. Owners could seek an individual valuation where they contended that the value of their property differed by more than 20% from the market value. The rate set for properties belonging to physical persons is 1% but municipalities can set a rate on properties owned by legal persons of between 0.3% and 1%.

Valuation for property taxation is undertaken by the Centre of Registers, a State Owned Enterprise vested under the Ministry of Justice. Property tax-related work is funded by the Ministry of Finance. The Real Property Valuation Department employs 40 certified valuers. Two valuers, a programmer and two GIS specialists are based in Vilnius and are responsible for work planning, methodological guidance, coordination, and control. The remainder are in branch offices and are responsible for the valuation of land and buildings in a county. The Department also carries out commercial valuations. The decentralised structure of the Department means that valuation is in the hands of those who have detailed knowledge of a local property market. In 2001 costs were estimated at 14% of yields for the land tax and 1.5% for immovable property. In 2015 the cost per valuation using mass valuation was estimated at 1 euro per property compared with €100 for an individual valuation. The State Tax Inspectorate maintains the register of taxpayers. Taxpayers submit annual returns, including for land and immovable property. Revenue is collected by the 10 County Tax Inspectorates, with the receipts being transferred to municipalities.

The Ministry of Finance began to provide funding to the Centre of Registers to develop its valuation system in 2002. It started with a pilot mass valuation of apartments to demonstrate feasibility and then, at the request of the Ministry of Agriculture in 2003, was extended to land [models]. The system was considered operational in 2005. The General Property

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Valuation Principles provide a detailed but flexible framework so that appropriate methodologies can be applied to different types of property and locations. Where there are sufficient sales, the preferred methodology is to use multivariate statistical models. A key part of the system is to collect data on market transactions and the properties involved in a standardised format, which reduces the potential for errors and random factors influencing valuations. Price data began to be collected in 1998 and the Centre of Registers records property prices, building costs, rents, and yields on real estate investments. Data on transactions come from notaries when the owner's rights are registered. Declared prices are believed to be substantially accurate. Notary and registration fees are only about 1% of value so there is little incentive to under-declare and there is widespread use of mortgages encouraging accurate declarations of collateral. The existence of a capital gains tax means that it is not in the buyer's interest to under-declare prices as this could expose them to the risk of having to pay capital gains tax in the future. Transaction prices are cleaned before they are used in analysis, for example, excluding transfers between related parties. Recently new cost manuals have been developed for use in the depreciated replacement cost method to remove reliance on book values and Soviet–era manuals. Special efforts are required to collect rents and operating expenses for use in the income capitalisation method.

Initially the only attribute data on properties was that contained in technical inventories of buildings and in records of agricultural holdings. This included information on size, layout and construction but not locational or qualitative features, such as condition and the quality of construction and finishes. The problem is that location and qualitative factors have been shown in studies in other countries to play a significant role in determining market prices. Moreover, the existing data was not well maintained or had been computerised when the process started. Location information has now identified 1,200 market areas or value zones and properties are geo-referenced by location and by floor. The Centre of Registers draws on the real estate register and cadastre and its market database, which records information about the property, the transaction, and when it took place. Values are updated annually and value zone boundaries reviewed and adjusted, even though values for tax purposes are valid for five years. This is so that the base information can be used for other valuation purposes. The sharing of information, so that it can be used for different forms of valuation, is efficient though it should be recognised that valuation for other purposes is based on different assumptions from those used in taxation. The most recent revaluation for tax purposes was 2011, though valuations for other purposes can be updated daily. The main method used is the sales comparison approach and this is used for residential property. The depreciated replacement cost method is used for industrial buildings, warehouses, and infrastructure. The income capitalisation approach can be used for healthcare buildings, office, and hotels and similar service properties. Location adjustments are applied to the values derived from these.

Land has been valued since 2003 using mass valuation models based on the sales comparison approach rather than soil productivity. The valuations for tax purposes are valid for five years, the most recent revaluation being in 2013. The main factors used in the models are location, size, land use, and land productivity with multiple regression and correlation being used to identify the significant factors. The valuations disregard certain factors including mineral resources, restrictions on economic activity, structures, prospective changes in land use, restrictions due to debt, and contamination so that they are based on a common set of assumptions. Coefficients used to adjust values include ones for recreational use, conservation, forest, productivity, small land parcel size, swamps, and communications, and power line corridors.

Lithuania has been able to build an impressive mass valuation system. It did so only after it had taken significant steps to create a valuation infrastructure. This meant that it had the necessary capacity, including human capital, to create and maintain the system. Centralised control of the system maintains quality whilst the input of local offices into assessments means that they are produced by those with knowledge of local markets. Although the recurrent property tax generates revenue for municipalities, its assessment and collection is in the hands of central government bodies. There are a large number of models which should mean that they accurately reflect sub-markets, whether by property type or area. There are concerns that the property tax might be avoided by not registering ownership or interest in a property. The two recurrent property taxes on land and immovable property have not been unified (planned for 2016) and have different design principles and valuation methodology. Qualitative data is not used in the mass valuation models and how location is included might not be defensible. However, Lithuania demonstrates that a value-based recurrent tax system based on mass valuation can successfully be created in the ECA region's transition economies.

