

**Valuing Land For Tax Purposes in  
Traditional Tribal Areas of South Africa  
Where There Is No Land Market**

Michael E. Bell and John H. Bowman  
With Lindsay C. Clark

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**Lincoln Institute of Land Policy  
Working Paper**

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Lincoln Institute of Land Policy  
113 Brattle Street  
Cambridge, MA 02138-3400

Phone	617.661.3016
Fax	617.661.7235
Email	<a href="mailto:help@lincolninst.edu">help@lincolninst.edu</a>
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## **Abstract**

South Africa envisions extending value-based property taxation, long established in white, urban areas, into rural areas and former black local authority areas (BLAs). Special problems arise in rural tribal areas, where continued traditional communal land ownership means property markets will not develop to provide values. A workshop held in a tribal area of Limpopo province sought to assist local residents identify land attributes affecting the relative desirability of different plots, and to apply those criteria to selected plots as a step toward developing taxable values that are reasonable proxies for market value. To inform this process, a literature review was undertaken to learn about tax practices in 11 countries imposing property taxes without good market data. Most use area-based taxes, with the base and/or rates adjusted for factors that might (or might not) move the distribution of tax liabilities closer to a market-based outcome. For further insight, a case study was made in one of these countries, Slovakia.

## About the Authors

**Michael E. Bell** is President of MEB Associates, Inc. and Executive Director of the Coalition for Effective Local Democracy. Dr. Bell is also a Research Professor at the George Washington University Institute for Public Policy. Dr. Bell's background is in public finance, with a specific focus on state and local finances and intergovernmental relations. He has recently been involved in projects to strengthen the capacity of local self-government in newly emerging democracies through in-country workshops, internships, study tours, expert missions and research projects. Recent projects in South Africa have focused on strengthening local democratic governance by encouraging greater citizen participation and strengthening local property tax administration. Dr. Bell has edited five books and published articles in several journals including *National Tax Journal*, *Public Finance*, *Urban Studies*, *Journal of Urban Economics*, *Environment and Planning C: Government and Policy*, *Public Budgeting and Finance*, and *the Regionalist*.

Contact information:

MEB Associates, Inc.

P.O. Box 869

Mc Henry, Maryland 21541

Phone: 301-387-9030

Fax: 301-387-4066

E-mail: [MEBAssociates@starband.net](mailto:MEBAssociates@starband.net)

**John H. Bowman**, Professor Emeritus at Virginia Commonwealth University, served 23 years in the Department of Economics. Since arriving at VCU in 1981, he has been a consultant on tax studies in many states, including Minnesota (1984) and Virginia (2000). Among earlier positions, he was head of an Ohio Department of Taxation unit responsible for tax policy analyses and revenue estimation, and was Senior Resident in Public Finance with the former Advisory Commission on Intergovernmental Relations (ACIR) in Washington, DC. He served 12 years as a member of the editorial board of the *National Tax Journal*. Since 1995, he has worked with Michael E. Bell on a series of projects on South African property taxes, with at least partial funding of most projects provided by the Lincoln Institute of Land Policy, including their first (2004) David C. Lincoln Fellowship in Land Value Taxation.

John H. Bowman

Emeritus Professor, Virginia Commonwealth University

8201 Marwood Drive

Richmond, VA. 23235

Phone 804-745-9169

e-mail: [jhbowman1@verizon.net](mailto:jhbowman1@verizon.net)

**Lindsay Clark**

Research Assistant, Urban Markets Initiative

Metropolitan Policy Program

The Brookings Institution

1775 Massachusetts Avenue

Washington DC 20036

(P) 202 797 4395

(F) 202 797 2965

[lclark@brookings.edu](mailto:lclark@brookings.edu)

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# Valuing Land for Tax Purposes in Traditional Tribal Areas of South Africa Where There Is No Land Market

## Preface

In December 2000, South Africa implemented the final stage of local government reform. This final step extended the boundaries of municipal government to cover the entire country – every piece of land in South Africa now lies within the boundaries of some municipality. In the rural areas this has created some tensions because there now are two governance structures in the same spatial area. One is a “western style” municipal government with elected councils, and the other is the traditional tribal authority. Because municipalities are required to establish a property tax policy that applies throughout its area, the question of how to include traditional tribal lands arises, where much land is owned commonly and managed by the local chief.<sup>1</sup> One approach to bringing these areas into the property tax base would be to privatize land ownership and allow property markets to develop, in the process generating value information needed for administration of a property tax. However, this undermines the tradition of communal land tenure, perhaps unnecessarily.

