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The evolution of property taxes in post-Socialist countries in Central and Eastern Europe

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ABSTRACT

This paper discusses the evolution of recurrent property taxes in transition economies of Central and Eastern Europe (CEE). The persistent use of an area-based property tax formula in some of these countries and the generally weak revenue performance of the property tax in most of these countries tend to slow the growth of urban productivity and, consequently, impact negatively on overall economic performance. It focuses on property taxation characteristics in these countries that are relevant to the urban (re)development challenges, describing in more detail the approaches in various countries, selected on the basis of their different tax-base formulae, revenue performance, reform directions and reform efforts. Lastly, the paper suggests possible ways forward to ensure a more significant role for the property tax in urban (re)development processes in CEE countries.

Key words: CEE countries, post-Socialist economies, property tax, tax-base formulae

JEL Classification: H71; P25; R51

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1. Introduction

'Transition countries' constitute a wide range of post-Socialist economies in Central Europe, Eastern Europe, South-Eastern Europe, the Baltics, the Russian Federation and the former Socialist republics of Central Asia. These post-Socialist economies, undergoing a transition towards a market economy, have been facing a daunting challenge of reallocating their basic resources (i.e., land, capital, labour) and reshaping their 'misdeveloped'[4] cities towards higher urban productivity through more efficient use of urban land and buildings. The Socialist cities of the centrally-planned dirigiste economies[5] were generally over-industrialised and their spatial- and land-use patterns were shaped by a logic and forces operating in a non-market system.[6] The logic of this economic model included, inter alia, such premises as (i) land had no value; (ii) capital had no interest; (iii) energy prices were a fraction of real cost; and (iv) that location did not matter for administratively determined wages, salaries, prices and costs. This led to the development of cities that, by market-economic standards, suffered four types of misallocations of urban land and building resources. These are: (i) excessive spatial dispersion (urban sprawl); (ii) suboptimal composition of urban land uses; (iii) irrational urban density distribution[7]; and (iv) the frequent occupation and inefficient use of potentially valuable land and buildings.

The centrally-planned dirigiste economic system was based on self-sufficiency, so that national economies had to produce almost all the goods and services needed by an economy.[8] This led to over-industrialisation and excessive urbanisation, which created large and extensive urban capital. When market forces were unleashed during the onset of the transition process, the market evidence indicated low urban productivity with highly inefficient land-use patterns caused by the profound misallocations of urban land and building capital.[9]

Against this background, this paper focuses on the evolution of the recurrent property tax systems[10] in a number of post-Socialist countries in Central and Eastern Europe, referred to as CEE countries. To better understand this evolution, property tax reform (or the lack

[4] I.e., developed in an abnormal or inappropriate manner as compared to market-based cities. Misdeveloped cities are cities without land markets.
[5] A dirigiste economy refers to a system of state control of economic and social matters.
[6] Decisions on what and how to produce were centrally planned by the state, which had to create its own enterprises and command them to produce what was planned. Producers were told what to produce and how much and thus made no sovereign decisions and took no risks.
[7] With land use densities do not declining (and often increasing) as you move from the urban core to the outer rings.
[8] Some specialisation and 'division of labour' were coordinated within Comecon – the communist trading block.
[9] These misallocations are discussed in Section 2.2.
[10] Recurrent property taxes are taxes levied annually on land and/or buildings.

thereof) must at least to some extent be viewed in the context of the misdeveloped cities in these countries.

Some post-Socialist cities still suffer from the excessively dispersed infrastructure systems as these are expensive to maintain and upgrade. Cities in the CEE countries need to invest heavily in infrastructure overhaul, modernisation and improvement if they want to support the process of correcting the four misallocations and thus increase their urban productivity. Although infrastructure investments in CEE countries were significant, they were mainly geared toward centralised industrial production that proved inadequate for market-driven industralised economies (Feinberg 2005). It was generally estimated that in order to reach Western European levels of infrastructure provision these economies would need to invest 6 per cent of GDP annually between 1995 and 2010 in physical infrastructure.[11] During the 1990s, about USD 25 billion was spent on infrastructure investments in these countries by international finance institutions, such as the World Bank and the European Bank. Some cities have benefited from special European Union grants and borrowing programmes, but the needs continue to be immense. As central governments are not able to fund all these investments the local governments need to mobilise more own-source revenues, which is where the recurrent property tax is a promising candidate to consider.

Many local governments in market-driven economies balance their budgets by adjusting property tax rates for a given fiscal year. Balanced budget and reliable autonomous own-source revenues generated by especially recurrent property taxes enhance local governments' creditworthiness and allow them to borrow for infrastructure investments in private capital markets. This is rarely the case in the transition economies, where local governments do not mobilise sufficient property tax revenues to fund infrastructure investments and provide local services. Consequently, they often balance their budgets by downward adjustments in capital spending on necessary pro-development infrastructure improvements and upgrading.

There is, therefore, a need for more revenue mobilisation for infrastructure investments in the transition economies through, *inter alia*, recurrent property taxes. This generally requires a higher level of taxation through both a broader tax base with less generous tax reliefs and higher tax rates than currently exist. The resultant higher tax burden is bound to require more attention to tax solidarity among taxpayers (i.e., the principle that everybody should pay) and to a more equitable sharing of the tax burden. For those CEE countries that have not yet

[11] Necessary changes in infrastructure would also require changes in the way it was used, through both privatisation and regulatory reforms, see Feinberg (2005).

migrated to a market value-based property tax, this will likely require increased market calibration of the area-based property tax formula (to achieve a better approximation of the market value). Market calibration of property taxation is an effort to differentiate property taxes among taxable properties in a way that mirrors value and price differences among these properties. Owners of more valuable properties should pay more than those of less valuable properties and in a similar proportion.[12]

In essence, the paper seeks to answer the question whether the recurrent property tax can be a useful policy instrument to not only mobilise revenue for local governments in former Socialist cities but also to address the misallocation and inappropriate use of urban real estate, especially urban land. Market-driven urban (re)development allocates urban land to its 'highest and best use'; that is, the land use that is reasonably probable and legal, while also physically possible, appropriately supported, financially feasible and that results in the highest value (Appraisal Institute of Canada 2018). Over time, as urban (re)development continues, the market redevelops and recycles urban land to its new highest and best use. In this way this constant process is securing urban (re)development towards higher urban productivity. Landowners and developers respond to market forces of demand and supply as well as to financing and taxation factors that influence their decisions. As was mentioned earlier, the investment calculus will include property tax on the expenditure side if the tax amount is sufficiently high to make a difference. A market-calibrated property tax imposes a high tax on highly valued property, pressing the owner to consider more intensive use of the property. This way, a market-calibrated property tax may provide additional pressure for moving properties to their highest and best use and, through this, may assist in attaining higher urban productivity.

An additional reason for market calibration of the property tax is the notion of value capture, which is based on the premise that public (infrastructure) investment costs should at least be partially covered by financial benefits generated by them for landowners. It is well known that urban land value can increase due to public and private actions. While the value increment contributed by the private action of the landowner is naturally captured by him/her, it is often argued that the value increment contributed by the public action should not become an unearned value increment captured only by the private landowner. Pursuant to this argument, various countries try to capture (for the public) the unearned value increment in a

[12] For example, if one property's market value exceeds another by 30%, the property tax on it should be 30% higher.

variety of ways (Smolka 2013; Walters et al 2016; Youngman 2016). A value-based or calibrated area-based property tax is one such instrument of value capture that can help to fund public infrastructure investments. A simple area-based property tax formula (i.e., without calibration) is not suitable for this purpose, unless used in tandem with other value-capture instruments, such as betterment levies,[13] planning gain fees, and public land leaseholds. In this paper, however, the focus is only on the recurrent property tax. The recurrent property tax is often considered as an ideal local tax (Bahl 2009; Bird & Slack 2004). It has received significant attention in most, if not all, of the CEE countries (Bahl 2009; FDI-CEE Report 2006; Bird & Slack 2004; Malme & Youngman 2001a; Maurer & Paugam 2000; McCluskey 1999).[14]

2 Property tax systems in the Transition Economies

2.1 Background

The leading transition countries of the CEE region experienced a fundamental economic and political breakthrough in 1989/1990 and the period following the collapse of their communist regimes. Many of these countries, especially in Central Europe, were characterised by a unitary system of government and finances, with local governments having little independent revenue determination or expenditure functions (Bird & Wallich 1992).[15] The legacy of a centrally-planned dirigiste economy strongly determined the attitude towards property taxation at the outset of the transition process, mainly because of the circumstances that existed at that time.

[13] In Poland for instance, some cities use value capture in terms of a 'betterment levy' called *oplata adiacencka* ('adjacency fee').

[14] A rich literature exists on this matter, including Aleknavicius (2011); Aleksiene & Bagdonavicius (2008); Bird & Slack (2003, 2006); Brown & Hepworth (2002); Bryson et al (2001); Brzeski (1999); Buzu, McCluskey & Franzsen (2012); Lados (2008); Péteri & Lados (1999); Plimmer & McCluskey (2008); Roshlikova (1999); Šulija & Šulija (2005); Tiits (2008); Tiits & Tomson (1999); Timofeev (2004); Trasberg (2004).

[15] The European Charter of Local Self-Governance is also instructive as regards the evolution of local government and especially local government finances. Article 9.3 of the Charter stipulates that at least a part "of the financial resources of local authorities shall derive from local taxes and charges of which, within the limits of statute, *they have the power to determine the rate*" (emphasis added). These sources should be "sufficiently diversified and [of a] buoyant nature to enable them to keep pace as far as practically possible with the real evolution of the cost of carrying out their tasks" (Article 9.4).

2.2 Initial conditions and early evolution

The absence of developed real property markets dictated tax base formulae that could not directly refer to market evidence. As Malme and Youngman (2001b:1) point out, this necessitated the use of price approximations and non-value means of allocating the tax burden. The lack of reliable market prices, together with the legacy of officially determined price levels, has encouraged the assignment of specific and sometimes arbitrary property 'values' for tax purposes. It might be concluded that neither citizens nor the politicians were actually aware of the actual value of real property and this together with restoration of private ownership and restitutions determined the slow development of real estate markets. There is also evidence of a common ambition to introduce *ad valorem* tax bases, but while real estate markets are developing to a point at which a value-based tax system can be supported by suitable, comprehensive open market transactional data, area-based systems continue to dominate (Plimmer & McCluskey 2008).