4.2 Moldova

Moldova introduced taxes on immovable property only once the privatisation of property had been introduced. Most apartments were privatised between 1993 and 1995 and industrial and commercial buildings between 1994 and 1998. Trade in land began after the passing of a law on land purchase and sale in 1997. Initially the property tax system for land was based upon the surface area of the parcel adjusted for its fertility. Residential buildings were taxed on their inventory value and buildings used by businesses on their book value. Essentially, buildings were valued at their depreciated replacement cost using depreciation norms according to how the buildings were constructed. The resulting valuation did not take into account the location of the property. In order to avoid the problem of a residential property built in the same way and of the same size being given the same valuation in Chisinau (the capital) as in a remote rural settlement, coefficients were applied to the valuation according to

the type of settlement. These did not fully reflect market differences or how location affects values within urban areas. The depreciation norms did not reflect how suitable the building was in meeting current production requirements and consumer expectations as distinct from the process of wearing out. As a result, the method used is unlikely to have produced the same valuation as if the depreciated replacement cost method was carried out in accordance with internationally-recognised valuation standards. The Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests calls for States to apply national valuation standards consistent with relevant international ones (18.4). By the mid-1990s, it was clear that these methods of valuing property for tax purposes were failing to reflect market values and, therefore, that assessment methods needed to be improved.

In 2000 a tax code was approved by Parliament which described a new value-based tax assessment method. Mass property valuation was introduced in 2004 and the implementation of the new value-based assessment method started in 2007. The plan was for a new type of property to be added to the system each year rather than to produce mass valuation models for all types of property at once. The mass valuation models were developed by the Cadastre State Enterprise Head office by licensed valuers with the same model being used throughout Moldova for each property type. Information about individual properties, the gathering of market data, value calculations, and notifications of assessments is undertaken by valuers in the territorial cadastre offices. Ten valuers are employed in the head office and 50 in the territorial cadastral offices. Valuation takes place on June 1 of the year in which a particular type of property is to be valued and then forms the basis for tax liability in the next year. Although assessment is undertaken through a central agency, property tax collection is the responsibility of local governments. The system relies on the cadastre for information about properties and taxpayers and this is continuously updated to reflect changes applied for by the property owner or changes of use or property characteristics that local governments are obliged to report.

The Tax Code does not precisely define the appraised value used in taxation but implies that it is the market value of a property in its current use. The valuation model used follows internationally-recognised valuation standards for arriving at market values in its assumptions, namely that property is available for sale, rental terms are standard ones, and the assessment is based on the price that a typical buyer would pay rather than that which might be offered by a special purchaser, such as the current owner or occupier. Measurement standards define how the area of a property is to be computed. Usually the direct sales comparison method of valuation is used in assessment but the income capitalisation or depreciated replacement cost methods can be followed for more complex commercial or industrial properties. The mass valuation models made use of prices in registered sales contracts, auction prices, asking prices, and price data from valuers and agents. The use of a variety of sources of price data to

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derive the dependent variable was necessary as registered contract prices were often understated. The mass valuation models were developed using a variety of methods to check and verify them. The tolerance should be within ± 25% for urban property but can be as high as ± 35-40% in rural areas because of the undeveloped nature of property markets.

The new valuation system has not been completed, with only certain types of property being covered by the new mass valuation system. They include apartments and single family residences in urban areas and industrial and commercial buildings, but not agricultural land, residential property in rural areas, property in public ownership, and infrastructure and networks. The result is that only 12.5% of properties are covered by the new mass valuation system with the rest continuing to be assessed under the old method. The confinement of mass valuation primarily to urban areas is significant as Moldova is a predominantly rural country with only 47% of the population living in urban areas. The reasons for the stalling of assessment on a value-based basis can be ascribed to three factors. Mass valuation is funded out of the national budget so that there is discontinuity between the apparent beneficiaries of the new system (local governments) and the body meeting the costs. Central government does not appear to appreciate the benefits to the national budget of improving revenues from recurrent property taxes. A particular obstacle is the lack of funds to register rural housing, public properties, and infrastructure and networks in the cadastre. The second factor is the impact that the new tax regime is likely to have on agricultural land, which accounts for 70% of the property in Moldova. It is currently assessed by area rather than market value. The market value of much of this land is very low and revaluation may well result in a significant reductions in assessment and cause a loss of revenue. Such a loss could only be made good by a significant increase in the rate at which the tax is levied. The third problem is that the methodological problems of registering and valuing infrastructure and networks have not been resolved. These have a value as complete networks but there are technical problems as to how to value the parts that lie within a specific local government area. It is difficult to, say, value a railway station and 10 kilometres of track and signalling when this only has a value through being part of a network. These are universal problems and not specific to Moldova. Some countries resolve them but putting a value on the network as a whole and then apportioning it between the various local governments through whose jurisdiction it passes. A further problem that has developed is that there have been no revaluations, although the Tax Code requires this to be done every three years. The result is that there are significant differences emerging between tax and market values, particularly for residential properties in urban areas where the assessments were made in 2004 and 2005. The failure to carry out regular revaluations undermined horizontal and vertical equity for taxpayers.