An alternative possibility seems to be blanket exclusion of tribal lands from the property tax roll, under the exemption authority contained in the new national property tax law.<sup>2</sup> Some may view exemption as a way to avoid the tension of applying municipal taxes within traditional authority areas. The attractiveness of this is increased by the view that adding these areas to the tax base entails substantial administrative costs without the promise of much revenue because, at least at this time, since tribal areas have comparatively little property of any great value. Blanket exemption seems inappropriate, however, because even now many properties in the tribal areas are substantial, indicating ability to pay taxes. Over time, more ability is likely to develop within these areas. While blanket exemption might seem attractive from the standpoint of the tribal authorities, and thus appear to municipal leaders to be a way to avoid tension between the two local governance forms, it seems likely that people outside the tribal areas would find blanket exemption to be a source of inequity – a feeling that is likely to grow as services in tribal areas improve and the areas become somewhat more prosperous.

The purpose of this project is to go into such a rural area to explore ways of including the land held under traditional land tenure systems in the property tax roll of the municipality where it is now located. The project has three distinct, albeit related, activities.

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<sup>1</sup> While the chief is responsible for managing the land and allocating sites to individuals and families, the tribe technically does not own the land. Since blacks have been prohibited from owning land going back as far as around 1913, the central government technically owns the land and holds it in trust for the tribe.

<sup>2</sup> The new national property tax act, *Local Government: Municipal Property Rates Bill* [Act No. 6, 2004, <http://www.dplg.gov.za/html/docs/PDFDocuments/a6-04.pdf>], passed by Parliament and signed by President Mbeki in May 2004, allows municipalities to establish differential rates for various categories or uses of property, including “formal and informal settlements,” “communal land” and “state trust land” [Part 2, Section 8(2)(k-m)]; moreover, exemptions and other forms of relief may be determined for the categories listed in Section 8(2) [Part 2, Section 15].

Specifically, we

- undertook a reconnaissance of the experiences of other countries implementing a local property tax in the absence of a well-defined real estate market to see what lessons could be learned from their experiences;
- conducted a more in-depth case study of one country, Slovakia, to see how it implemented a local property tax when there was no real tradition of private property; and
- explored how we might include traditional tribal land on the property tax roll of a rural municipality in South Africa.

The three chapters of this final report reflect these tasks. The first chapter contains the results of the reconnaissance of experiences of other countries. It identifies several lessons learned that emerge from the reconnaissance. The following chapter then explores these general lessons in the context of a specific country, Slovakia, which has been wrestling with the issue of implementing a local property tax when there is no well-developed real estate market. The final chapter explores how these lessons might inform the extension of the local property tax to traditional tribal lands in rural South Africa.

## **Section I: Property Taxation in the Absence of Property Market: A Literature in Review**

### **Introduction**

A critical component of fiscal decentralization is the ability of local governments to generate their own revenue to deliver public services to their constituents. Property taxation has proven to be an appropriate and important source of revenue for local governments. However, it can also be politically contentious if citizens are unfamiliar with property taxation or if the tax burden is not distributed equitably. A market-value-based property tax system allows for a more equitable distribution of the tax burden than other non-value-based systems because it better reflects the benefits of location, quality, or use of property. However, such a system requires a well-developed property market.

