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BARRIERS TO THE SUCCESSFUL IMPLEMENTATION OF PROPERTY TAX REFORMS

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World Bank/ FAO Knowledge Project Aims

- To identify good practice in mass valuation systems, valuation infrastructure and property tax reforms with the framework of the *Voluntary Guidelines on Responsible Governance of Tenure*
- Focus on value-based recurrent property taxes in the Europe and Central Asia Region (ECA)
- Identification of pre-conditions needed for the successful introduction of value-based property taxes
- Identification of the obstacles to property tax reform and the strategies that can be used to overcome obstacles
- Many of the lessons learned are applicable to other regions and not confined to ECA

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Project Methodology

- **9 case studies**: Albania, Kazakhstan, Lithuania, Moldova, Netherlands, Poland, Serbia, Slovenia, Turkey.
- **Range of countries** from those who had implemented successful value –based property tax reforms to those experimenting with pilot studies
- Role of the **Netherlands** as a **control** – successful system of value-based property taxation with annual reassessment, assessment by municipalities with central standards setting body
- Case studies published in *Land Tenure Journal*, issue 2, 2015
- Use of **common template**: outline of property tax system, role of property taxes in public finances, how property taxes assessed, valuation standards and infrastructure, mass valuation, lessons learned from reforms

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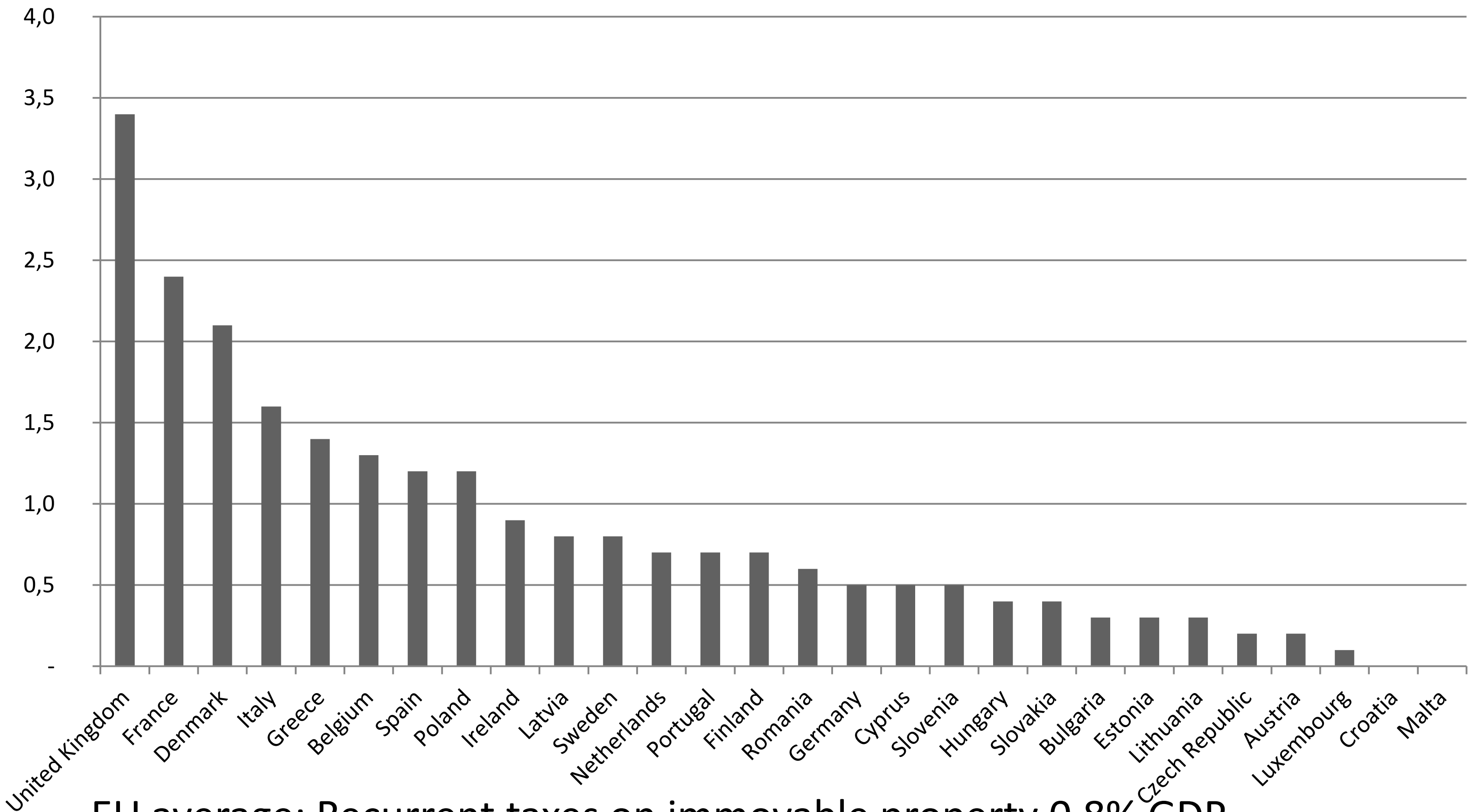
Role of Value-based Property Taxes in Fiscal System