In spite of the problems encountered, there have been significant benefits from mass valuation. Revenues for local governments have increased, though the impact of this has been

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limited by exemptions that certain bodies and individuals enjoy and the discounts given for early payment of the tax. The tax base has been improved with up to 30% of properties in some regions being added to the cadastre and becoming taxed as a result of mass cadastral surveys. Equity has been improved with owners of more valuable properties having to pay increased property taxes. Taxpayer confidence in the system has increased. Still, the current lack of attention to the mass valuation system and the failure to carry out periodic revaluations means that a well-designed system is in danger of being undermined.

4.3 Serbia

Having started the development of value-based property taxes and mass valuations in 2007, Serbia is at an earlier stage in their development than Lithuania and Moldova. The result is that the private sector is smaller than in the transition countries that have joined the EU. It has also followed a different route in the development of its real estate market. Privatisation and restitution have played an important part in this, though the restitution process is still partially on-going. However, although buildings were privatised, the land under them was not sold at the same time. Whilst the process of converting land under residential buildings into private ownership has not been problematic, the conversion of land under industrial and commercial buildings has been difficult so that privately-owned commercial buildings stand on state land and, until 2014, an annual urban land use fee was paid to local governments for the use of the land.

The annual property tax is levied by local governments, who are also responsible for its assessment. As was noted above, much of the revenue for local governments comes in the form of shares of national taxes. Transfers of personal income tax in 2010 provided 26% of local government revenue in Belgrade and 33% elsewhere, whilst the annual property tax and urban land use fee raised 18% and 13% respectively. In addition, central government directly pays some significant costs of locally delivered public services, such as the salaries of teachers and primary healthcare workers. There is evidence of weaknesses in the efficiency with which recurrent property taxes are levied. It has been estimated 14% of apartments, 22% of family houses, and 15% of commercial premises are unregistered, and 37% of municipalities believe the level of unregistered properties to be between 20% and 40%. Collection rates are also relatively low at 85% for legal entities and 75% for physical persons (Arsić et. al, 2012).

A further problem has been the use by local governments of "shadow" property taxes to make good deficiencies in revenues. The urban land use fee was until the end of 2013 charged on land that had not been converted into private ownership. As households could do this easily and at nominal cost, this was, in effect, a tax on business premises and probably raised a similar amount of revenue to the annual property tax. A development fee is charged for

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infrastructure when development takes place. It is believed that the fee does not reflect the actual costs of infrastructure but has been used as a device for value capture when development consent is granted. Until 2012 local governments charged a range of communal fees, including on business signs, gambling and local business taxes. These shadow taxes could have a distorting effect on investment and economic activity.

The various shadow taxes appear to be a response not just to fiscal weaknesses but also to the way in which the annual property tax was assessed on business premises owned by corporate bodies. The tax base was the book value. These were the historic costs of creating or acquiring assets, which had been reduced through depreciation. In most cases, they probably have little relationship to current market values. In 2014 the basis of the tax was changed to fair value (as defined by international accounting standards) rather than the book value, though it is not clear whether capacity exists to produce fair value balance sheets for businesses. The change in valuation method was compensated by the ending of the urban land use fee in 2014. The problem is that one source of revenue was abolished without any guarantee that the annual property tax assessments on business premises would be increased.

Responsibility for the annual property tax passed in 2007-08 from central government to local governments. This was done without support from central government and without the staff responsible for its collection being transferred. Local governments were faced with having to find assessors and collectors at a time when the Ministry of Finance placed a maximum limit on the amount that could be spent on salaries. They were obliged to transfer employees from other activities or to find ways of hiring in new staff. Some recruited former central government employees and were able to retain their knowledge and experience. Serbia has 22 cities and 168 municipalities for a population of 7.1 million and all are unitary authorities responsible for the entire range of local services. There are questions as to whether all the local governments have the capacity to undertake value-based property tax assessments. The assessment methods used by local governments are not transparent, although the implication of the legislation is that market values should be used. There is a valuation rule book but some local governments use their own data and there have been reports that they have difficulties in accessing the data they are supposed to use. Unlike Lithuania, there are no officially adopted valuation standards or principles though in 2014 the Ministry of Finance formed a commission for the development of a legal framework for the valuation profession. The only licensed valuers are court experts licensed by the Ministry of Justice for mortgage valuations, who have construction rather than valuation qualifications and are not required to follow any internationally-recognised valuation standards.