Many countries in the process of transitioning to a decentralized government and a market economy still tax property despite the lack of a well-developed property market. Even if a property market exists, developing and transitional countries may lack the financial and technical resources to implement an ad valorem tax. In examining the development of property taxation in Central and Eastern European countries, Malme and Youngman found that “the absence of developed property market requires the choice among formulary values, price approximations, and non-value means” to determine

property value<sup>3</sup>. The purpose of this review is to identify a set of countries that have implemented a property tax system in the absence of a well-developed property market, or use a method of property assessment other than value, to answer three questions: What types of non-value-based methods are used for property assessment? When a non-value-based method of assessment is employed, what type, if any, adjustments are made to the base to account for differences in property, such as the location, use, quality, etc., to better reflect value? And finally, if adjustments are made, how are these adjustments determined? In addition to answering the three primary questions, the governmental and political context within which the local property tax is operating are also briefly discussed.

The property tax systems in 12 countries are examined in this review: 11 transitional and developing countries from Central and Eastern Europe and East Africa, and one developed country, Israel. All of the 11 transitional and developing countries lack a well-developed property market and, therefore, at least in part, use some type of non-value-based system to assess property. Israel is the exception in that it employs a non-value-based property tax system, despite the fact it has a well-developed property market.

Before reviewing the select countries, the next section briefly outlines the advantages and disadvantages of non-value-based systems.

#### **Overview of Non-Value-Based Property Assessment<sup>4</sup>**

Area-based formulas are a commonly used means of assessing property in the absence of a well-developed real estate market, although other methods of assessment are possible, such as counting the number of windows on a structure. Area-based formulas use the area of land and/or buildings as the taxable base. The area of the property is then multiplied by a tax rate, which is a fee per unit of measurement, to determine the amount owed by the owner or user of the property.

The advantages of an area-based property tax system are that it is cheap to administer, reevaluations are infrequent, and it is less volatile because the tax base does not fluctuate with the market. Under a market-based system, the valuation of property can be costly and require resources and expertise often unavailable in developing countries. Moreover, area-based measurements are more understandable and less subjective than value-based measurements, and, therefore, may be politically more acceptable. The low cost and

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<sup>3</sup> Malme, Jane H. and Joan M. Youngman. 2001. *The Development of Property Taxation in Economies in Transition: Case Studies from Central and Eastern Europe*. (Washington, DC: World Bank), pg 1.

<sup>4</sup> This section draws heavily from Almy, Richard. 2001, "A Survey of Property Tax Systems in Europe." Prepared for the Department of Taxes and Customs, The Ministry of Finance, Republic of Slovenia; and Bird, Richard M. and Enid Slack. 2002. "Land and Property Taxation: A Review (Washington, DC: World Bank Institute).

simplicity of area-based assessments may be an important advantage for fiscally strained localities.

There are also important disadvantages of an area-based, or other non-value-based, assessment methods. As mentioned above, market prices better reflect the benefits of location, quality, or use of property, which area alone does not. For example, all other things being equal, properties located near a transit system, a park, or other public amenities are more desirable. The inability of the area-based systems to reflect these differences in property values may result in an inequitable distribution of the tax burden, with a larger share falling on low-income taxpayers. Area does not reflect ability to pay, which may compromise public acceptance. Moreover, while the amount of property taxes owed may be less volatile, because the area of property does not fluctuate with the market, property revenues are less buoyant under an area-based system.

Some of the disadvantages of the area-based system can be mitigated through the use of differentials, or a classified property tax system. Differentials classify property based on differing characteristics that affect the value of property such as property use (e.g., residential vs. nonresidential) or location. Differentials can take the form of a classified rate structure, which are variations of tax rates applied based on differing property characteristics, or adjustment coefficients, which are applied to the area measurements, again, based on differing characteristics. Differential tax rates and adjustment coefficients may also be used together and are in many of the former Soviet Union countries discussed in this review.

