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.

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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.

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Initiative on Property Valuation and Taxation 2014 - 2015

CENTRE OF REGISTERS

- 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.

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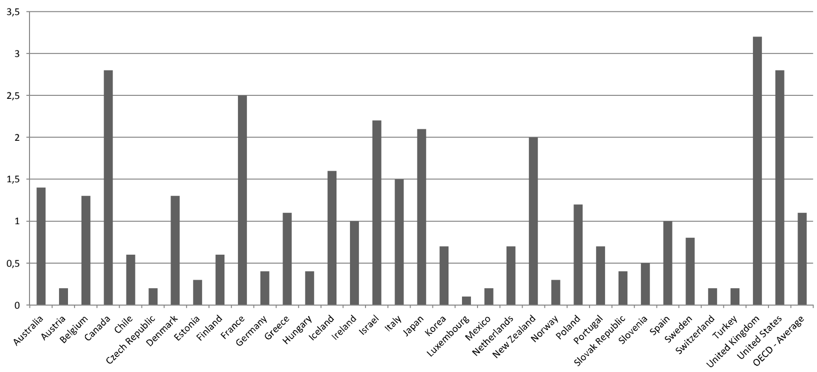
Recurrent Taxes on Property in OECD

(Countries as a % of GDP, 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

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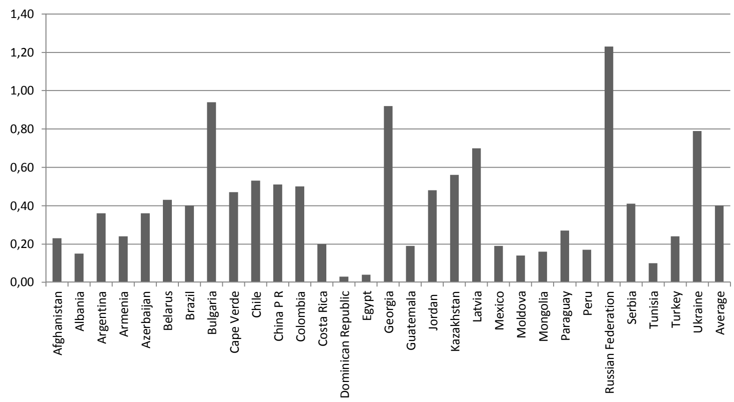
Recurrent Taxes on Property in Middle- and Low-Income Countries

(as % Gross Domestic Product, 2010)



Source: Norregaard (2013), p. 39.

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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
  - eg 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?

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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

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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

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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.*

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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.

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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

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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
- **Evolution**: new **value-based tax code** in 2000; mass valuation in 2004; implementation in 2007
- 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

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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

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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

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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.

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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

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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.

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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

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Property Valuation and Taxation Conference June 3 – 5, 2015, Vilnius, Lithuania

www.registrucentras.lt/PropertyValuationConference

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