The Republic Geodetic Authority (RGA) became responsible for mass valuation in 2011. It started capacity building for mass valuation with aid from the Swedish International Development Agency in 2007. A key element of this has been the creation of a Sales Price

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Register. The IT system for this was completed in 2012. Mass valuation requires transaction prices from a sample of properties whose characteristics are known. RGA received information on 685,000 transactions for the period 2007-2011 from the Tax Authority's property transfer tax database. However, there were problems with identifying the properties in the transactions, particularly parts of buildings, like apartments and business premises, as roughly half the records were missing information on the municipality and address, and 40% of parcels had no parcel number. In any case, the cadastre records parcels and not buildings or occupancy units within buildings. There is a major task to be undertaken to compile a comprehensive buildings register which records each address and unit of occupancy. Some local authorities have undertaken this but the records are incomplete for most areas. There was a problem in obtaining good quality data about the properties. The only available data on real estate for market analysis, apart from the price, purchase date and surface area, was that from the Real Estate Cadastre. Matching the property with the REC data provided additional information: for land – the type of land; for agriculture land – cadastre cultivation and class; and for apartments – the number of floors in building, usage, structure and floor. A great deal of work was needed to link the property transfer tax and cadastre data but with limited results. It was concluded that there was insufficient data or quality of information in the records to carry out mass valuation so a different approach was adopted, namely reliance on the Sales Price Register.

The Register became fully operational at the beginning of 2014. RGA maintains records on prices and rents derived from verified contracts obtained initially from courts and, latterly, from notaries. The rule book on mass valuation defines the system: procedures and organization for data collection, data analysis, model design, determining value, and real estate classification, and the publication of data from the Sales Price Register. RGA has received around 71,000 contracts for transactions in 2012-2013 and 111,000 in 2014. Of these 75% are sales and the rest are mainly gifts, but also exchanges, leases and other transfers. At the end of 2014 additional data about properties were being completed by the parties to the transaction when they came to the local cadastre offices to register transfer of title. The Basic Sales Price Register data is available via the internet. The data from the Sales Price Register should improve the quality of market data available as well as providing the basis for mass valuation. The yield from the annual property tax could be increased by ensuring that all properties on which there is a liability to pay the tax are actually assessed and the revenue due collected and by assessing properties on their actual market value. This could contribute to resolving the fiscal crisis Serbia faces.

4.4 Turkey

Turkey, unlike the former Socialist countries in the ECA region, is not a transition country. Its presence enables exploration of the extent to which the issues in improving recurrent property

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taxation are a legacy of transition as distinct from those that are likely to be faced by any emerging economy. The first Turkish Civil Code adopted in 1926 confirmed that everyone has the right to own and inherit property. Property ownership rights had been valid since the latter part of the Ottoman Empire.

The valuation profession in Turkey, though, is of relatively recent origin. When the law on Real Estate Investment Companies was adopted in 1992, it was not envisaged that there would be private valuers working in Turkey. Rather, these companies were to have their assets periodically revalued by two state-owned companies (Çelen, 2009, p. 190). During the 1990s private professional valuation companies were established and professional bodies for valuers were formed. They gained recognition from The European Group of Valuers' Associations, but have subsequently withered away. The Capital Markets Board was established in 1981 and in 2001 set out minimum qualifications for valuers. Since 2003 real estate valuers have been amongst the market professionals who require a license in order to be employed at intermediaries or other capital market institutions, such as mortgage finance institutions, housing and asset finance funds, and asset management companies. Valuers require a license to carry out residential and commercial mortgages and other forms of residential and commercial valuation. Licensed valuers are to be members of the Association of Appraisal Experts of Turkey (Türkiye Değerleme Uzmanlari Birliğ1 or TDUB), which is responsible for standards, education, licensing, and disciplinary matters. The standards adopted follow those of the International Valuation Standards Council. The 2012 Capital Markets Law requires licensed valuers to send to TDUB information about the valuations they make in connection with housing finance.