The previous system of the use of land according to the 'take which one you want' principle significantly complicated the processes of ownership restitutions and updating the cadastres with accurate data on properties and their owners so that the object of taxation and persons liable to the property tax could be identified. This is also the reason why in some CEE countries the occupiers or users may be liable for the property tax if neither the owner nor the lessee is known.[16] Another common feature was the non-application of the '*superficies solo cedit'* principle[17] leading to a different treatment of land and improvements (i.e., buildings and other structures) since these could have been, and were, owned or used by different persons. Furthermore, the construction of a building on land not owned by the person who constructed the building, even without the permission of the landowner, occurred frequently.

Lastly, periods of financial hardship present special problems in imposing taxes on assets that do not produce income with which to pay the tax (Malme & Youngman 2001b). As the result of restitution or standard inheritance, many buildings in transition countries were (and still are) inhabited by 'asset-rich, income-poor' taxpayers. Hence, any increases or changes in property taxation were (and still are) politically strongly contested. Considering these, in the time of enormous political, social, economic and legal changes, it was much easier and therefore almost an obvious choice to 'grandfather' the former property tax system, typically

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[16] E.g., Bulgaria, Czech Republic, Slovakia, Slovenia and Poland.
[17] I.e., the legal principle that the owner of land also owns the building(s) or other immovable improvements on the land.

using an area-based formula. The supportive reason for retaining the area-based model was the administrative simplicity on the one hand, and on the other hand, the high development and maintenance costs of an *ad valorem* system given the low revenues generated by the property tax. The limited administrative capacity, sparse experience and scant resources of local government were similarly decisive in not supporting, and often simply opposing any move towards market calibration.

However, some countries indeed decided to move towards *ad valorem* models,[18] while others increased market calibration of land and building area, and the remainder retained the simple area-based formula. Consequently, substantive differences developed over time among the transition countries as regards key features of the recurrent property tax, more specifically as regards fiscal significance, tax base coverage, tax base formula, tax rates and tax relief. Poland is still using a very simple area-based property tax formula for taxing land and buildings, but has chosen a simple *ad valorem* system for plant and machinery based on 'initial (acquisition) value'. This country generates by far the most revenue (as a percentage of GDP – see Table 1) from recurrent property taxes in the CEE region and has very strong local governments. Slovakia also uses an area-based property tax formula but has introduced some market calibration. The revenue from this tax, however, is rather insignificant (as evidenced by Table 1). Lithuania has chosen to adopt an *ad valorem* property tax formula, but still only generates low levels of revenue from the property tax (see Table 1). Before we review the evolution of the property tax in these three countries, the revenue importance of property taxes in the CEE region is reviewed.

2.3 Revenue importance of property taxation in CEE countries

Property tax systems exhibit considerable differences as to their role and importance in transition countries' fiscal architecture and as regards the tax base(s) used. Generally, the fiscal significance of property tax in these countries is at a low level of between 0.2 and 0.6 per cent of GDP as compared to the level for OECD member states of between 2 and 3 per cent of GDP (Bahl & Martinez-Vazquez 2008; Norregaard 2013). However, these percentages are premised on a broad definition of property taxes that includes a number of

[18] These often are called 'value-based', but the relation to market prices are not so close as to call them 'market value-based'.

property-related taxes over and above the recurrent tax on immovable property.[19] Table 1 provides an overview of the importance of only the recurrent property tax (as a percentage of GDP) in those CEE countries that are member states of the European Union (EU) for the ten-year period from 2006 to 2015.

Table 1: Recurrent property taxes as percentage of GDP in CEE member states of the EU for 2006 to 2015

Country	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Bulgaria	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3
Croatia[1]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Czech Republic	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Estonia	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Hungary	0.2	0.2	0.3	0.3	0.3	0.3	0.4	0.5	0.6	0.5
Latvia	0.6	0.5	0.4	0.6	0.7	0.8	0.8	0.8	0.8	0.8
Lithuania	0.3	0.3	0.3	0.3	0.4	0.3	0.3	0.3	0.3	0.3
Poland	1.3	1.2	1.2	1.2	1.1	1.1	1.2	1.3	1.2	1.2
Romania	0.6	0.7	0.6	0.6	0.7	0.7	0.6	0.6	0.6	0.6
Slovakia	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Slovenia	0.4	0.4	0.4	0.5	0.5	0.5	0.5	0.6	0.5	0.5

Source: Eurostat 2017.

Note: 1. Croatia only levies a tax on vacation homes and a so-called 'communal fee' on properties.

As indicated in Table 1, Latvia, Poland and Romania are the only three CEE countries where recurrent property taxes average or exceed 0.6 per cent of GDP. The Czech Republic, Hungary and Slovenia show a marked increase albeit from a low base. In the other countries reflected in Table 1, recurrent property taxes have remained relatively constant over the ten-year period. Over the same period Moldova (not reflected in Table 1 as it is not an EU member state) showed a steady decline (IMF 2017).

Table 2 provides an overview of the importance of non-recurrent property taxes in the CEE countries that are member states of the EU. The importance of these taxes (in most cases the

[19] The International Monetary Fund (IMF) as well as the OECD classification of property taxes also include real property transfer taxes, stamp duties, financial transaction taxes, as well as gift and estate taxes (IMF 2014; Eurostat 2017).

real estate transfer tax), as opposed to the recurrent property taxes, are especially apparent in Croatia and Hungary.

Table 2: Other property taxes as a percentage of GDP in CEE member states of the EU for 2006 to 2015

Country	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Bulgaria	0.4	0.5	0.5	0.3	0.2	0.2	0.2	0.2	0.3	0.3
Croatia	0.5	0.5	0.6	0.5	0.5	0.5	0.4	0.5	0.5	0.5
Czech Republic	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.4
Estonia	0.1	0.2	0.1	0.0	0.0	0.1	0.1	0.1	0.1	0.1
Hungary	0.6	0.5	0.6	0.5	0.8	0.8	0.8	0.7	0.7	0.7
Latvia	0.5	0.5	0.3	0.3	0.3	0.3	0.4	0.3	0.4	0.3
Lithuania	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.4
Poland	0.3	0.3	0.3	0.2	0.3	0.3	0.3	0.3	0.2	0.3
Romania	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Slovakia	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Slovenia	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.2	0.1

Source: Eurostat 2017.

In Hungary, the estate tax and real estate transfer tax (levied at a tax rate of 4 per cent) constitute a significant portion of property taxes. For example, in 2010 recurrent property tax constituted only 0.3 per cent of GDP with the transfer tax and other property taxes at 0.8 per cent. In 2015 recurrent property taxes increased to 0.5 per cent while the other taxes still amounted to 0.7 per cent. However, in Latvia and Poland, significant revenues were generated from the recurrent property tax over this period, with transaction taxes playing an unimportant role. For example, in 2015 the recurrent property tax in Latvia constituted 0.8 per cent of GDP and transaction taxes only 0.3 per cent and in Poland, the recurrent property taxes constituted 1.2 per cent and other property taxes 0.3 per cent of GDP (Eurostat 2017).

Another way of looking at the importance of property taxes in CEE countries, vis-à-vis the Western European members of the EU, is on a per capita basis. Although the calculations in Table 3 are based on somewhat crude population estimates and property tax revenues that are rounded up to the nearest €100 million, Table 3 provides an indication of the levels of taxation for recurrent property taxes, other property taxes (mostly property transfer taxes) and

all property taxes collectively. For the eleven CEE member states, the collective average per capita recurrent property tax in 2015 amounted to only about €80, whereas for the non-CEE member states it amounted to about €583. Amongst the CEE countries that are EU member states, and excluding Croatia where a recurrent tax is almost non-exisitent, it ranged from a mere €13.99 in Bulgaria to €137.26 in Poland. Only in Poland and Latvia did the per capita recurrent tax exceed €100 in 2015. It is also noticable, for both the CEE countries and non-CEE countries, what a prominent role the other property taxes play. It is, however, also noteworthy that property transfer taxes have been abolished or are negligble in a number of CEE countries, such as Estonia, Slovakia and Slovenia.

Table 3: Per capita revenue from property taxes in the European Union in Euro in 2015

Country	2015 Population ('000)	Recurrent PT ('000)	PT in € per capita (est.)	Other PT ('000)	Other PT in € per capita (est.)	All PT ('000)	All PT in € per capita (est.)
Austria	8 545	700 000	81.92	2 200 000	257.46	2 900 000	339.38
Belgium	11 299	5 400 000	477.92	9 500 000	840.78	14 900 000	1 318.70
Bulgaria	7 150	100 000	13.99	100 000	27.97	0 300 000	41.96
Croatia	4 240	0	0.00	200 000	47.17	0 200 000	47.17
Cyprus	1 165	200 000	171.67	0	0.00	0 200 000	171.67
Czech Republic	10 543	400 000	37.94	600 000	56.91	1 000 000	94.85
Denmark	5 669	5 600 000	987.83	1 500 000	264.60	7 100 000	1 252.43
Estonia	1 313	100 000	76.16	0	0.00	100 000	76.16
Finland	5 503	1 600 000	290.75	1 400 000	254.41	3 000 000	545.16
France	64 395	69 700 000	1 082.38	31 600 000	490.72	101 300 000	1 573.10
Germany	80 689	13 200 000	163.59	19 100 000	236.71	32 300 000	400.30
Greece	10 955	4 700 000	429.03	1 000 000	91.28	5 700 000	520.31
Hungary	9 855	600 000	60.88	800 000	81.18	1 400 000	142.06
Ireland	4 688	1 800 000	383.96	1 600 000	341.30	3 400 000	725.26
Italy	59 798	27 500 000	459.88	16 900 000	282.62	44 300 000	740.83
Latvia	1 971	200 000	101.47	100 000	50.74	300 000	152.21
Lithuania	2 878	100 000	34.75	100 000	34.75	300 000	104.24
Luxembourg	567	0	0.00	700 000	1 234.57	800 000	1 410.93
Malta	419	0	0.00	100 000	238.66	100 000	238.66

Netherlands	16 925	5 800 000	342.69	4 300 000	254.06	10 100 000	596.75
Poland	38 612	5 300 000	137.26	1 400 000	36.26	6 700 000	173.52
Portugal	10 350	1 500 000	144.93	2 000 000	193.24	3 500 000	338.16
Romania	19 511	1 000 000	51.25	400 000	20.50	1 400 000	71.75
Slovakia	5 426	300 000	55.29	0	0.00	300 000	55.29
Slovenia	2 068	200 000	96.71	0	0.00	200 000	96.71
Spain	46 122	13 600 000	294.87	16 900 000	366.42	30 500 000	661.29
Sweden	9 779	3 600 000	368.14	1 700 000	173.84	5 300 000	541.98
United Kingdom	64 716	79 300 000	1 225.35	29 700 000	458.93	109 000 000	1 684.28
CEE countries	103 567	8 300 000	80.14	3 700 000	35.73	12 200 000	117.80
Non CEE countries	401 584	234 300 000	583.44	140 300 000	349.37	374 400 000	932.31
European Union	505 151	242 600 000	480.25	144 000 000	285.06	386 600 000	765.32

Source: Eurostat 2017; United Nations Department of Economic & Social Affairs 2015.

