PROPERTY VALUATION AND TAXATION
FOR FISCAL SUSTAINABILITY AND
IMPROVED LOCAL GOVERNANCE:
Case Studies from the ECA Region

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Responsible Governance of Tenure;
Property Valuation and Taxation

• Voluntary Guidelines on Governance of Tenure (CFS 2011):
  – States should ensure that appropriate systems are used
     for the fair and timely valuation of tenure rights for
     specific purposes, such as … taxation.
  – Taxes should be based on appropriate values.
  – … valuations and taxable amounts should be made public.
  – Tax(es) … should be used … to provide for effective
    financing for decentralized levels of government and local
    provision of services and infrastructure.
Why Are We Interested?

- **Growing interest** in ECA countries to increase local revenues, enhance state land management, and define state asset values accurately.
- Property taxes can be efficient, equitable, and **least distortive towards long-term GDP per capita**.
- Need to provide **best practices** on consolidation of cross sectorial knowledge on land records, valuation and taxation applications, taxation policies and municipal financing.

Initiative on Property Valuation and Taxation 2014 - 2015

- The World Bank and FAO initiative to increase the **knowledge of land and property valuation** and taxation, and **revenue collection** for improved local governance
  - Financed by the WB ECA Trust Fund for Public Finance Management.
  - Case studies: Albania, Kazakhstan, the Netherlands Russia, Lithuania, Moldova, Serbia, Slovenia and Turkey.
  - Countries at different stages of taxation and valuation system development.
  - Lessons that can be learned from divergent experience.
  - Conference and Best Practice publications.
Recurrent Taxes on Property in OECD
(Countries as a % of GDP, 2012)


Recurrent Taxes on Property in Middle- and Low-Income Countries
(as % Gross Domestic Product, 2010)

Yet most countries make little use of recurrent property taxes

- Especially true of transition and emerging economies in ECA region
- In spite of suitability as local taxes, they generate only small part of local governments’ revenues
  - e.g. Moldova 8%; Lithuania 10%; Turkey: 15% districts, 5% cities, 0% metropolitan areas
- Does this matter?
- If so, why is there so little use made of them and what can be done about it?

The case for recurrent value-based property taxes

- Well suited to be local taxes as fall on immobile objects
  - no leakage of tax revenues across jurisdictional boundaries
- Relatively neutral in impact
- Difficult to avoid or evade as assets cannot be hidden
- Identify those with ability to pay as the taxpayers own or occupy valuable assets
Balanced tax system requires value-based recurrent property taxes

- Heavy reliance by local governments on inter-governmental fiscal transfers
- Failings in property taxation made good by transfers to local government of tax revenue from incomes, profits and sales – negative impact on incentives for work, invest, innovate, and on national financial stability and sustainability
- Reliance by central government on taxes that are becoming more difficult to collect e.g. profits taxes, taxes on high net worth individuals
- Need to overcome inequity between wealth-owning and income-earning groups

How to improve yields from recurrent property taxes

- Comprehensive tax rolls to ensure all properties that should be taxed are actually assessed – linked to cadastral reform eg Moldova up to 30% properties in some regions not registered for tax before mass cadastre reforms. One-off benefit from doing this.
- Improve tax administration so that billed taxes are actually collected eg Serbia only 85% for legal entities and 75% for natural persons collected. One-off benefit from doing this.
- Assessments based on market values with regular revaluations tap rising values – securing of buoyancy in yields. The gift that keeps on giving.
What are the challenges?

• Land and property **valuation systems** are often of **poor quality** and unable to assess market values
• Administrative systems can be weak
  – Not all properties are recorded in tax rolls; levels of collection can be poor
• **Illiquidity** of some taxpayers who acquired property through privatization and restitution
• Shortcomings impact negatively on governance.
  – Wealthy may escape proper taxation, undermining local finances and public services.

A brief overview of the countries

The adopters: Lithuania/ Moldova

**Lithuania – the “Poster Boy”**
- Property taxes 1990 & 1995
- 2005 use of market values
- Centralised system for assessment and revaluations

**Moldova – the stalled reform**
- Initially taxes based on area
- 2007 value based taxes
- Centralised system but incomplete

The beginners: Serbia/ Turkey/ Kazakhstan/Albania

**Serbia – the “new kid on the block”**
- Unreliable price data so creation of Sales Price Register
- Weak valuation infrastructure

**Turkey – the one to watch**
- Pilots show price data unreliable
- Good valuation infrastructure

**Kazakhstan – yet to start**
- Taxes based on area but reliable price data
- Valuation infrastructure

**Albania – lessons from restitution programme**
- Taxes based on area and failure to tax all properties as registration not kept pace with urban growth
- Restitution programme analyses data on sales prices
**Lithuania**

- Taxes on land and buildings first introduced in 1990 and 1995 respectively – not based on market values
- Price data collected from 1998: low transfer fees, use of mortgages and capital gains tax encourage accurate reporting- use of other sources
- Centre of Registers unveiled valuation system in 2005 – centralized methodology but assessments by valuers working in branch offices with knowledge of local property markets
- Use of multiple regression mass valuation models — sales comparison, income capitalization, depreciated replacement cost
- Regular periodic revaluations for taxation
- Low cost of mass valuations – 1 euro per property (€100 normally)
- Problems remain with qualitative data and possibly location data
- Land and buildings taxes not integrated