- Difficult to avoid as they fall on **immobile assets**
- Suitability as local taxes as they **identify those with a stake in the community**
- Less prone to leak **across jurisdictional borders** than other taxes
- Amongst the **least affected** taxes by **globalisation**
- Fall on wealth and so identify those who have **ability to pay**
- Relatively **neutral** in impact on economic activity
- Enable communities to **share in the rising property prices** to which they have contributed through economic, urban, and demographic growth
- Encourage **productive use of land**

Recurrent taxes on immovable property as a percentage of Gross Domestic Product in the countries of the European Union, 2012



EU average: Recurrent taxes on immovable property 0.8% GDP

Source: Eurostat (2014) *Taxation Trends in the European Union,* Luxembourg

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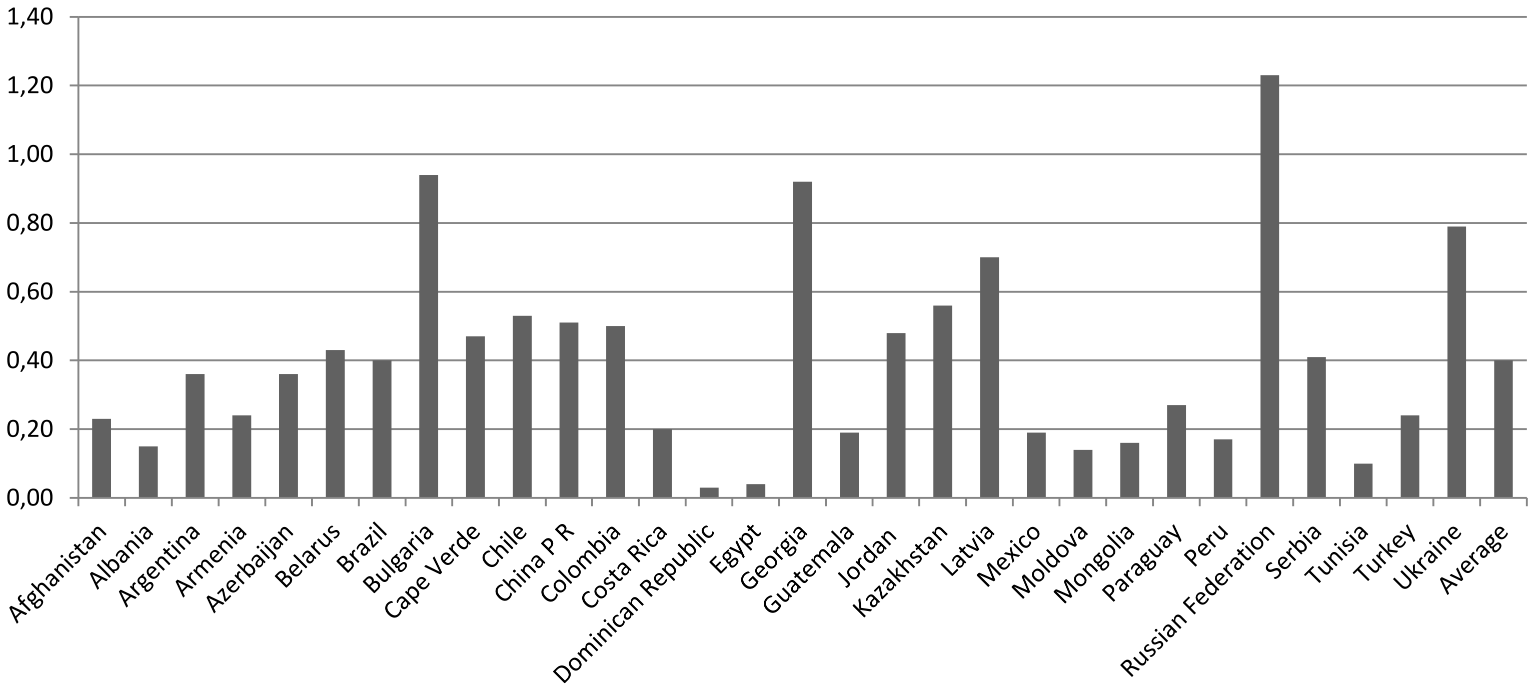
Recurrent Taxes on Immovable Property as a Percentage of the Gross Domestic Product in Selected Middle- and Low-Income Countries, 2010