## **Case Studies of Transitional and Developing Countries in Central and Eastern Europe and East Africa**

### **Central and Eastern Europe**

#### **Albania**

##### **Background**

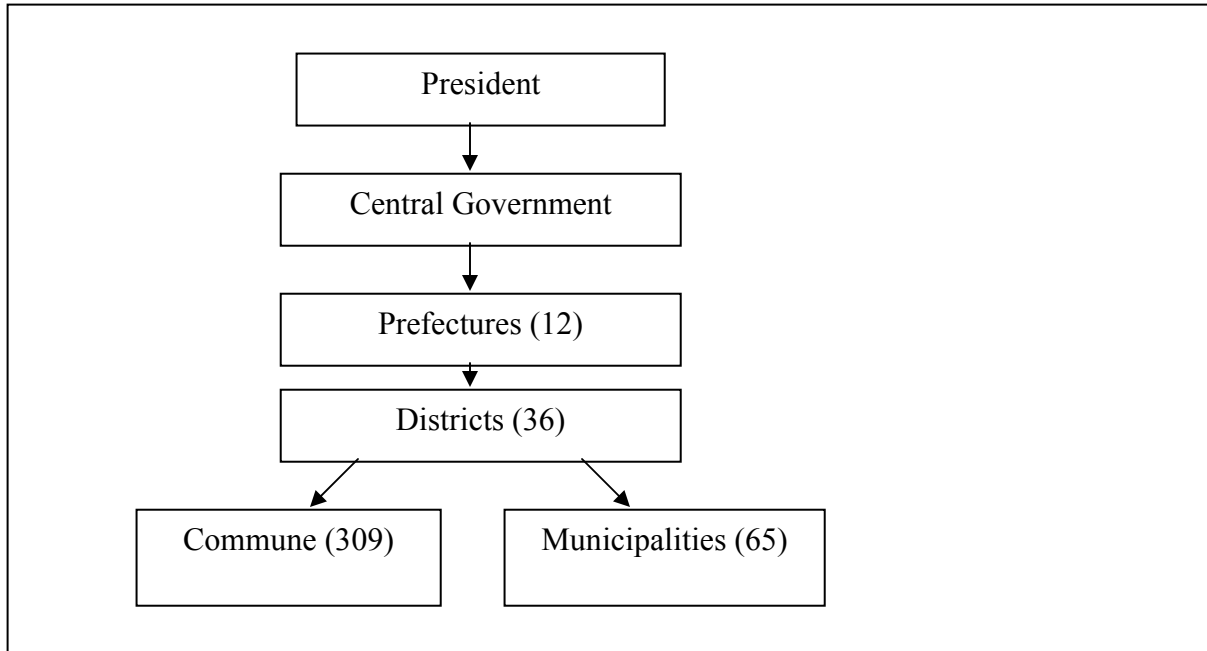
Albania is an emerging democratic country. The first democratic election was held in 1992, in which The Democratic Party was elected to office. Since then, the government has started to implement democratic and market-based reforms, part of which is to increase local government capacity to assist with the provision of public services. To enable local governments to deliver public services, the property tax was introduced to increase local fiscal capacity.

##### **Government Structure**

Albania is a unitary state and an emerging democracy. There are five levels of government. The first level is the President, which is largely ceremonial; the majority of governing power lies with the central government. Below the central government, there

are three-tiers of local government: Prefectures (12), Districts (36), which are then further subdivided into municipalities (65) and communes (309).<sup>5</sup> See figure 1 below.

Figure 1. Levels of Government in Albania



Source: Brown & Hepworth, 2002

### Property Market

Prior to independence, housing was owned by the state. Following independence, housing was denationalized and sold to inhabitants. General market activity in Albania is considered to be limited.<sup>6</sup>

### **Property Tax System**

The *Property Tax Law*, Law No. 7805, passed in March 1994, authorizes the central government to tax immovable property. There are primarily three revenue sources from which local governments derive revenue: transfers from the central government, shared national taxes, and local taxes and fees. The property tax is a shared national tax, which means the revenues are shared between the central (80%) and local governments (20%). In 1999, the property tax made up about 15 percent of local government revenues.<sup>7</sup>

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<sup>5</sup> The new constitution has provisions for regional governments to be introduced to replace the Districts. A provision is also made for communes and municipalities to join to provide services. However, as of 2002, not all provisions of the 1998 constitution, relating to governmental structure, had been implemented. See Brown & Hepworth, 2002.

<sup>6</sup> Almy, 2001 p. 54.

<sup>7</sup> Brown, P.K. and Hepworth, M.A. 2002. "A Study of European Land Tax Systems: Second Year Report." Working Paper.