The annual property tax was first introduced in 1931 with land and buildings taxes regulated separately. Since 1972, when the current property tax law came into force, buildings and land taxes have been regulated together. Before 2002 taxpayers completed a property tax report every four years in which they declared the value of their property. It is believed that the values declared were often underestimates. In 2002 this declarative approach was replaced by an information system one. Taxpayers provide information about their immovable properties, including any change that may have resulted in a 25% increase or decrease in value, such as additions, changes of use, and changes in building services. The tax is imposed, assessed and collected by local governments, except metropolitan municipalities. Valuations of rural and urban lands are undertaken every four years by local commissions. In urban areas the valuations of land should take into account transportation, distance to commercial areas, municipal services, zoning, topography, and position. In rural lands the valuations are determined by the land type and are largely a function of size. Building valuations are undertaken by municipalities and are derived using the cost approach, assuming that the construction follows a standard method. The valuation of each property is the sum of the

building and land valuations. Valuations are increased between revaluations to reflect inflation. The local valuation commissions do not include professional valuers, though they can request expert advice. Valuations can be outsourced to the private sector. In principle, accurate market land valuations together with the valuation of buildings on a depreciated replacement cost basis could produce reasonably accurate value-based tax assessments. However, this does not seem to be the case, with tax assessments being below market prices. The problem appears to be that valuations in urban areas do not adequately reflect the factors that influence value because the commissions apply a single rate per square metre to whole streets or groups of streets. The method for carrying out the depreciated replacement cost valuation does not produce market values as to do so requires that building costs reflect current construction costs and that the rates used for depreciation and obsolescence reflect occupiers' assessments of the suitability of the premises.

Local governments do not control the rates at which the property tax is imposed. These vary according to whether the property is in a metropolitan or non-metropolitan municipality. For urban lands the rates are 0.3% and 0.6% respectively; for rural lands 0.1% and 0.2%; for residential property 0.1% and 0.2%; and for other buildings 0.2% and 0.4%. There are a number of exemptions, including for public buildings and certain types of buildings, such as religious facilities, if they are not rented out. There are also temporary exemptions, such as 25% of the value of new residential buildings, certain buildings for tourism, and industrial facilities in backward areas, which all apply for the first five years, and buildings constructed after natural disasters, which are exempt for ten years. Afforested areas are exempt for 50 years and reclaimed areas for 10 years. There are reductions for certain groups such as those on low incomes, the disabled, and veterans. In addition to the property tax there is a participation charge that beneficiaries of the construction or renovation of roads, water or sewage systems must pay. This is a sporadic charge of up to 2% of the tax value.

Tapu ve Kadastro Genel Müdürlüğü (TKGM), the Turkish cadastre and land registry, has undertaken pilot studies to establish the feasibility of value-based recurrent property taxes using mass valuation (Yildiz, Güneş and Almy, 2014; Güneş and Yildiz, 2015; Yildiz and Güneş, 2015). The pilots were undertaken in 2014 in two areas, Fatih Municipality in Istanbul and Mamak Municipality in Ankara. The main variables examined were parcel details, such as type, location, street width, and parking, zoning details, distances from features such as metros, hospitals, and universities, building details, such as number of floors, age, and construction, and details of the specific property, such as the number of rooms, surface areas, the floor, heating system, and whether it has a balcony. In all, 80 characteristics of each property were collected. Since many of these do not form part of the cadastral record, it was necessary to collect data through fieldwork and research in municipal archives into building plans.

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Both pilot areas had active property markets but the problem was to obtain reliable price data. The buyer and seller of a property must declare the price when the transfer is registered but many of the declared prices are understated. Land registry fees are 4% of the declared price and there is no risk to the buyer of capital gains tax from an under-declaration. In the pilot studies, it was also necessary to make use of asking prices, valuations from TDUB members for mortgages, and interviews with buyers and sellers. These sources also presented problems, such as the different measurement standards that mortgage banks require valuers to use. The data enabled a variety of statistical approaches to mass valuation to be tested. Problems were encountered in developing models for non-residential properties due to the relatively small number of sales in the pilot areas. TKGM have therefore decided to undertake in 2015 a third pilot study specifically of commercial properties in three districts in central Ankara. The pilot studies in Fatih and Mamak found that the assessed values for the recurrent property tax should be increased by three times to reflect market values so that the effective tax rate was 0.065% rather than the nominal 0.2%, and assessments for the property tax would need to be increased by 2.5 times so that the effective tax rate was only 1.5% compared with a nominal rate of 4%. Mass valuation offers the potential for replacing the valuations produced by local commissions with ones that more closely reflect market values. As well as providing a fairer and more buoyant way of raising local revenue, the valuations could allow property transfer fees to be lowered, which could produce a higher yield through reducing incentives and opportunities for evasion.

4.5 Kazakhstan

In 1991 Kazakhstan was the last of the Soviet Republics to declare its independence. It has a strongly performing economy due to its rich oil and gas resources. Property taxes take the form of a tax on agricultural land, an urban land tax, and property taxes on individuals and legal entities. The revenue from property taxes amounts to just 0.56% of GDP.