Note: 1. Amounts have been rounded up to the nearest 100 million.

2.4 Differences in property taxation

2.4.1 Diverse systems in use

Traditionally, the transition countries have been relying on area-based property tax formulae to define their recurrent property tax base, albeit with varying degrees of market calibration in order to differentiate tax amounts beyond the property size (area). Market calibration typically takes the form of different tax rates (in some cases, tax amount coefficients) by property type, location in tax (land-value) zone and sometimes city size, in addition to property size (usable area), which, in itself, is a major market calibration factor.

The Czech Republic and the Slovak Republic use calibrated area-based formulae (Radvan 2014; Románová & Forraiová 2016) adjusting for property type, city size and ranking,[20]and location within a tax zone,[21] with Slovak local governments having wider competencies in tax rate setting and in providing for tax relief.[22] Slovakia is considering further calibration and

[20] City rank is defined by its status as the country's capital, region's capital, or county's capital city. For more detail, see Radvan (2012) and Bujňáková & Románová (2014).

[21]Actually, the term 'fiscal zone' is used, but it may be misleading as it does not refer to land-use zoning, but focuses on creating zones for taxation based on property prices or values.

[22] In the Czech Republic and Slovakia municipalities are numerous and very small, often lacking sufficient administrative capacity. For more, see Radvan (2018), Románová & Červená (2016) and Románová & Červená (2017).

also preparing for a gradual shift to a value-based formula in the medium term. The first contemplated step is to start collecting sales data, as well as to collect value-related attributes of apartments and homes.[23] In the Czech Republic, three attempts to shift to an *ad valorem* tax base have failed politically and the country is now focusing on more tax differentiation through market-calibrated tax-base zones for individual municipalities (Holmes 2016). Several pilot projects have demonstrated that such tax zoning is technically feasible, mostly through the use of land-use planning maps, as well as market-derived value-zones.

In Hungary, local governments have had a broad choice regarding property taxation (Tassonyi 2004). They can decide whether to levy a property tax,[24] apply an area-based or value-based formula, calibrate an area-based tax base (buildings) with pro-market adjustments, and differentiate between residential and non-residential property. Local governments have the same discretion to tax vacant land. No municipalities have chosen *ad valorem* formula; only 12 per cent have decided to tax residential property and 13 per cent to tax vacant land. There has been some discussion about introducing a statutory requirement for some pro-market calibration of the area-based formula, but it has not yet been legislated.

Moldova and Slovenia have attempted to move towards the capital value (*ad valorem*) tax-base formula. However, in both countries, these attempts have not been satisfactorily completed and the *ad-valorem* reforms have effectively stalled and have faced mounting challenges. While technical issues have generally not been a problem, their expert-led, valuation-focused reforms have missed the efforts to win over taxpayers and politicians. In Moldova, the lack of intergovernmental cost-sharing to provide sufficient property tax-revenue funding of mass appraisal and revaluation is undermining the timeliness of cadastral values (Buzu, McCluskey & Franzsen 2012). Local governments support *ad valorem* reforms, but are unable to finance cadastral values and are thus pressing the central government to reduce statutory tax relief granted by national laws, while central politicians are generally not eager to support fiscal decentralization and *ad valorem* reforms.

In Slovenia, where valuation-driven reforms focused initially on non-fiscal uses of cadastral values, the effort to extend the use of these values to property taxation has run into problems due to the 2014 ruling of the Constitutional Court that rejected the draft *ad valorem* law

[23] Such as property description (balconies, district heating, elevators, etc.), location of property and financial indicators of property; it is also necessary to avoid collecting irrelevant data.
[24] The Act on Local Taxes allows local governments to levy five types of local taxes, two of which are the recurrent tax on buildings and the recurrent tax on vacant land.

leaving the country with temporary use of its ineffective land-fee system based on area-based formulae with little pro-market calibration. The Court referred to 'endangered' local government sovereignty,[25] and to the lack of taxpayer rights to appeal cadastral values construed as generalised values.[26] Consequently, the Ministry of Finance is presently working with a new version of the property tax draft law that endeavours to respond to the objections outlined by the Constitutional Court.

The Baltic countries have adopted value-based (ad valorem) formulae applied to land (Estonia) and to land and buildings separately (Latvia and Lithuania). The taxation issues of these countries vary as regards the *ad valorem* formula (Šulija 2008). Estonia taxes only land, and land values have not been revalued since 2001, which refutes the purpose of an *ad valorem* system and resembles the problems of major European countries or jurisdictions with out-dated values (e.g., Great Britain – being England, Scotland and Wales – and also Germany and Spain).[27] Consequently, Estonia mobilises disappointingly low revenues from recurrent property taxes. Latvia has the most complete *ad valorem* system by taxing improved properties and land, which results in much higher property tax revenues than the other Baltic countries. However, there appears to be a major tax revolt brewing in the country, which might undercut the good fiscal performance of recurrent property taxation in this country. Lithuania taxes the land and buildings separately, which makes their cadastral values difficult to establish and explain to the taxpayers. The country does not tax residential property, which explains the disappointingly low level of recurrent property taxes mobilised in this country.

Some countries, such as Poland and Romania, use dual tax-base fomulae with some properties taxed through area-based and some through value-based formulae. Poland uses the simplest version of the area-based formula for its residential and non-residential properties [28] and uses initial (non-depreciated) book values of non-residential structures.[29] No policy changes are officially contemplated at the moment, except for some administrative improvements,[30] although policymakers recognise the need to reduce relative over-taxation of

[25] In Hungary, e.g., local governments may decide whether they want to tax residential property or not.
[26] The Court has since also questioned the use of generalised values in other laws.
[27] Residential properties in England and Scotland have not been revalued since the introduction of the council tax in 1991. France has updated taxable values with effect from 1 January 2017 after using 1970 values with subsequent indexation.
[28] Distinguishing mainly on the basis of land and buildings, as well as residential and non-residential property.
[29] Non-building fixed assets attached to land and recorded in business taxpayers' accounts.
[30] Such as allowing skipping collection of tax amounts smaller than the cost of their enforcement and setting a minimum tax amount to be paid in one instalment.

business properties, to broaden the tax base[31] and to encourage more pro-market calibration of tax amounts through market-calibrated fiscal zones.[32]

Romania uses an area-based formula for residential land and buildings with differentiation by tax zones,[33] while taxing (depreciated) book values of business properties, but introduced individual valuations by licensed valuers of business properties in 2016. These valuations are provided, and paid for, by business taxpayers. If valuation reports are not submitted, these properties will be taxed at very high rates applied on an area basis. Some more pro-market calibration is contemplated through city differentiation by size and/or rank, similarly to Czech and Slovak practices. There is an understanding that property tax reforms take longer and need to be staged in line with the incremental education of politicians, municipalities and taxpayers that properties have values that should be taxed as they are influenced by publicly-funded services and infrastructure.

The choice of base has seemingly little to do with revenue performance – as is evidenced by Tables 1, 3 and 4. The standard of international comparison is typically the ratio of property tax revenues to the country's GDP, as well as the share of property tax revenues in total tax revenues of a country. However, the differences in performance are even clearer if one looks at property taxes per capita across all the member states of the EU (Table 3 above). Yet another indicator is the ratio of property tax revenues to local government revenues and sometimes just to own-source local revenues. Table 4 provides three indicators for the selected countries and also states their respective tax-base formulae. One should also keep in mind that differences in the fiscal performance of property taxation may also stem from different types and levels of municipal services provided by local governments in different countries.

[31] Many properties zoned for residential construction avoid urban property tax by continued registration as agricultural use.

[32] This is already allowed, but only 10 out of 2,500 jurisdictions set fiscal zones and these are hardly reflecting market relations.

[33] Although these are based heavily on land-use planning and there is a need for valuation standards to demarcate market-derived fiscal zones.

Table 4: Recurrent property tax bases and fiscal performance indicators in selected CEE countries

Country	Tax base		% of GDP	% of total taxes	% of local revenues
	Area	Value			
Czech Republic	Calibrated		0.2 (2015)	0.6 (2015)	1.4 (2012)
Estonia		Market value (land only)	0.3 (2015)	1.0 (2014)	6.8 (2014)
Latvia		Market value	0.8 (2015)	2.8 (2015)	8.9 (2015)
Lithuania		Market value	0.3 (2015)	1.7 (2016)	8.2 (2016)
Moldova		Market value	0.1 (2013)	0.3 (2013)	7.6 (2013)
Poland	Simple		1.2 (2015)	3.9 (2013)	22.0 (2016)
Romania	Calibrated (residential)	Book value (non-residental)	0.6 (2015)	4.0 (2015)	9.0 (2015)
Slovakia	Calibrated		0.4 (2015)	3.0 (2016)	7.1 (2015)
Slovenia		Statutory value	0.5 (2015)	1.7 (2015)	10.6 (2015)

Source: Eurostat 2017; IPTIpedia 2017; Lincoln Institute of Land Policy (2015, 2016, 2017).

There are no definite trends or lessons to be gleaned from Table 4 that would suggest that one system generally performs better than another – suggesting that there are also other factors to consider such as the importance of intergovernmental grants, the strength of local government institutions, and tax base erosion through various types of tax relief. It is noteworthy, however, that Poland – the only country with a simple area-based system – relies significantly on the recurrent property tax as a local tax.

The very different systems in operation in Poland, Slovakia and Lithuania will now be reviewed in more detail.