Local taxes and fees (solid waste fees, business registration fee, market tax, and small business tax) are collected and retained by the local authorities. These revenues also make up about 15 percent of local government revenues.

#### Local Authority

Because the property tax is primarily a national tax, the central government sets the property tax rates, determines the property tax base, and performs administrative functions such as property assessment, collection, and enforcement.

Local governments have no discretion in setting tax rates.

#### Tax Base

The property tax base consists of buildings and agricultural land. The responsibility of the property tax falls on the owner of the property.

#### Exemptions

Property of the government and its agencies is exempt, as well as cultural and historical property. This may not be an exhaustive list of exemptions because information regarding other types of exemptions (e.g., public areas, hospitals, charities) was not available in the literature reviewed for this paper.

#### Tax Assessment Basis

The taxable base of property tax is the area of the property. Buildings are measured in square meters, and agricultural land is measured in hectares.

### **Differentials**

#### Tax Rates

In Albania, a classified rate structure is used to reflect property differences. In the case of agricultural land, tax rates vary depending upon soil class. As of 1996, agricultural land was divided into 10 groups based upon the fertility of the land; the tax rates ranged from 15 to 60 USD per hectare.

In the case of buildings, tax rates range from .92 to 1.00 USD per square meter depending on use. See table 1 below for 1996 tax rates:

**Table 1. Albania Property Tax Rates 1996**

Public Buildings	.02 USD per sq.m
Residential Accommodations	.03 to .06 USD per sq.m.
Industrial buildings	.5 USD per sq.m
Commercial and Service Industries	1 USD per sq.m
Agricultural Land	15 – 60 USD per hectare

*Source: Brown and Hepworth, 2002*

## Belarus<sup>8</sup>

### Background

Belarus is a former Soviet Union country. It gained its independence in 1991.

#### Government Structure

The Republic of Belarus is a unitary state and a parliamentary republic. The 1991 Law on Local Self-Government and Local Economy recognizes the establishment, functions, and responsibilities of local government in Belarus. There are three tiers of local government: 1) the municipal level (villages, town, cities, and city districts); 2) the district level (districts and cities divided into city districts); and 3) the regional level (regions and the capital city of Minsk). Each level has a council and executive committee, which have horizontal relationships. The executive committees at each level have a wide range of administrative and organizational powers. Some of these include: the collection and utilization of budgetary funds; management of local property and financial resources; and deciding upon the establishment, reorganization, or closure of community enterprises, among other things. The heads of the executive committees are determined in a centralized manner: the president appoints the head of the regional and Minsk executive committee, and the executive heads of other levels of government are selected by the higher level executive committee. The president must approve the executive committee heads for the District level.<sup>9</sup>

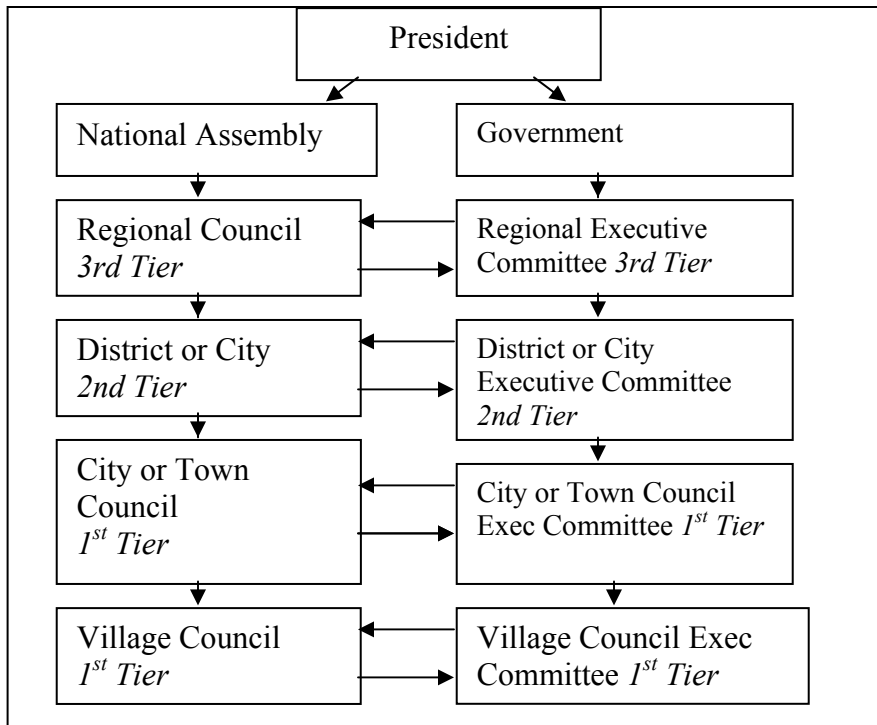
Local governments are primarily responsible for public service provisions. Districts and cities deliver the majority of public services (2<sup>nd</sup> tier). Regional governments are primarily responsible for funding and managing the activities of lower-level government. See figure 2 below.