Source: Norregaard (2013), *Taxing Immovable property - Revenue Potential and Implementation Challenges*, International Monetary Fund

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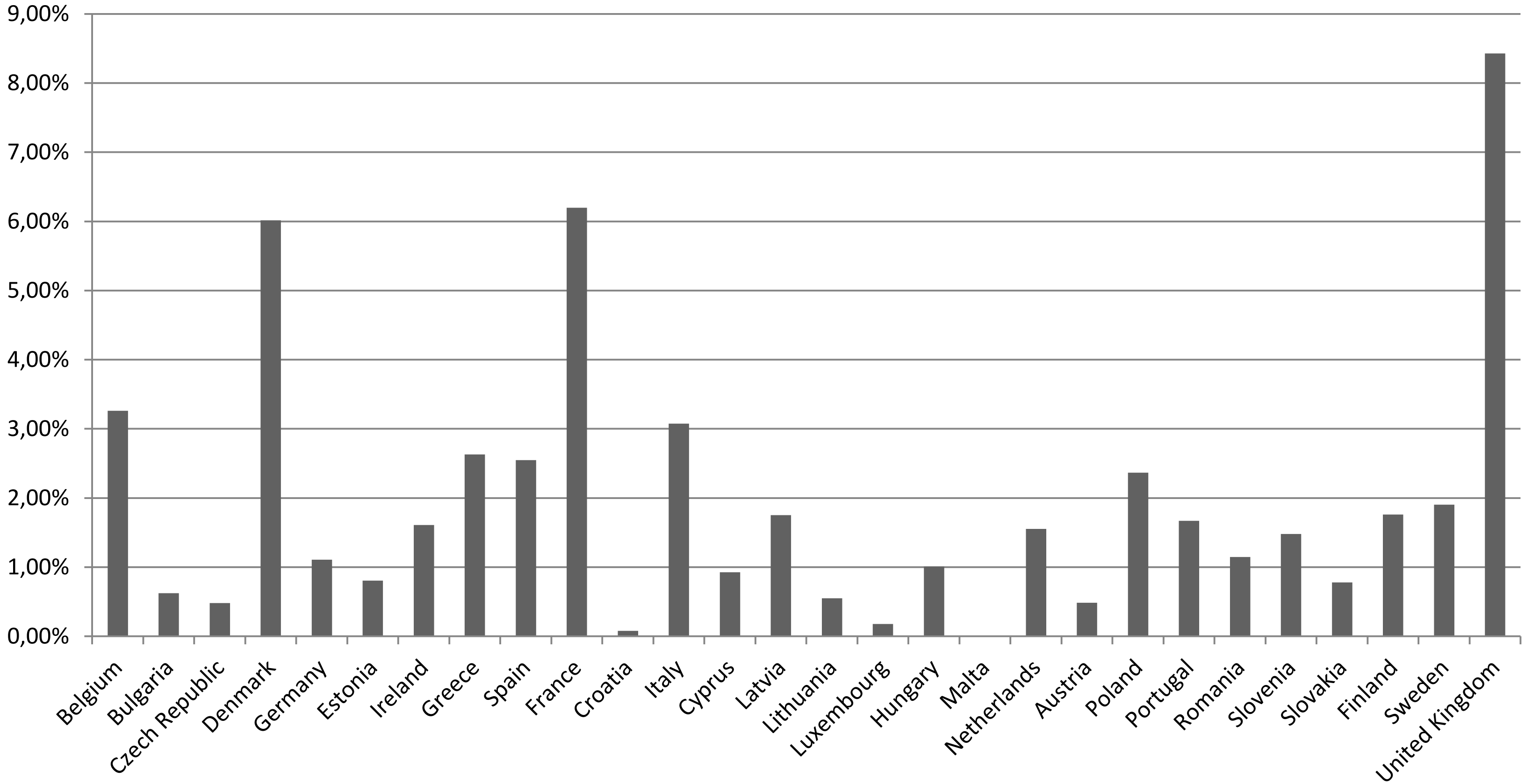
Recurrent Taxes on Immovable Property in the EU as a Percentage of Gross Value Added Less Employee Compensation