The land tax takes the form of a fixed payment based on the area of the parcel. Taxpayers are those with ownership rights and those with rights of permanent use or unpaid temporary use. Land is classified into various categories, including agricultural land, forestry, land for industry and non-agricultural purposes, and land in populated areas. Exemptions from the land tax include forestry land, protected areas, land in the possession of religious associations and state-owned institutions, and housing land belonging to Second World War veterans or occupied by pensioners living alone. For agricultural land the amount paid per hectare depends on whether the land is classified as steppe or desert or upland land. In each category the tax varies according to the quality points allocated. Land in populated areas is divided into land occupied by residential property and that not so occupied. The land tax per square metre in populated areas varies between settlements, with the highest rate being in Almaty and much lower rates in smaller settlements than in the cities. Local authorities can raise or lower the

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basic rates of land tax by up to 50%.

The property tax on legal entities and individual entrepreneurs is based on the annual book value of the assets, with legal entities paying a rate of 1.5% and individual entrepreneurs 0.5% per annum. The exemptions of bodies and individuals from the property tax are similar to those for the land tax. Housing is taxed using a base rate per square metre. This rate varies between settlements with Almaty and Astana having the highest rates and settlements and villages having lower rates than the cities. The rate for Almaty and Astana is 11 times that of the villages. The basic rate is modified by coefficients for physical and functional depreciation and for zoning. Physical depreciation rates vary according to the type of construction and functional depreciation according to the storey, where within a building the housing is located, the wall material, the type of heating, and the comfort level. The tax rate varies on a progressive scale according to the value of the building.

The land and property taxes are assessed on area modified by coefficients that reflect characteristics of the unit. The system of coefficients is complex and would be difficult to apply in a country that did not have a heritage of technical inventorisation of its buildings. Although it can be argued that the characteristics used to modify the base tax rates are all ones that ought to have an influence on the market value, there is no direct market price input into the assessment process. It is likely that there are other characteristics that influence prices and the ones that are included may not influence prices by the amount implied by the coefficients. It may therefore be concluded that Kazakhstan's land and property taxes are specific rather than *ad valorem* taxes even though the unit rates are modified by coefficients.

The system of property registration does not lend itself very well towards the development of value-based property taxes. Kazakhstan has a dual agency approach to land registration with a cadastre maintained by the Land Resources Management Agency and a registration system operated by the Ministry of Justice. Whilst it is mandatory to register all leases and conveyances from the state to private persons or legal entities, subsequent registration of transfers is not mandatory. Consequently a number of property transactions are not registered in the Immovable Property Registration System. The system functions as a deeds register recording claims to property rather than as a land registry which definitively records ownership. Kazakhstan has an active property market. There are no property transfer taxes and the fees for registering property rights are relatively low. Therefore there is little incentive to declare false sales prices. The issue is whether, without compulsory registration, the prices recorded by the Ministry of Justice are representative.

The Chamber of Professional Appraisers was founded in 2001and has 57 member companies and over one hundred individual appraisers. It has played a significant role in developing national valuation standards based on those of the International Valuation Standards Council.

It is a member of The European Group of Valuers' Associations. In 2003 the Institute of Professional Appraisers was established under the Chamber to provide initial training programmes for valuers and continuing professional development.

There has been a pilot study to examine the feasibility of mass valuation in Kazakhstan. This involved apartments in Astana using sales prices recorded by the Ministry of Justice. A substantial data set of 46,680 transactions exists, though significant amounts of data cleaning was needed to remove those with inconsistent data, resulting in approximately 40,000 transactions being available for analysis. The independent variables for which data was available for each transaction included the size, whether there was a balcony, the number of bedrooms, the age of the property, the number of floors, and the district in which each apartment was located. The resulting model explained 67% of the variability in the price. This would suggest that there were missing variables that have an influence on the price. The data on location was crude and this might be a factor. There are also issues of multi-collinearity with this type of approach because some of the independent variables are themselves correlated.

Kazakhstan currently has a system of land and property taxes which are essentially based upon the size of the parcel or property modified by coefficients to reflect characteristics or qualities of the units. The assessments are not reconciled with market prices. Kazakhstan has developed a valuation profession and valuation standards. There is data on transactions prices from the land registry, though registration is not compulsory. There is little incentive to under-declare prices as there are no property transfer taxes and relatively low registration fees. Experiments on mass valuation suggest that additional data is needed about each property in order to produce a more robust statistical model.

4.6 Albania

Albania, like Turkey, has experienced rapid growth in its urban areas. Since the ending of Communist rule, this has resulted in both over concentration of development in existing urban areas and dispersion as corridors and suburban areas have been developed. This has taken place in a context of weak strategic planning of development and an inability to control intensification of use. Urbanisation on this scale has outstripped the provision of infrastructure. The resulting increase in value of urban land has primarily benefitted its owners but Albania has lacked the means of capturing part of this to finance the costs of the infrastructure urbanisation requires.