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<sup>8</sup> This section draws primarily from Brown and Hepworth, 2002 and Almy, 2001.

<sup>9</sup> For a more detailed discussion of the relationship of the differing levels of government and their responsibilities, see Kobasa, Karamyshev, and Dritz, 2001

**Figure 2. Levels of Government in Belarus**



Source: Kobasa, Karamyshev & Dritz 2001

### **Property Tax System**

The land and real estate tax were adopted in 1991. The property tax system in Belarus is similar to that in Albania. The real estate and land tax are shared national taxes that are assigned to local budgets based on annually established standards. Other assigned taxes include the income tax, VAT, and excise duty on alcohol. National tax revenues make up the largest share of local government revenues. In 1999, they accounted for 33.7 percent of total local revenues – the income tax (7.5 percent) and VAT (18.2 percent).<sup>10</sup>

Information regarding the property tax system in Belarus is not readily available.

#### Local Authority

The central government establishes the property tax policy (i.e., base and rates). Local governments do not have the power to adjust property tax rates.

#### Tax Base

There are two different taxes – a land tax and a real estate tax. The base of the land tax is the area of the land (e.g., taxed on a per hectare basis). The base of the real estate tax is the value of buildings and offices and other improvements to land.

<sup>10</sup> Kobasa, Karamyshev, and Dritz, 2001



The owners or lessee are responsible for the land tax.

### Exemptions

The following are exempt from the land tax:

- social and cultural facilities and social housing;
- fixed assets owned by organizations for the disabled;
- production facilities belonging to telecommunication services;
- cemeteries; and
- land to which administrative buildings are attached (Brown and Hepworth, 2002).

### Tax Assessment Basis

The individual taxpayer is responsible for determining the tax payable. The taxable base of buildings and improvements on land are determined by the individual owners, insurance value, and/or the legal persons balance value.<sup>11</sup> Newly initiated building projects involving production are assessed based on the estimated value of the future facilities.

### **Differentials**

#### Tax Rates

A classified rate structure is used for both land and buildings. For land, tax rates differ based on whether or not the property is located in the central city, smaller villages or an unpopulated area. See table 2 below for tax rates:

**Table 2. Rate Differentials for Land in Belarus**

<b>Location</b>	<b>Tax Rate</b>
Minsk	47,700 to 124,800 Roubles per hectare
Small Villages	2,000 to 4,400 Roubles per hectare
Unpopulated Land	10 to 132 Roubles

*Source: Brown and Hepworth, 2002*

For buildings, tax rates differ based on the use of the property. Newly initiated building projects involving production facilities pay the highest rate, followed by State-owned enterprises, private enterprises, and individuals. See table 3 below

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<sup>11</sup> Almy, 2001.