3 The systems in Poland, Slovakia and Lithuania

3.1 Poland: A simple area-based system with high-level revenues

Poland began development of its contemporary property taxation regime before the 1989 political-economic breakthrough. The agricultural property tax was introduced in 1985 and urban property tax[34] (or real estate tax) in 1986 in a move to expand the tax base into the non-income sphere and to capture wealth being diverted to this untaxed area at a time of declining revenues and worsening macroeconomic conditions. Since this still happened during the late Socialist planned-economy socialist era there was a lack of functional real estate markets,

[34] Formally it is levied on all properties that are not subject to agricultural and forest property taxes (Bird 2004a).

which necessitated adoption of a non-market tax-base formula based on land and building area for the urban real property tax.[35] The market-oriented democratic government, installed in 1989, re-established local self-governments (i.e. municipalities) in 1990, assigned property taxes as autonomous own-source local revenues in 1991 (Brzeski 1999; Bird 2004a), and also introduced a forest property tax in 1992. These taxes have been subsequently amended mainly to close loopholes and broaden the tax base.[36] In 1995, a comprehensive package of laws introducing an *ad valorem* property tax formula was prepared at the Ministry of Finance (Brzeski 1999), but the political adversity surrounding the proposed change effectively blocked further steps towards its implementation. There were several successive attempts to rekindle interest in moving towards the *ad valorem* formula, but the renewed attempts met equally staunch political opposition. Consequently, the country still uses an area-based property tax base except for plant and machinery owned by legal persons (entities) and still has some distance to go to introduce *ad valorem* property taxation (Bird 2004a).

Poland is a unitary state with three levels of self-government: (i) 16 regions (*Voivodships*); (ii) 314 counties (*Powiats*); and (iii) 2,479 municipalities (*Gminas*). Recurrent property tax is an important own revenue source for municipalities. There are presently three recurrent property taxes: (i) the urban property tax contributing about 85 per cent of revenue; (ii) the tax on agricultural property contributing about 13 per cent of revenue; and (iii) the tax on forest property contributing about 2 per cent of revenue (Bird 2004a). Two tax-base formulae are used for the urban property tax: (i) area basis for land and buildings; and (ii) initial (acquisition) cost for plant and machinery (i.e., fixed installations or 'engineering structures').[37] The area-based tax rates are set locally, but capped by the central government regulations and applied to a very limited number of land and building categories.

Tax rates on land are lower than on buildings and the non-residential building rate ceilings over 30 times higher than on residential buildings,[38] which does not reflect market relationships. The rate difference is only two times for land.[39] Consequently, the recurrent urban property tax is mainly paid by business buildings (more than 50 per cent), although these buildings constitute less than 5 per cent of the overall capital value of real estate (Bird

[35] With the exception of the agricultural tax, which was linked to soil fertility (bonitation grade) and thus implicitly to economic productivity.
[36] These amendments mostly clarified and expanded the land uses included in the non-residential category and added statutory exemptions.
[37] These are formally fixed assets carried in the books of legal persons (businesses).
[38] Tax rate on residential buildings is about €0.18 per m^2 and on business-use buildings about €5.57 per m^2.
[39] Tax rate on business-use land is about €0.22 per m^2 and on residential land about €0.11 per m^2.

2004a). Some 30 per cent is paid on plant and machinery and about 20 per cent on land. This is clearly not related to market pricing. The tax rate on plant and machinery is capped at 2 per cent of the initial (acquisition) cost and contributes about 30 per cent of revenue. Tax liability is set on property owners and if these cannot be identified it is levied on users or occupiers. Business owners (legal persons) contribute almost 80 per cent of the tax and individuals (natural persons) contribute about 20 per cent of property tax revenues.

There are numerous statutory exemptions (Brzeski 1999; Bird 2004a) for various categories of infrastructure: for foreign governments, certain international organisations, on the basis of social policy purposes (e.g., pensioners and veterans), buildings used for agricultural and forestry purposes, property used by non-profit and charitable organisations, church property, schools, universities and research institutions, and properties listed as heritage as well as institutions related to filmmaking. While government property is not exempted, local governments do offer additional exemptions including for some government property like hospitals. As of 2015 the exemptions amounted to significant forgone revenue – out of the total potential revenue of about €7.2 billion the statutory exemptions amounted to some €1.2 billion (about 23%) and the local government exemptions amounted to some €0.7 billion (about 13%). Consequently, the exemption-related forgone revenues amounted to approximately 36 per cent of the potential revenue from the recurrent property taxes (including taxes on agriculture and forest).[40]

Administration of the recurrent property taxes is done locally in larger cities, but for small municipalities the national tax office may assist (Brzeski 1999; Bird 2004a). For the most part administration is rather simple and thus easily carried out by local governments. Legal persons (businesses) perform self-assessment and pay on a monthly basis, while residential property is assessed by municipalities and payments are quarterly. Appeals on the recurrent property taxes can be taken to three different levels: (i) first to local government; (ii) then to a county-level appeals board; and (iii) finally to the Administrative Appeals Court. Appeals are limited because of the simplicity of verifying land and building area measures,[41] and accounting for initial (acquisition) cost by businesses. Tax administrators are comfortable with such a system and taxpayers understand it.

[40] Data presented by Poland's Ministry of Finance at the CEE Strategic Workshop *Strengthening the Property Tax in CEE Countries: Improving Administration and Tax Policy*, Vilnius, Lithuania June 29-30, 2017.
[41] Most of appeals are on business properties and classification of building area – many municipalities charge different rates on primary and secondary (auxiliary) floor areas.

Although the area-based property tax was functioning quite well fiscally, producing high-level revenues (at 1.4% of GDP) in the early transition period, the government understood that the simple area-based tax was not capturing the growth in the tax base resulting from the nascent market economy with rising capital values of real property. Fiscal reformers were in general agreement that an overhaul of real property taxation towards market calibration (like all other taxes) was necessary for the longer term.

Following a resolution passed by the Polish Parliament in March 1994 that instructed the government to prepare a comprehensive draft *ad valorem* real property tax law, the Council of Ministers adopted (in June 1994) a long-term development strategy for the country. This broad-based strategic statement included a vision of a comprehensive fiscal cadastre including mass appraised cadastral values forming the tax base for property taxation by the year 1999. The fiscal cadastre was envisioned as the first and most logical step toward a national land information system that would contain a complete inventory of all physical, economic and legal information on real property in Poland.

Early in 1995 an inter-ministerial Working Group was formed under the chairmanship of the Ministry of Finance and included Ministries of Justice, Construction and Agriculture. At the same time, the Finance Ministry set up an internal task force to develop the reform concepts and to draft legislative proposals. The Working Group was charged with determining basic premises of the *ad valorem* reform and resolving institutional and jurisdictional issues, including disagreements among ministries over who would control various elements of property data registers and valuation.

The Working Group developed and adopted a Memorandum containing premises of a new *ad valorem* property tax, which would subsume agricultural and forest taxes into one tax. The Memorandum affirmed the need for an *ad valorem* tax as a necessary step for continuation of the restructuring of the tax system in Poland, which began in 1990, with the purpose of establishing a stable and effective funding system for local self-governments. The Memorandum listed the following agreed premises:

- the new property tax should include all types of real property, and will replace the present area-based taxes: (urban) real property; agricultural and forest;
- a real property cadastre, initially focused on fiscal functions, will be developed for use in the mass assessment of taxable real properties;

- the tax base for *ad valorem* taxation will consist of cadastral values determined through general assessment (cadastral valuation) of all taxable properties;
- the proposed reform would offer the additional benefits of encouraging clarification of ownership titles, orderly development of property markets, housing investments, and development of mortgage finance systems; and
- a central agency should be created to develop and manage property information systems and registers, as well as perform national cadastral valuations (assessments).

In 1995, a special Task Force at the Finance Ministry drafted a package of five draft laws to establish an enabling framework for the *ad valorem* property tax system. The proposals incorporated recommendations from the Working Group, as well as elements drawn from modern international *ad valorem* experience and practice. After extensive discussions and lobbying by local governments the Ministry modified the initial proposals in 1996 and gave municipalities a greater role in self-administering the *ad valorem* property tax.[42] The draft laws proposed an effective date of 2001 for implementation of the *ad valorem* system, but allowed an earlier implementation if requested by a municipality if it could prove that it was capable of fulfilling certain legal and technical prerequisites.

The draft *ad valorem* legislative package stalled at inter-ministerial consultations, as one of the government's coalition partners (farmers) turned against the reform. At the same time, negative publicity was stirred up in the media by miss-quoting deputy finance minister as saying that the new tax rate would be at the level of about 10 per cent of value. In 1997 a new government with a strong decentralisation agenda including fiscal decentralisation, was formed. The *ad valorem* reform returned to the agenda and work on formulating a long-term gradual reform strategy resumed. A resolution by the Finance Ministry to work towards this reform was reinforced by recommendations of major international development institutions.[43] To facilitate further work in this direction the Finance Ministry established a new dedicated Department of Local Taxes and Cadastre charged both with supervising the existing property tax system and developing its modification towards the *ad valorem* tax-base formula.

A group of reformers at the chronically understaffed Finance Ministry travelled on study tours to various countries in order to identify issues and challenges on the way to a workable

[42] Administration of local taxes would be left wholly to local governments, subject only to general laws, while cadastral information operations were to be supervised and coordinated by national cadastral bodies.
[43] *Ad valorem* property taxation was strongly recommended by the World Bank (IBRD), the International Monetary Fund (IMF), the Organization for Economic Cooperation and Development (OECD), the European Bank (EBRD), and the United States Agency for International Development (USAID).

ad valorem system.[44] A number of pilot studies were commissioned to foreign experts to evaluate the financial and technical feasibility of *ad valorem* implementation. The International Property Tax Institute was invited to organise its annual global conference in 1999 in Krakow and then again in 2009 in Warsaw in order to expose the Polish audience to international issues and best practice.

Given this experience and accumulated knowledge, the Task Force adopted a cautious approach by envisioning a long-term step-by-step implementation strategy rather than an all-out approach. This included a tactical proposal of modifying the existing area-based formula rather than discarding it outright and linking the implementation steps to fiscal decentralisation reforms that were then under discussion. Since the work on fiscal decentralisation became delayed the draft law modifying the existing property tax system was forced to wait in the Parliament till the pre-election summer of 2001.