Source: Eurostat (2014) with calculations by the authors

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If value-based recurrent property taxes are so good, why is greater use not made of them?

- Almy (2014) identified **166 countries** with recurrent property taxes
- Issue is that they are **lightly used** rather than being absent
- The **problem is the tax base** most countries use: area or based on inventory or cadastre values rather than market values
- Result is that most governments have no idea what the **effective tax rate** they impose is
- Therefore tax based on **convoy principle** (everyone travels at the speed of the slowest) rather than on ability to pay

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Consequences of inaction

- Local governments **impose other taxes and charges** that can have adverse effects on business and the local economy
  - ***Serbia***: 15 communal fees before 2012 reforms eg on business signage, the keeping of animals, gambling, and local business taxes particularly on banks, casinos and petrol stations
  - **Slovenia:** Land use fee
  - ***Moldova***: Include fees on commercial units and services, advertising, and markets, local payroll taxes, passenger transport tax, accommodation tax
  - **Pseudo property taxes** on development and town planning consents
- Local governments can become dependent on **revenue from land sales**
  - ***Turkey***: Metropolitan municipalities cannot levy an annual property tax
- Local governments can become dependent on **inter-governmental fiscal transfers** and lack incentives to maximise **own source revenues**

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Main problem areas

- Technical issues:
  - Lack of comprehensiveness of tax registers
  - Poor quality of data about property prices
  - Quality of valuation infrastructure
  - Quality of tax administration
- Governance issues:
  - Lack of champions of reform
  - Opposition to tax reforms

Comprehensiveness of tax registers

- Is there a **comprehensive** register of properties? Is it **up to date**? Does it record just **parcels or three dimensional** sub-divisions of properties into occupancy units? Are the **characteristics and attributes** of properties recorded?
  - ***Serbia:*** Thought to be 2.8 million unregistered properties due to poor planning during rapid urbanisation, influx of refugees during Yugoslav wars, and high cost of legalisation. Typical municipality 20-40% properties not taxed. Work in progress on comprehensive buildings register using satellite imagery.
  - ***Moldova:*** Mass valuation identified up to 30% properties not recorded in registers. Systematic first registration not completed for rural areas or for public sector properties. Mass valuation covers just 12.5% of properties.
  - ***Albania:*** Properties no registered until disputes resolved.
- Potential **one-off benefit** from increased tax registrations

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Quality of price and property data

- Need for source of **accurate price data** as basis for estimating market prices eg declared prices on registration
- Active markets for all types of properties in all locations or **missing cell problems**
- Problem of **tax evasion and declaration of false prices** – incentives to cheat to avoid taxes and fees
  - ***Moldova***: 90% of registered prices thought to be false due to capital gains tax at 18
- **Weak tax enforcement** mechanisms undermine data quality
- Unreliable data can be declared about **property characteristics** eg size
- If declared transactions prices **unreliable** can use asking prices, mortgage valuations, databases of valuers and realtors
- Development of sales price, rental and mortgage valuation **registers**
  - ***Serbia***: Sales price register from registered contracts
  - Reforms to encourage accurate price data: Lithuania 0.8% registration fee