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**Moldova**

- Initial taxation method – land: surface area adjusted for fertility; residential properties: inventory value; non-residential properties: book value
- Models by the Cadastre State Enterprise Head Office by licensed valuers - annual revaluation
- Use of internationally-recognized standards for market values
- Registered contract prices unreliable so variety of sources used
- Mass valuation excludes agricultural land, residential property in rural areas, property in public ownership, and infrastructure
- Lack of resources to extend valuation system (on 12.5% properties covered) and revaluations not being carried out
Serbia

- Serbia in fiscal crisis: deficit 5% of GDP; government debt 63%
- Revenue sharing between central and local governments so that local governments lack incentive to develop own revenues
- High levels of properties not registered and low collection rates – capacity problems but some municipalities very efficient
- Use of disruptive “shadow” taxes e.g. urban land use charge, development fee
- Problems with valuing properties especially non-residential – no standards – municipalities responsible for assessment
- Republic Geodetic Authority became responsible for mass valuation in 2011 – problems linking cadastre and property transfer tax data
- Creation of Sales Price Register using data from contracts registered with courts/notaries – data publicly available through internet

Turkey

- Capital Markets Board 1981-2001; minimum qualifications for valuers – 2003; licenses for valuers – licensed valuers to be members of TDUB – use of international valuation standards
- Integrated property tax 1972 – pre 2002 taxpayers declare values – then information approach – valuations by local commissions every 4 years but not by professional valuers – cost approach to valuations
- Problems of rapid urbanization and a very low level of sub-national expenditure – need to fund infrastructure out of rising land values – municipalities rely on revenue from enterprises and sales and rents from real estate
- TKGM (land registry and cadastre) has undertaken pilot studies into feasibility of value-based recurrent taxes
- Problem of unreliable price data so need for database
Kazakhstan

- Land tax based on area of parcel and property tax based on area of building.
- Unit tax rates modified by coefficients that reflect characteristics of units – no reconciliation of tax assessment with market prices.
- Mandatory registration of leases and conveyances from state but otherwise registration is voluntary.
- Low registration fees and no property transfer taxes likely to mean that declared prices are accurate.
- Establishment of valuation profession, standards and education.
- Pilot study of apartments in Astana produces model with $R^2 = 0.67$ – multicollinearity and missing variables likely.

Albania

- Agricultural land tax based on area adjusted for quality – buildings tax based on surface area adjusted for land use and age of construction – not value-based.
- Yield only 0.13% of GDP so that local governments dependent on central government funding – but national debt is 71% GDP – property tax yields 25% of its potential.
- Rapid urbanisation resulted in congestion in cities and development of corridors and suburban areas – need for infrastructure.
- Patchy registration in urban areas means many properties escape taxation – under-reporting of surface areas.
- Restitution programme collects and analyses sales data from contracts and uses international valuation standards.
Issues to resolve

- Need for accurate transactions price data on which to base market valuations
  - eg Turkey true prices 3 times those reported.
  - eg Serbia Sales Price Register collecting contract prices from notaries/courts
- Lack of capacity/qualifications amongst assessment bodies.
  - eg Lithuania overcome this by: 1994 Association of Property Valuers; General Property Valuation Principles approved by government 1995
- How to value non-residential property
  - Should produce 50% tax revenue
  - Few sales transactions so need to collect rental and yield evidence
  - Use variety of models: eg Lithuania income capitalisation, receipts and expenditure, depreciated replacement cost as well as sales comparison

What seems to work

- First, develop establish a valuation infrastructure:
  - Principles of valuation based on internationally-recognised standards
  - Define the qualifications needed for valuers and establish training and education programmes to produce a sufficient number.
- Second, collect reliable data on transaction prices – rents (commercial properties) and sale prices (residential)
  - Low transfer fees/taxes can produce Laffer curve effect of low rates producing higher yields
  - Capital gains taxes increase risk to the buyer of big tax bill from under-reporting
  - Unification of mortgage and transfer registrations so that collateral is reported
  - Publication of assessments so that neighbours and competitors can check them
- Third, focus on the most valuable properties
  - Tax offices, big industry, shopping malls, luxury villas
  - Don’t waste resources trying to tax poor farmers or housing of urban poor.
  - Remember the Pareto principle applies to taxation!
- Fourth, make use of mass valuation approaches
  - Significant reduction in cost per valuation eg Lithuania 1 euro per valuation compared with 100 euros for conventional valuation.
Conclusions

- Need to make progress on value-based recurrent property taxes because of impact on national economy of poor yields from them
- Improved valuation needed for improving revenue collection
- Mass valuation for taxation most effective when
  - an effective valuation infrastructure exists
  - Good price data exists, and
  - Reliable land records exist
- Better valuation methods improve fairness and enable tax rates to be reduced whilst increasing yields

Property Valuation and Taxation Conference
June 3 – 5, 2015, Vilnius, Lithuania
www.registrucentras.lt/PropertyValuationConference

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