The draft law prepared by the Finance Ministry was to replace the three property taxes (urban, agricultural and forest) into one property tax. The land portion of this tax was left free for modification by municipalities if they elected to adopt more than one land taxation (presumably value) zone in their jurisdiction. These land taxation zones would reflect land price differentials and municipalities would impose different land tax rates in each zone. By the end of 2017, only ten out of the 2,479 municipalities opted to use these zones with little relation to market price differences.[45]

Differential tax rates would also be allowed for vacant land depending on the existence of zoning bylaw and land servicing (infrastructure). This would effectively introduce location coefficients to land area and thus move toward market calibration on the way to an eventual *ad valorem* formula albeit retaining the formal structure of the area-based formula. Residential buildings would continue to be taxed on an area basis only, while business-use buildings and premises would be taxed on their initial (acquisition) values, similar to the current taxation of engineering structures. It was envisioned that in further steps residential buildings would also be taxed on their initial (acquisition) values, which would later change to market values. The land tax base would also be enriched by adding other coefficients reflection zoning and infrastructure availability. Finally, land and buildings would be joined

[44] The group travelled to France, the United States, Canada, the Netherlands and Germany.
[45] Information provided by Poland's Ministry of Finance, Department of Local Taxes.

into one taxable property, subject to one tax rate, and individual market-based valuations would be applied. The whole adjustment process was expected to take about ten years.

Each step envisioned in the implementation strategy would have to be self-financing in the sense of full cost recovery and, in addition, the first stage would need to be revenue neutral in terms of the tax burden of existing taxpayers (and thus local revenues). This would only be feasible if previously undiscovered properties were added to the tax base and some exemptions were eliminated, which the draft law was trying to encourage.

Not unexpectedly, a Parliament in preparation for general elections was not interested to handle such a sensitive issue during the election campaign. Consequently, it refused to place the draft law on its agenda thus relegating the issue to a new political reality after the election. But the new government and its successors never came back to the proposed reforms, being content with the high level of revenues mobilised by the existing, albeit highly distorted, area-based property taxation system.

In conclusion, the recurrent urban property tax in Poland is a very simple system, transparent and easily understood by tax administrators, taxpayers and politicians. However, the use of a non-market tax base formula for land and buildings induces profound suboptimal distortions in urban land uses. However, the present rate structure heavily overtaxes business properties relative to residential (Brzeski 1999; Bird 2004a) and overtaxes large-size properties (typically industrial) relative to commercial property. It also overtaxes business buildings relative to land. The very low rates on land encourage land speculation. Very importantly, the current rate structure does not differentiate the tax burden by location and thus also overtaxes property in poor locations in respect of both residential and non-residential properties.

3.2 Slovakia – some market calibration of area basis and medium-level revenues

Immediately after the Velvet Revolution in 1989, the system of real property taxation in the Slovak Republic and Czech Republic (then Czechoslovakia) comprised the former socialist system of agriculture land tax (the tax base was the estimated profit derived from the property) and a house (building) tax based either on the rental value of the building or the floor area.

The new Slovak Republic adopted Act no. 317/1992 Coll. on real property tax. This law provided for a three-tier state property tax, namely the tax on lands, the tax on buildings and the tax on apartments and non-residential premises. While the tax on buildings and the tax on

apartments and non-residential premises were solely based on area, the tax on lands used a similar principle as in the Czech Republic[46] – forest lands and fish farms were taxed based on area and value determined according to pertinent price regulations, while arable land, hop fields, vineyards, orchards and permanent grasslands were taxed on the base of area and value of the land stated in the appendix to the Act. The remainder of the land types was taxed on the basis of simple area. The tax rate in case of lands within the built-up area of a municipality or city was adjusted by a coefficient corresponding to the size of a municipality or city.

From 2004, the real property tax in Slovakia is a local tax levied in terms of the Act on Local Taxes and Local Fee for Communal Waste and Minor Construction Waste (hereinafter the Act on Local Taxes). Although the overall revenue accruing from real property tax in 2015 is rather low at only 0.415 per cent of GDP, it generates about 7.1 per cent of total municipal revenues and definitely has the potential to raise more local government own-source revenue. Since its adoption in 2014, it also emphasised the role and self-governing position of municipalities by transferring the competence to impose the tax (following the statutory regulation) and grant discretion on its elements (values of some types of properties, tax rates, additional reliefs, floor surcharge, instalments) to municipalities. This was achieved through local bylaws, or so-called generally binding regulations (GBR) (Bujňáková, 2015). The Act on Local Taxes was adopted as a part of regulation that truly started the process of fiscal decentralisation (Štrkolec 2007; Bobáková 2016).

The Act on Local Taxes provides for separate tax bases for land, constructions, apartments and non-residential premises. There are even different means of determination of the base for tax on land dependent on the type of land plot.[47] Nevertheless, within the GBR, a taxing jurisdiction may establish a land value not exceeding 50 per cent of the average land value of a particular district in case the value stated for a particular plot in Appendix 1 cannot be used. Such established land value may be used only on the condition that the taxpayer does not prove the value of particular land by means of an expert´s opinion. Concerning gardens, built-

[46] Since the formation of the Czech Republic, the regulation of real property taxation (Act no. 338/1992 Coll. on Real Estate Tax) built this tax largely on an area-based approach. The tax base for land and structures was solely the area of particular property, except for arable land, hop gardens, vineyards, gardens, orchards, meadows and pastures, where the tax base was assessed as the area of land multiplied by the average value of property (stated by ministerial decree) and for commercial forests and fish farms, where the tax base was the price of land determined according to prescribed price regulations.

[47] E.g., the tax base regarding arable land, hop gardens, vineyards, orchards and permanent grassland is the value of the land without vegetation calculated as the area of land in m^2 multiplied by unit value of $1m^2$ stated in Appendix 1 to the Act on Local Taxes.

up areas and courtyards, other areas, and building plots, the tax base is the value of land calculated as the area of land in m^2 multiplied by the value of $1m^2$ of land stated in Appendix 2 to the Act on Local Taxes.[48] Deviations from these values may be determined by the GBR of a municipality only in the case of building plots (which municipalities often do). In the case of forest lands used for commercial timber, ponds with fish farming and other commercially used water areas, the tax base is the value of the land without vegetation calculated as the area in m^2 multiplied by the unit value per $1m^2$ in accordance with the regulation establishing the general value of assets (i.e. an expert's opinion). However, the tax jurisdiction may establish a different land value by means of the GBR.[49] The base for tax on buildings and the tax on apartments and non-residential premises is determined solely on the simple area of the property. The tax base of tax on buildings is the built-up area in m^2. The built-up area is considered as the floor area of the building at the most extensive above-ground floor of the building. However, a tax jurisdiction may also tax atypical buildings or constructions.[50] In case of the tax on apartments and non-residential premises, the tax base is the floor area of the particular apartment or non-residential premises in square meters.

Tax jurisdictions (municipalities) may correct for the strictly defined tax base by selecting different tax rates (from basic to statutory ones) in the GBR, which is a common practice. Moreover, they are allowed to determine different rates for different types of lands constructions, flats and non-residential premises, and may also consider the use and the location, for instance in relation to the city centre, cadastral areas and other zones (Románová & Forraiová 2017).[51] This diversification of tax rates can be fully adjusted to local circumstances and used as a tool of local tax policy of each municipality since the Act on Local Taxes gives the municipalities almost full powers to determine different tax rates within the area of the municipality. Consequently, tax jurisdictions may set tax rate schedules in order to differentiate tax amounts in a way that simulates relative market values. Elements of market calibration are thus introduced.

The mentioned different determination of tax rates shall observe two-tier limits. The first is the limit regarding the determination of zones; i.e., individual parts of municipal areas must

[48] Appendix 2 stipulates the values of these types of lands in relation to the size of a municipality, particularly by the number of their inhabitants. This criterion determines eight classes of municipalities with particular values for the mentioned types of lands.
[49] Such other land values may only be used on condition that the taxpayer does not prove a different value of particular land by means of expert opinion.
[50] E.g., in the case of construction of underground parking garages it would be the underground floor area.
[51] In larger towns, it is standard to set two to four zones usually based on a traditional division of city centre, wider centre and suburbs; the choice of division depends on each municipality.

form a geographically compact part of the municipality, comprise a minimum of 5 per cent of the property-tax taxpayers of the municipality and be established within the GBR of the municipality. Individual parts of the municipality may be formed by a street, neighbouring streets or neighbouring plots of land. Second, the municipalities are limited by maximum tax rates.[52] This limitation also confirms that the self-governing position of municipalities is not absolute. In multi-storey buildings, the municipality may determine a floor surcharge in the amount of maximum €0.33 per floor except for the first above-ground floor resulting in a coefficient that enables much higher taxation of multi-storey buildings, which echoes market price differences. Changes in tax rates and the amount of floor surcharge are allowed to be made effective January 1 of each year.

The case of Slovakia shows that despite the tax base being determined mainly by the area, the actual tax amounts may be adjusted by each municipality through applying different tax rates in accordance with the type of property, its use, the location of the property within the area of municipality, as well as the floor surcharges in the case of buildings. Although factors such as the condition of a property, its accessibility, age, number of storeys, equipment and other factors that may also be relevant for market value are not considered, it is not only the simple area that is taken into account. There are still cases where the value of particular types of properties that become part of the tax base[53] can be influenced by municipalities, albeit in a

[52] There are several limitations: (a) highest rates stated in the GBR must not exceed the basic statutory rate more than five times in the case of arable land, hop gardens, vineyards, orchards and permanent grassland; (b) highest rates stated in the GBR must not exceed the basic statutory rate more than ten times in case of forest lands with economic woods, ponds with fish farming and other economic-use water areas; (c) the rate regarding the land tax on lands functionally connected to nuclear facility must not exceed the rate stated by the Act more than 100 times; (d) highest rates stated in the GBR must not exceed the lowest rates stated in the same regulation by more than five times the land tax on other types of lands; (e) special tax rates regarding land for which a permit to extract unlisted minerals was issued and land on which facilities producing electricity from solar energy, transformer stations or sales booths are situated may be determined by the municipality even beyond above limitations; however, the maximum limit stated under d) above must be observed; (f) highest rates stated in the GBR must not exceed the lowest rates in the same regulation by more than ten times the buildings tax, tax on flats and non-residential premises.