Quality of valuation infrastructure

- Even mass valuation requires **competent valuers** – to advise on models and data cleaning, value properties that cannot be modelled, hearing of appeals
- Valuation infrastructure = valuation **standards**, **qualifications** of valuers, **ethical** standards and codes of professional conduct, **terms of engagement**
  - ***Serbia:*** Pre-2017 mortgage valuations could only be undertaken by court experts – construction qualifications but not valuations. Other valuations unregulated. IMF forced government to adopt new valuation law.
  - ***Lithuania***: Association of Property Valuers established in 1994.General property valuation principles approved by the Government in 1995. Law on Fundamentals of Valuation of Property and Business (1999) established valuation procedures. Ministry of Finance began certifying valuers in 1998.

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Quality of tax administration is important

- Reliable **tax billing and collection** systems. What are collection rates for billed taxes?
  - ***Moldova:*** Collection rates 90-99% but collection costs 43% of revenue.
  - ***Albania:*** less than 50% in urban areas due to lack of effective enforcement mechanisms resulting from informal transfers
- **Culture** of tax payment. Do people think it acceptable to evade property taxes? Is there **corruption** in tax system? Is tax system **transparent**?
- How extensive are tax **exemptions**?
  - ***Moldova***: 15% discount for payment six weeks before deadline. Many personal exemptions. Exemptions amount to 27% of maximum tax revenue payable by individuals and 55% of that for entities.

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Resistance to reform

- Property taxes are **highly visible** and intrusive – not stealth taxes
- Quality and management of **local services** highly visible
- Conflict between **ease** of imposing mass valuation on **residential** properties (and voters) compared with **technical difficulty** on (non-resident) **commercial** property owners
- Taxation policy the responsibility of Ministry of Finance – property taxes out of their **comfort zone**. Issue of whether there are **champions** in government.
- Wealth taxes **unpopular with the wealthy** – have the resources to oppose them.
- Beneficiaries **unorganised and inarticulate**
- Opposition is not always rational and can be out of proportion to tax burden
- Problems of **cash-poor asset-rich** households eg due to housing privatisation and low pensions

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Case studies of opposition (1)

- ***Poland:*** Work started in 1993 with legislation in 1997 and 2005. Further work 2012. Preparatory work for a new system but **no commencement date or source of funding** identified. Technical guidelines still have to be adopted Electronic property registers not fully developed. or how costs will be met. **Lack of political will** and belief by public that reforms will **increase tax burden**.
- ***Moldova:*** Mass valuation undertaken for urban housing and commercial and industrial properties 2004-11. **Revaluations not carried out** for financial reasons. **Not extended to rural areas** due to lack of funding for systematic first registration or delineation of public lands. **Beneficiaries are local governments** but costs fall on central government.

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Case studies of opposition (2)

- ***Slovenia:*** Introduction of mass valuation in 2013 **opposed by municipalities** and some residential taxpayers. New system mixed up with proposals to **change balance** between residential and commercial properties and for central government to take part of the revenue. Blocked by **Constitutional Court**.
- ***UK:*** Recurrent property taxes on **non-residential property regularly revalued to current market values**. **Council tax on domestic properties has not been revalued since 1992**. Values by type of property and regions have changed by different rates so no longer horizontally equitable. Use of bands rather than individual valuations but **problems of open-ended band H** and **lower bands paying higher percentage of values than upper bands**. Plans for revaluation have been abandoned in favour of higher rates of property transfer taxes.

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Conclusions

- Development of effective and efficient value-based property taxation a **long-term goal**
- Likely to require **several iterations** – successful innovators did not do this in one go
- **Opposition can be well-organised** and resourced but there can be a lack of champions in government
- **No universally applicable model** – need one that reflects individual circumstances – but common challenges
- Sensible to **focus** first on **higher yielding properties** – grade A offices, shopping malls, luxury villas rather than mass housing and agricultural land – produce quick gains for popular support
- Some **improvements** can be made to yields through more **comprehensive tax rolls** and **better collection methods**
- **Sustainable growth** in revenue requires **value-based property taxes** with regular revaluations to capture uplift in property values

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