Albania has two recurrent property taxes, an agricultural land tax and a buildings tax on residential, business and institutional buildings. The buildings tax is based on the surface area adjusted for the age of the building (whether constructed before or after 1993) and the current

use. The agricultural land tax is based on the area of the land with rates varying between agricultural zones. The revenue from these taxes goes to local governments, who are responsible for their collection. The rates of tax are set by law. The yield is only 0.13% of GDP so that local governments are dependent on funding from central government rather than being able to raise significant funds from their own sources. The property tax produces between 10 and 21% of local government revenue and an infrastructure tax levied on new construction a similar proportion. Local governments' revenue is only 1.9% of GDP. Albania has a relatively high level of national debt at 71% of GDP, even though tax rates and public expenditure are low. There are strong fiscal reasons for needing to improve property taxation to alleviate the burden on national finances and to tap into the increase in property values that have resulted from urbanisation. In a country where the citizens have not been used to paying property taxes, there is also the need to educate the population that there is a link between the taxes paid and the quality of public services.

The IMF has estimated that the property tax is only yielding a quarter of its potential. One of the main reasons is because of the problems is achieving comprehensive property registration. Although first registration has been substantially completed with an estimated 60-70% of properties being registered, in rural areas registration is 83% but only 25% in urban areas. Albania has had a significant level of illegal building and registration cannot take place until all legal permissions and ownership claims are resolved. There are issues with the recording of subsequent transactions. Consequently many urban properties escape taxation. For agricultural properties there is the problem of small and fragmented holdings making taxation challenging.

Even when registered, the characteristics declared by owners can be less than the true ones so that the properties are under-assessed. The surface area declared for buildings may be just the footprint, omitting the area in upper floors and basements. Tax collection rates are poor with less than 50% of the tax being collected in the largest local governments. Some municipalities have responded to the problems with property registration by creating their own databases, supplementing the registry data and that from self-declarations with field surveys and inspections. There has also been use of the system of water bills to collect property taxes. These measures have resulted in significant increases in tax yields.

Although there are problems with realising the potential from property taxes and there is no mechanism for valuing land and buildings at their market value for tax purposes, there has been some progress in valuing properties for the restitution programme. This is undertaken by the Agency for Compensation and Restitution of Property. This makes use of contract prices recorded by Immovable Properties Registration Office and the methodology is intended to reflect international valuation standards. The prices used reflect age and condition of the buildings, distance from the city centre, the quality of land (for agriculture), and the quality of

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wood (for forestry). Data is pooled for cadastral zones and type of real estate. The top and bottom 10% of observations are excluded and an average value calculated, with the stipulation that there must be at least three contracts within an asset group. Where there are fewer than three contracts, then aggregation takes place at for bigger areas, communes or districts. Value maps can then be produced.

The most pressing problem for Albania is to improve the administration of property taxes so that there is a comprehensive record of the properties that should be taxed and all the tax billed is actually collected. Accurate data about each property is also required. Equity in property taxation requires that taxes are levied on the value of properties rather than their size since properties of similar area can very significantly in terms of their value. This means that the effective rate of tax as a percentage of the value of the property can vary significantly between taxpayers if taxes are imposed on the basis of size alone. Albania has made important strides towards developing value-based taxes through the work of the restitution programme, which has started to develop the type of methodology for fair compensation that would be suitable for property taxation.

5. CONCLUSIONS

Recurrent property taxes can help produce a more balanced tax system by reducing the burden on incomes and profits, and the consequential disincentives for work, enterprise, and investment. The use of inter-government fiscal transfers means that failure to adopt value-based recurrent property taxes can adversely affect national public finances. A one-off benefit can be achieved through the creation of comprehensive tax rolls that record all taxable properties. This should ensure that all properties that should be taxed are actually taxed, a measure that improves the equity of property taxes. The evidence from some of the countries in our sample is that 30% of properties may be missing from property tax rolls in some countries. A further one-off benefit can be secured by improving the tax administration so that billed taxes are actually collected. Rates of collection of 95% or more on taxes on immovable property are achievable but the evidence from some of the countries in our sample is that collection rates might be as low as 85% for businesses and 75% for households. Increasing collection rates improves the equity of the taxes. However, buoyancy in tax revenues can only be achieved through assessments based on market values with regular revaluations to tap into rising values resulting from economic or demographic growth. Continuing equity between taxpayers also requires regular revaluation as the values of individual properties can fall as well as rise and the various types of properties may increase in value at different rates.