[53] As in the already mentioned values defined by Appendices 1 and 2 in the Act on Local Taxes. The values stated therein, unfortunately, are not in line with market values, or only approximate market values in a small number of cases. In the most productive areas of the country, market values are approximately at the level of statutory values of lands. Prices of land on the outskirts of villages and towns are many times higher. Market prices of land located in less productive areas of the country reach, in many cases, only 1/3 of the statutory values of agricultural land (according to Market prices of agricultural land, available at http://agrofarmy.sk/Rmenu/Informacie/Cenapody/cenapody.php, accessed 29 August 2016). The value of forest land, ponds and other economic-use water areas is determined by expert opinion and therefore reflects the whole spectrum of factors in the valuation methodology stipulated by statutory regulation.

limited way (e.g., in the case of construction plots[54]). In short, the current real property tax in Slovakia is not purely area based, but indeed contains some elements of market calibration.

Since the tax is imposed and fully administered by municipalities themselves, it also faces challenges. For example, many small municipalities struggle to perform all their administrative duties duly and efficiently, including tax collection. The system of territorial self-government in the Slovak Republic consists of 2,927 municipalities (including 140 cities and 35 urban districts) and eight higher territorial units. According to the 2011 population census in Slovakia, 1,145 out of the total 2,751 municipalities (excluding cities and city districts) had less than 500 inhabitants. However, these municipalities are still obliged to fulfil the duties of a public administration authority, including the administration of local taxes. The problem is partially solved by the existence of joint municipal offices; nevertheless, many tasks of such municipalities remain their sole responsibility (Románová & Červená 2016).

In recent years, the Government of the Slovak Republic (perhaps also due to pressure from the European Union[55]) has been presenting an idea of fundamental reform of the base of property tax. The eventual proposal should move from area-based system to an ad valorem system, which notion was presented in the last several National Programmes of Reforms in the Slovak Republic (Bujňáková & Románová 2014). The case seemed most urgent around 2013 when even the declaration within the mentioned programme envisaged a bold time horizon for preparation of the reform – namely that exact proposals will be finalised during 2013 and a new system introduced by 2015 (Government of Slovakia 2013: 34). The National Programme of Reforms in the Slovak Republic 2014 states (Government of Slovakia 2014: 24):

> "The system in its current configuration is less efficient and less fair because the tax base does not reflect the real value of property ... This, in turn, leads to a different effective tax burden on the property (as a ratio between the tax paid and the price of the immovable property) and regressive effects of the system. As far as tax equity is concerned, an optimum solution is to configure the system in such a way that the tax base will be linked to an estimated market value of a particular real estate. This would

[54] E.g., the GBR for the capital city, Bratislava, sets the value of €179.22 per m^2 as compared to €59.74 per m^2 established by Appendix 2 in the Act on Local Taxes.

[55] See Council Recommendation of 8 July 2014 on Slovakia´s 2014 National Reform Programme and delivering a Council opinion on the Stability Program of Slovakia, 2014 (2014/C 247/23).

> ensure that the tax base would be changing along with the market value of the property and the effective taxation would remain constant at an unchanged rate. The Ministry of Finance is currently examining possible alternatives to introduce a property tax system based on market values of real properties. First steps in implementation of the new system will be taken after 2015."

The proposal provoked strong opposition from the public that feared rising property taxes and thus has not progressed beyond political declarations (Románová & Červená 2016).

There are several factors discouraging more complex reform towards a market-value (*ad valorem*) based approach. First, the nascent real estate market in the Slovak Republic has developed in an unbalanced manner among different regions of the country. Information on a tool that would be used to estimate market prices of properties based on data of offer prices of residential properties has not been presented in detail yet. In our view, the overall tax burden on taxpayers of residential properties is very low, which might create a good starting point for the expected reform, however, other problems emerge, being a large number of asset-rich income-poor citizens and a very high overall tax/social security's burden laid upon average citizens causing general public refusal of *ad valorem* taxation that has always been perceived as a 'huge tax rise'. Other issues such as cost-to-revenue ratio, the accuracy of appraisal and appeals procedures, revaluations, keeping current with market price movements, etc., need to be taken into consideration, as well. Currently, the National Programme of Reforms in the Slovak Republic for 2016 states that the task of the Government in coordination with the Association of Towns and Municipalities of Slovakia is to 'create the technical conditions for change of the system of property taxation towards determining the tax base by the property value in order to increase tax fairness and efficiency concerning local taxes' (Government of Slovakia 2016: 52). Nevertheless, there is no deadline for the fulfilment of this task. The encouraging news is that this task was included in the *Manifesto of the Government of the Slovak Republic 2016-2020*. Under the current circumstances, we do not see the adoption of an *ad valorem* system as a political priority.

3.3 Lithuania – ad valorem basis and low-level revenues

The Republic of Lithuania declared its independence from the USSR in 1990. Separate taxes on land and buildings were introduced respectively in 1992 and 1994. Although the largest of the Baltic countries, it was the last of the three to introduce a market value-based tax – only

in 2006 (Aleksiene & Bagdonavicius 2008). However, the country kept reforming the tax system established in the early post-Socialist period and introducing market value-based taxes on land and buildings with granting a greater role for local government to play in the fiscal decision-making process was identified as a priority in the Lithuanian Governmental Action Programme for 2001-2004 (Sabaliauskas & Aleksiene 2002).

Lithuania started developing computer-based real property data in 1992. Since the establishment of the State Land Cadastre and Register in 1997, a fully computerized real property registration system links land parcels and buildings, and cadastre and register data into one unified system. This enabled the monitoring of changes in the real property market, statistical analysis, and utilization of computer-assisted mass appraisal techniques. This is one of the necessary prerequisites that truly facilitated the introduction of the *ad valorem* system (Aleksiene & Tumelionis 2009). The current property tax system comprises Tax on Real Property (buildings) and Land Tax. These are in reality supplemented by a 'third' real property related tax/fee, the land leasehold fees/tax, that concerns state-owned land units used by private persons and legal entities using their land on long-term rental bases (Aleksiene & Tumelionis 2009; IPTI - Lithuania n/d).

The Land Tax was based on the Law on Land Tax adopted in 1992. Since the tax base was normative (area-based) value of the land, calculated according to the method approved by the government, it met neither fiscal requirements nor did it promote efficient and sustainable land use. In 2002, the so-called Resolution of the Government on the Procedure of Land Appraisal was adopted which established mass valuation of land to be used for land taxation and, in reality, introducing land *ad valorem* tax. However, the severe reaction of the society and mass media forced the Government to withdraw this Resolution in 2003 (Aleksiene & Bagdonavicius 2008).

The legal basis for the current form of 'buildings' tax was the Law on Immovable Property Tax from 2005, which came into force on January 1, 2006 (Aleksiene & Bagdonavicius 2008). The Law was passed aimed at unifying competition conditions for entities engaged in commercial activity extending the immovable property tax base. The tax base is the average market value of the real property determined using the real estate mass valuation and sometimes (industrial property and engineering structures) the value determined by using the replacement value (cost) approach. Tax rates may vary between 0.3 and 3.0 per cent (between 0.3 and 1.0% when it was introduced) under the decision of the municipal council (Aleksiene & Bagdonavicius 2008). The State Enterprise Centre of Registers administers the cadastre

and performs mass valuation. A computerized mass valuation, integrating the information of the cadastre, register and market database into a single system was implemented in 2002-2003. It provided a possibility to evaluate the real property in the entire territory of the country based on single principles, within the defined time and using updated market data. It also allows periodical re-evaluation of property taking into account the market developments. The results were integrated with a geographic information system (GIS) and therefore provided a possibility for public access to the value maps and received mass appraisal results on the Internet (Aleksiene & Bagdonavicius 2008).

Despite not being able to cover also the land tax into a market value based real property taxation system, the reform from 2006 was beneficial (especially in larger cities, where property previously was under-valuated) and improving the distribution of the tax burden (Aleksiene & Tumelionis 2009), nevertheless, it was not sufficient as regards the overall success in reformation of the system towards becoming more efficient and fair. In 2011 Aleknavicius concluded that the real property tax system in Lithuania was not efficient, flexible and fair – there were three different real property taxes with its own taxable base, assessment methods and tax rate. The revenue from real property taxes was less than 0.1 per cent of the country GDP (Aleknavicius 2011). Using market-oriented land taxable value would help municipalities to raise the market value of land within its territory by developing infrastructure and creating more attractive conditions for living and investments. Shifting to average market price as a taxable value would not harm land owners since the average market prices calculated by mass appraisal were much lower than real market value and the same applied to natural persons as regards the residential premises considering the prospective reform of real property (buildings) tax (Aleknavicius 2011).

The land tax was finally reformed towards determination of the tax base on market values in 2011 with effect from 2013, stipulating that the tax base of this tax shall be tax value of land and the taxable value of land shall be the average market value of land. Valuation of land shall be performed by using maps of land value zones prepared by mass appraisal method and the models of assessment of the average market value of land parcels.[56] Tax rate ranges from 0.01 per cent to 4.0 per cent. The highest rate of 4 per cent is applied to abandoned land (IPTI – Lithuania n/d).

[56] Law amending the Law on Land Tax from 21 December 2011, art. 58, 9 and 11.

Various methods within mass appraisal are used – with land it is model based on sales data, with commercial properties models based on sales and income (rentals) data, with industrial properties based on the application of replacement cost approach. Periods between reassessment are one to five years (IPTI – Lithuania n/d). It is the central government who is responsible for the assessment of property values (State Enterprise Centre of Registers). Municipalities receive the real property tax revenues and are entitled to reduce the tax at the expense of their budget or completely exempt from the payment thereof. The country is divided into counties that are formed by 60 municipalities and Lithuania can be considered as a country at a medium level of fiscal decentralisation (Tamošiūnas & Stanytė 2015).

4 Property Tax Reform Efforts

As stated in Section 2, property tax reform efforts started with the onset of the transition process in the early 1990s. Even after almost 30 years, many countries have not moved at all towards more market calibration, while those that eventually adopted value-based tax formulae have generally failed to mobilize significant revenue levels as well as failed to make their 'cadastral values' close to market level and/or to keep value registers up to date. In this section, we discuss two 'unsuccessful' attempts at reform – in the Czech Republic and Hungary. Thereafter seemingly 'successful' reforms in the Estonia and Latvia are briefly discussed.

4.1 'Unsuccessful' *ad valorem* reform efforts in Czech Republic and Hungary

4.1.1 Czech Republic

The current system of property taxation in the Czech Republic consists of land tax, buildings tax and apartment and non-residential properties, all of them based largely on the area. The value becomes a part of the tax base in case of lands, where it is determined either by a ministerial decree (based on soil quality – so-called 'bonitation') or as in case of forestlands and ponds with fish farming determined in line with pertinent price regulations. Value of building plots is reflected in differential tax rates set by the law according to the size of the municipality in which the plot is situated. Municipalities are allowed to increase the final tax (excluding arable land, hop-fields, vineyards, orchards and permanent grasslands) by coefficients; however, only about 8 per cent of municipalities use this possibility (Sedmihradska & Bakos 2016). Alongside with permanent amendments to the regulation

which led to improvement of fiscal performance and quality of tax characteristics, the performance of the tax is still insufficient (at 0.2 per cent of the GDP) and the system as such has not reached a modern standard (Radvan 2012).

Since 1993 the central government has been making efforts for adoption of an *ad valorem* property tax system, but little progress has been achieved to date. Pilot studies on the feasibility of local value maps have been performed since May 2009. With the adoption of a new Civil Code, the definition of immovable property changed. As a result, a new property transfer tax, the Real Estate Acquisition tax, was introduced in 2014. Property tax has been amended only in definition to correspond with the new Civil Code (IPTI – Czech Republic n/d).

Currently, the Czech Ministry of Finance is drafting a bill that will apply an *ad valorem* system of taxation to those parts of land situated in the areas that are or could be developed. The change would not affect the current system of taxation of arable land. The value of land should be determined based on value maps, preparation of which should be the responsibility of each municipality (Radvan, 2014). There are some critical voices to be heard about the intended reform. For example, the unequal treatment caused by the duality of valuing agricultural land using the current approach based on the soil quality (i.e., bonitation), and the other types of land by use of value-based maps. There could be significant costs for municipalities in the administration of the property tax and in the development of the tax base maps (Radvan 2012). Other problem, similarly to Slovakia case, is the large number of asset-rich income-poor taxpayers, which is mainly the result of inheritance of highly valuable real property or acquisition of those through restitution. Radvan (2012) mentions also regulation of rent as an obstacle to the introduction of market value-based approach and doubts the fairness and accuracy of value maps preparation process if those are to be prepared by local persons - the taxpayers of the future tax, but also the competence of persons participating in the determination of value maps, particularly in small municipalities and the subsequent differences in quality of maps among various municipalities. Despite several benefits of *ad valorem* property taxation – better fiscal performance,[57] equity in taxation and incentives for efficient land use (important for urban development), the disadvantages are significant and there is a strong doubt whether the country is already capable of introducing such a demanding and costly reform (Radvan 2012).

[57] This has not worked in the transition countries – the *ad valorem* systems there do not produce considerable revenue levels.

4.1.2 Hungary

In Hungary, early post-socialist reforms included adoption of the Act on Local Self Government and the Act on Local Taxes in 1990 (Tassonyi 2004), where the newly-adopted local taxes, comprising local business turnover tax, a communal tax on entrepreneurs (a payroll tax), a communal tax on individuals (a poll tax), a tax on land parcels, a tax on buildings, a tourism tax, and a land transfer tax, basically extending the pre-existing 'local taxes' collected under the old communist system (Bird & Wallich 1992; Tassonyi 2004). The tax on buildings was then based on useable building area in m^2 multiplied by 300 forints per m^2 per year or on the 'adjusted sales value' (i.e., 50% of the assessed value as per the Act on Duties – at about 25% of market value) with a rate of 3 per cent. Tax on undeveloped plots and land was similarly based on the area or adjusted sales value (in this case 50% of the government determined 'assessed price' corresponding to actual observed market price), but at lower tax rates. As for the communal tax on private persons, this was levied on an individual owning a dwelling or downtown plot of land with a maximum tax rate of HUF12,000 per property (Péteri & Lados 1999; Tassonyi 2004). At least as regards the buildings tax, there is almost exclusive reliance on area measure rather than values (Bird & Wallich 1992). This might partly explain the low tax revenues – with a comment that the amount of local tax paid by a household sector in 1998 (HUF6-8 billion) basically equals the amount the household sector spends on cigarettes (HUF7.5 billion) (Hegedűs 2002).

In 2017 revenues are still generated from the building tax, the communal tax on households and the (development) land tax applicable. The tourism tax is no longer levied and a new tax – public utility tax was introduced in 2013. Regarding the building tax, the local government may still choose whether to use either the usable building area with maximum thresholds, or the adjusted market value of the building ('adjusted sales value' – i.e., 50% of local government-determined 'assessed value', which corresponds to 50% on average of actual observed market value).[58] Almost every municipality using this tax (which is optional) apparently employs the area-based formula. The public utility tax is levied on cables and pipelines and is calculated per running metre basis. It is still the local government who is responsible for the administration of its taxes and for determination of property 'market' value. With over 3,000 municipalities this amounts to quite a high total volume of administrative responsibilities. They also determine the mentioned aspects of the taxes in the

[58] Same principle is used as regards the land tax.

local law, within the central government´s statutory framework. Since the country has traditionally been focused on area-based property taxation, and given the attitudes of municipalities (choosing an area-based formula and exempting residential property), there are few efforts towards market calibration, apart from the central government´s attempt in 2007, which was not successful. This can be ascribed to the lacking interest by local communities, human capacity constraints, missing or weak technical skills, the fragmented housing market, and missing institutional framework (valuation regulations, valuation profession)(Lados 2008).

4.2 'Successful' *ad valorem* reforms in Estonia and Latvia

4.2.1 Estonia

Globally, Estonia is one of the few countries that levy only a land tax (Franzsen 2009). The land tax has proved to be a stable, albeit modest, revenue source for local government, averaging 0.3 per cent of GDP between 2008 and 2015 (Eurostat 2017) and representing 6.8 per cent of local government´s revenues in 2014 (Table 4). It has a high collection ratio of almost 99 per cent and only a limited number of tax appeals of less than 1 per cent annually (Tiits 2008). This tax was introduced in 1993 as a part of land and fiscal reforms in the form of a national tax with shared revenues (Tiits & Tomson 1999; Malme & Tiits 201). Parliament chose to establish a tax on land only tax base, basing its decision on economic, political, and practical considerations. Assembling the information needed to value both land and buildings within a reasonable time, as land and buildings had been treated and recorded separately under the Socialist system, were perceived as nearly impossible. The decision was made to base the tax on land values, which was finally accepted by the public, as a result of an extensive public education effort combined with the use of factors understood by the general public for determining the taxable value (Malme & Tiits 2001). We could not find any evidence comparing the land-use impact of this tax on land as compared to tax on land and buildings. It seems unlikely that the low rate of this tax in Estonia could create significant incentives to influence the behavious of property owners.

The legal framework was created by the Law on Land Tax (effective from 1 July 1993) and the Law on Land Price, adopted in 1992 and then replaced by the Land Valuation Law 1994. The tax base is the capital value of land without buildings, timber, plants, or structures. The tax has been market value-based from its inception, even though the lack of market data has

necessitated the use of market simulation models. Exemptions are limited. The tax rate is decided annually by local councils within the limits specified by national legislation. When the land tax was enacted in 1993, the tax proceeds were to be shared equally between the national government and 256 municipalities. Since 1996, the revenues are fully retained by the local governments. Municipal councils determine the rates, within the limits set by national law (Malme & Tiits 2001). From 2002, local councils have the opportunity to make decisions related to land value zones. This option has only been used by only a few municipalities. Tax rates vary between 0.1 and 2.5 per cent in accordance with a decision of the municipal council. However, the majority of municipalities implement a uniform tax rate for all land and an equal rate for all agricultural lands (Tiits 2008; IPTI – Estonia n/d).

Land tax valuation and collection are central government functions. Valuation is performed by the National Land Board, an agency of the Ministry of Environment, and the National Tax Board in the Ministry of Finance is responsible for the administration of the tax (Tiits & Tomson 1999). These agencies are funded by the national budget (Malme & Tiits 2001). The National Land Board has local cadastral offices in each of the fifteen counties. The central office of Land Board has a responsibility to, for example, arrange valuations, co-ordinate valuations, approval of valuation schedule, coordination and control of the assessment as well as approval of assessors. It is also responsible for preparation of methodology, it supports education and it has the authority to revise valuations and of advising on the implementations to methodology (Malme & Tiits 2001).

When the first valuation of land was undertaken in 1993, the obstacles were enormous. The valuation system developed for urban land combined an area-based pricing system using market criteria for location, quality, and usage to create relative price zones among and within each urban area. Relative market desirability was established through opinion and judgment by expert valuers and local officials, augmented by whatever reliable price information was available. In the two largest cities, Tallinn and Tartu, rental information could be capitalized into values. The same method was used for rural land, although separate criteria related to soil capability and productivity as well as location. The final valuation report with price schedules for each area required approval by the municipal council. This basic methodology has been used for land taxation since 1993. The 1994 Law on Land Valuation set forth the legal basis and procedure for land valuation, whether for private or public purposes (Malme & Tiits 2001). Preliminary assessment values are posted on the internet and in meetings some months before the roll’s publication. Taxpayers have the

opportunity to evaluate and give feedback on the parameters employed in the mass appraisal model, the accuracy of the physical characteristics applied to their property and the accuracy of the property value (IPTI – Estonia n/d).

Currently, despite the overall satisfaction with the tax indicators, one of the problematic issues is the lack of statutory-based periods for reassessment. According to the law, the period is rather vaguely based on significant changes in land market circumstances. In reality, the last re-assessment was carried out in 2001 (IPTI – Estonia n/d) which influences the ratio of market value in particular year and assessed values 2001 which disturbs the equal treatment of taxpayers (Tiits 2008). Another issue raised by Tiits (2008) is the ratio of costs of collection and valuation to revenues, which should be lower and there are also opinions stating that the tax has potential to raise much more revenue than currently does.

4.2.2 Latvia

Latvia levies a land tax and a tax on immovable property. These taxes provide a source of revenue for local government. As indicated in Table 4, these taxes constituted 0.8 per cent of GDP (IPTI – Latvia n/d) and 8.9 per cent of local government revenues in 2015, as opposed to 1.4 per cent in 1999 (Bird 2004b). Although the revenues accrue to local government, the base and tax rate threshold are determined nationally (Bird 2004b). Current regulation is based on the Law on Immovable Property of 1997 that was implemented in 1998 (Bird 2004b).