The evidence from the case studies suggests that value-based property taxes can be challenging to establish. There is a need for accurate records of the prices achieved in transactions on which to base market valuations. The under-declaration of sales prices in

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order to minimise property transfer taxes and registration fees has to be tackled. Low transfer fees and taxes provide less incentive for evasion and can produce higher yields than if rates were set at a higher level. Capital gains taxes increase risk to the buyer when he subsequently comes to sell of big tax bill from under-reporting the purchase price when the property was acquired. The unification of mortgage and transfer registrations serves to bring together valuations of the collateral offered for the debt with the purchase price so it is clear if there is a mismatch between the two. Secrecy provides an environment in which evasion can flourish so publication of transaction prices and assessments so that valuers, neighbours and competitors can check and challenge them and their own assessments is a useful tool.

Lack of valuation capacity is a serious constraint to the use of value-based property taxes. Mass valuation systems can significantly reduce the cost of assessing each property but do not eliminate the need for skilled valuers. This requires government action to promote the development of valuer education and the adoption of valuation standards. Governments do not need to invent valuation standard but can adopt internationally-recognised ones. They do need to define the qualifications needed for valuers, though there are also internally-recognised standards that they can draw upon. They do need to encourage the establishment of training and education programmes to produce a sufficient number of valuers by recognising the qualifications from such programmes.

The evidence from countries with well-developed systems of property taxation is that approximately half of the tax revenues can be raised from non-residential properties even though there are far fewer of these than residential properties. The Pareto Principle applies to property taxation with the most valuable properties contributing a disproportionate proportion of tax revenues. By contrast, taxing small farmers or the housing of the urban poor may yield little additional revenue and can, in some cases, even cost more to collect than can be raised in revenue. This implies that mass valuation systems should not just be developed for residential property, even though the models may be easier to develop and market evidence more readily available than for commercial properties. As Lithuania has shown, it is possible for countries in the region to develop mass valuation systems for non-residential properties though this requires models for each type of property and the use of income capitalisation, receipts and expenditure, and depreciated replacement cost valuation models as well as sales comparison ones. These models require the collection of rental and yield evidence as well as that on sales prices.

There is evidence that value-based property taxes are easier to establish when a suitable valuation infrastructure and capacity is already in place. The creation of such an infrastructure is highly desirable in any case in order to improve the efficiency with which property markets function and to increase vestment potential. Improved valuation systems can enable better management of state and public sector assets and fairer systems of compulsory purchase

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compensation. The efficient of valuation systems reflect the comprehensiveness and quality of land records. Accurate transaction prices, freely available to interested persons and organisations, serve to increase the efficiency of property and investment markets and can be regarded as a public good that benefits all. The benefits of creating systems for accurately recording and disseminating property prices are far-reaching, going beyond improvements in the tax system. Property markets that are not transparent and do not have good data about prices are more risky, so that investment is discouraged, banks cannot rely on the collateral they are offered for loans, and the potential for releasing capital from property diminished. Value-based property taxes play an important part in creating a virtuous circle in which investors have access to reliable property market data, banks are willing to release capital tied up in property, and taxpayers recognise the legitimacy of the taxes they are required to pay.

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BIOGRAPHICAL NOTES

Richard Grover is currently a part-time senior lecturer in real estate management in the Department of Real Estate and Construction at Oxford Brookes University. Before retirement, he was assistant dean of the School of the Built Environment. He is an economist and chartered surveyor and has worked on land rights, privatisation and land registration projects for bodies such as the UK Know How Fund, World Bank and Food and Agriculture Organization. He represented the Royal Institution of Chartered Surveyors on Commission 7, Land Management and Cadastre, of the International Federation of Surveyors (FIG) for a number of years.

Dr Mika-Petteri Törhönen is Senior Land Policy Specialist at the World Bank based in Washington DC with responsibility for land administration projects in the Europe and Central Asia Region. He is the project leader for the project *Property Valuation and Taxation for Improving Local Governance in ECA* (P152456) on which the material for this paper has been derived. Before joining the World Bank, he was a Land Tenure Officer in the Land Tenure and Management Unit of FAO. He has a vast research and practical experience working in developing and transitional countries in the fields of land administration, land tenure and real property markets. He is a Finnish national with a Dr. of Science from the Department of Surveying of the Helsinki University of Technology.

Dr Paul Munro-Faure is the Deputy Director, Climate, Energy and Tenure Division (NRC) at the Food and Agriculture Organization of the United Nations (FAO) based in Rome. He is a past chair of FIG Commission 7.

Aanchal Anand is a Junior Professional Associate at the World Bank based in Washington

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DC. She works on a variety of land administration project in the ECA region. Before joining the World Bank she worked in investment banking.

CONTACTS

Richard Grover
Department of Real Estate & Construction
Faculty of Design, Technology & Environment
Oxford Brookes University
Gipsy Lane
Oxford OX3 0BP
United Kingdom
Tel +44 (0)1865 483488
rgrover@brookes.ac.uk
Web: www.brookes.ac.uk

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