Since 2010 the base of taxation for all land and buildings subject to taxation (i.e., all objects in the National Real Estate Cadastre Information System) is the appraisal value. Previously other approaches were used, for example between 1998 and 2006 book value was used for buildings and fixed assets (IPTI 2017). The cadastral value base shall be a set of data characterizing the value necessary for calculation of the cadastral value – base values and correction coefficients, which, on the basis of analysis of data of the real estate market, has been specified for the group of cadastre objects in terms of values within a relatively homogenous territory – zone. In the development of the base of cadastral values assessment methods specified in the standards for assessment of real estate recognized in the state shall be observed – the method of comparing transactions, income capitalization method and method of costs (according to Art 67 and 69(1) of the Law). The values shall be assessed according to the situation in the real estate market, which existed eighteen months before the application of the values base to the calculation of values (reference date – 1 July). The

assessed value level shall be on average 85 per cent of average market prices valid on the reference date. Revaluation of property in accordance with the market situation is performed every two years.

Local municipalities (by adopting binding regulations) are entitled to determine tax rates within the limits of 0.2 per cent up to 3 per cent (set nationally). A tax rate exceeding 1.5 per cent shall be determined by a local municipality only in the case that particular real estate is not maintained in accordance with laws and regulations.

The State Land Service (acting under the guidance of Ministry of Justice) maintains the National Real Estate Cadastre Information System and the Real Property Market Data Base. It is also responsible for mass appraisal (market analyses, development of assessment models, value zonings, determination of models´ parameters, ratio analysis) and performing automated assessments of all cadastral objects according to data included in the cadastre. The Cabinet of Ministers approves the base of cadastral values, confirms regulations on mass appraisal, value zoning, and models´ parameters in two-year periods. Municipalities are responsible for the administration of property taxes and for the proper exercise of conferred powers through binding regulations.

5 Possible Ways Forward

5.1 Strategic approach rather than incidental initiatives

Lessons learned from the 'successful' and 'unsuccessful' property tax reforms in the selected CEE countries indicate that there is a need for a comprehensive strategic approach to property taxation rather than a patchwork of incidental efforts driven either by valuation or collection interests alone. The *ad valorem* reform needs to be 'demystified' in that it is a means to an end rather than the end in itself. The strategic approach requires a certain sequence of steps beginning with the determination of the role of property taxation in the fiscal architecture and in other policies including the non-fiscal concerns with land-use efficiency, which is key to this paper.

A broad consensus is required on the need for a significant level of property tax revenues as a way to fund necessary local services and infrastructure and that means considerable tax burden on the taxpayers who need to understand tangible benefits of this tax. This should, in turn, make room for a 'tax solidarity' argument linking the tax burden level with the number of taxpayers carrying it – more taxpayers (hence tax solidarity) means lower tax burden on

individual taxpayers. In consequence, the tax solidarity arguments should help reduce the over-generous tax relief measures.

The strategic consensus on the higher level of tax revenues, and thus higher tax burden should make it possible to make bolder calls for more equity in sharing the high tax burden through increased market calibration so that taxpayers of similar value properties pay similar levels of property tax. And once the equity argument is accepted the discussion about the best ways of market calibration and its 'political packaging' can be addressed.

5.2 Modernization rather than reform

Machievelli (1995: 19) stated that

> "… there is nothing more difficult to carry out, nor more doubtful of success, nor more dangerous to handle, than to initiate a new order of things. For the reformer has enemies in all those who profit by the old order, and only lukewarm defenders in all those who would profit by the new order, this luke warmness arising partly from fear of their adversaries, who have the laws in their favour; and partly from the incredulity of mankind, who do not truly believe in anything new until they have had the actual experience of it."

Political economy has been at the root of many failed reform efforts. The societies of the transition countries have become 'reform fatigued' and respond adversely to proposals of further reforms.

A more tactical approach may, therefore, be to 'dress up' the reform efforts into 'modernization efforts' by focusing the advocacy efforts on failures of the existing system rather than extolling the virtues of the *ad valorem* system. Consequently, the criticism of the existing area-based formulae should focus not so much on equity (given the low tax burden), but on the need reduce economic waste and speculation, i.e. to make property owners use their properties more efficiently, especially if they are located in attractive locations that have been 'improved' through considerable public spending efforts. The arguments for 'value capture' and for better 'land-use efficiency' should help make the case for more market calibration, which can be added as a modernization measure of the existing area-based systems rather than radical *ad valorem* reforms. This has been well demonstrated in some non-transition countries like India and Israel where market calibration of area-based property taxation has worked considerably well at high administrative simplicity. Taking a longer-term

perspective, market calibration should ideally progress step-by-step and eventually lead to a smooth transition to an ‘overt’ *ad valorem* tax base – all in a favourable political economic climate. Such a strategy worked successfully in, for example, The Netherlands, where property tax jurisdictions had an option or using either area-based taxation or ad-valorem taxation. While are-based taxation was easy to administer there was a need to apply market calibration to tax amounts, which necessitated market knowledge. Market calibration coefficients, such as location, type and age, were used to differentiate tax amounts and with time it was realized that it was more transparent to switch to market-value ad valorem tax basis (Verbrugge 1999).

5.3 Recognition of additional non-fiscal goals

Although the fiscal goals are typically the main argument for property taxation, there are other goals that help convince the politicians to agree on increased market calibration. The additional benefits generated by attainment of the non-fiscal goals help improve the cost-benefit ratio of proposed modernization efforts. The benefits of more efficient urban land uses and consequent increase in urban productivity are difficult to prove and quantify, but given the sufficiently high tax burden, their incentive effects should be explicitly recognized. UN-HABITAT (2011) has articulated this importance by showing how efficient land and property taxation can foster infrastructure and services in cities and promote urban development including affordable housing.

The problem with promoting the non-fiscal agenda is that the fiscal interests (i.e., finance ministries) are not going to articulate these effects and there is a need for appropriate ministry (planning, construction, housing and the like) to request more market calibration of the property tax in order to create incentives for more efficient use of urban land and buildings. This is what this discussion paper argues for as an additional argument for more market calibration of property taxation in the transition economies.

6. Concluding comments

There are some common features of the countries that still have not moved to value-based taxation of real property. First, there is strong public opposition to taxation of real property because of: (i) a large number of asset-rich income-poor residential taxpayers; (ii) high overall burden of taxation and public/social (security) payments; and (iii) the traditional view

that if someone built a house or inherited it from their parents, no additional tax burden should be placed on it. Second, when taxpayers pay low property taxes, they do not necessarily care about equity considerations, since they treat the property tax payments as 'administrative fees' and thus do not require tax burden differentiation reflecting 'relative values' – i.e., ensuring that taxpayers with higher-value properties pay more than those owning lower-value properties.

The negative attitudes to property taxation always surface when governments express intention to reform or at least adjust the current tax regime. The governments well know of these issues which explain why *ad valorem* reforms have been unsuccessful in various transition countries. Unbalanced or immature real estate markets are factors impeding reform progress and exacerbated further by the post-Socialist legacy of incomplete or invalid cadastral data. Another hindering factor, already mentioned earlier, is the unfavourable revenue/cost ratio with high initial costs that need to be incurred upon implementation of the *ad valorem* system. The governments well know that the high initial costs need to be recovered through higher revenues (i.e. tax burden), which will raise taxpayer fears and public opposition. The only way to move forward with the stalled reforms is to increase the public awareness that property taxation is the way to collectively pay for the necessary local public benefits in the form of non-fee services and infrastructure, without which there will be no progress in urban liveability and quality of life. That requires an intensive public relations campaign including the assurance to the taxpayers that an effective and equitable appeals system will be in place.[59]

Those CEE countries that have implemented *ad valorem* systems have attempted to develop the necessary infrastructure regarding information about properties and market activity, including provisions for necessary updating. They have been able to articulate additional benefits of better-informed market participants thanks to better information infrastructure. However, these countries have failed to increase the level of taxation so that they could maintain the necessary infrastructure and reassessment of values would be frequent enough to guarantee that 'cadastral values' reflect market levels and their timeliness. In Lithuania, for example, the *ad valorem* model uses an artificial division of real property into separate components of land and buildings and then analytically assigns separate 'market values' to

[59] Various political economic issues related to property tax reforms are thoroughly discussed in Bird and Slack (2014).

the land and buildings components (IPTI – Lithuania n/d). This is not how the market operates making it difficult to explain the system to politicians and taxpayers.

Perhaps the most telling story is that of Estonia that is sometimes used as a model *ad valorem* country in transition that started with 'relative values' even before the market mechanisms produced sufficient market evidence. Estonia has not revalued its land values since 2001 (Tiits 2008), which resembles the problems of many advanced economies (such as Germany, Great Britain[60] and Spain) with the political economy of revaluations. The valuation-driven *ad valorem* reforms, which seems to be the typical case in the transition countries reviewed, suffer from the common failure to first agree on the importance of property taxation as a source of revenue; only thereafter followed by the reforms that will lead to implementing the *ad valorem* system.

Although the fiscal goals are typically the main argument for using property taxation, the articulation of non-fiscal benefits can help convince politicians to dedicate more financial and political capital towards increased market calibration of simple area-based property taxation. However, the benefits of more efficient urban land uses and consequent increase in urban productivity are difficult to prove and quantify, especially with the current low tax burdens and relatively weak tax incentives for more efficient land use.

We hold the view that a value-based or a market-related calibrated recurrent property tax levied at meaningful levels (i.e., with an appreciable tax burden), especially on the land component, may improve (re)allocation of urban land and property and result in more efficient land use. However, achieving this goal in practice often seems to be a bridge too far – given the political challenges alluded to. The revenue and burden of the tax on taxpayers of especially the recurrent property tax in most CEE countries are too low – as evidenced by Tables 1 and 3 – to achieve this desirable goal.

The political economy of property taxation in the CEE countries, which has been at the root of many failed reform efforts, would need to change through recognizing non-fiscal benefits of market-calibrated taxation. This would require giving political voice to ministries dealing with local urban planning, development and housing so they could articulate their request for sufficient market calibration of property taxes. Fiscal arguments of revenue mobilization, expounded by finance ministries, would then be changed to tax base formulae.

[60] As regards the council tax in Great Britain there has been no revaluation since its introduction in 1991.

We believe that such an approach would, at a political-economic level, help make a plausible cost-benefit case for more market calibrated taxation, especially regarding urban land.

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