**Table 3. Belarus Buildings Tax Rates**

<b>Real Estate</b>	<b>Tax Rate</b>
State-owned and governmental entities	5 %
Private Enterprises	2 %
Individuals	.15 %
Newly initiated building projects	30%

*Source: Brown and Hepworth, 2002*

## **Czech Republic**

### **Background**

The Czech Republic was liberated from Communist control in 1989. In the early 1990s, they began to implement tax reforms after their separation from the Slovak Republic, which is known as the “Velvet Divorce”. Of the transitional Central and Eastern European countries, the Czech Republic is considered one of the most successful in terms of moving towards fiscal decentralization. The Czech Republic was the first post-communist country to be accepted into the OECD, in 1996.<sup>12</sup>

### Property Market

Like other post-communist countries, the Czech Republic lacked a well-developed property market because the majority of housing and land were state-owned under communism: business property, agricultural property, and apartments were nationalized, but family houses and recreational cottages were not. A restitution program was implemented in 1989; however, it had not been completed as of 2001. Since the move towards decentralization, a property market for residential property and rental commercial property has been established.<sup>13</sup>

### Government Structure

The Czech Republic is a unitary state and a parliamentary democracy. It consists of two levels of government: national and municipal. In 1997, there were 6,234 independent municipalities. As of 2002, regional governments were slowly being reintroduced to help with the administration of the municipalities.

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<sup>12</sup> Bryson, Phillip J. and Cornia, Gary C. with Alena Rohlickova Holmes (2001) “Taxes on Real Property in the Czech Republic” In J. H. Malme and J.M Youngman (eds) *The Development of Property Taxation in Economies in Transition: Case Studies from Central and Eastern Europe* (eds).

<sup>13</sup> Almy, Richard. (2001). “A Survey of Property Tax Systems in Europe.” Prepared for the Department of Taxes and Customs, The Ministry of Finance, Republic of Slovenia, p. 55.

## Property Tax System

The property tax is called a Real Estate Property Tax and is levied on both land and structures, which are assessed and taxed separately (Act 338/1992). The property tax is not a significant source of revenue for municipalities. Between 1993 and 1998, the real estate tax made up 2.5 percent of total revenues and 8.4 percent of total tax revenues. See table 4 below.

**Table 4.**  
**Real Estate Tax as Percent of Other Revenues of Districts and Municipalities**

Category	1993	1994	1995	1996	1997	1998
Of total revenues	2.9	3.4	2.9	2.5	2.7	2.5
Of total tax revenues	8.4	7.1	5.4	5.5	5.2	4.9
Of other tax revenues	9.2	7.7	5.6	5.8	5.5	5.2
Of nontax revenues	15.8	17.7	21.0	18.8	16.7	16.6
Of state budget Transfers	7.8	24.5	23.2	23.8	21.9	22.9

*Source: Czech Statistical Office (1997), taken from Bryson and Cornia, 2001*

### Local Authority

The central government determines the property tax policy and performs all administrative functions. The local governments, however, are granted the authority to apply coefficients to the tax rates set by the central government to reflect differences in the location and quality of buildings. Local governments are the recipients of all property tax revenue.

### Tax Base

The property tax base consists of both land and structures, which are assessed and taxed separately.

Taxable land includes privately owned agricultural and forestland plots and privately owned developed land plots. The building tax is levied on buildings and other defined structures.

Individuals are responsible for reporting their taxable property. Because property identification and assessment is costly and time consuming, especially for transitional countries that lack fiscal and technical resources, employing self-assessment reduces these costs. Surprisingly, tax evasion does not seem to be a serious problem. Other countries, such as Armenia, Belarus, Georgia, Lithuania, Poland, Romania, and Russian Federation, also use self-assessment for enterprises.

The owners are identified as the taxpayer. In the case of state owned property, the user is responsible for the tax.

### Exemptions

The Czech Republic allows the standard property exemptions.<sup>14</sup> Embassies and public housing are also exempt. Public housing makes up 50 percent of all housing.

A 15-year exemption from property tax is also granted to new homes in order to encourage private residential constructions. Moreover, a 15-year exemption is also granted to low-income, older homeowners who received their residence through the restitution program. This was done to ease and encourage the transition to market ownership.<sup>15</sup>

### Tax Assessment Basis

Nonagricultural land: the taxable base is the area of land plots in square meters.

- Agricultural land: the taxable base is the purchase price.
- Buildings: the taxable base is the area of the floor space in square meters.

### **Differentials**

The Czech Republic uses both adjustment coefficients and rate differentials to better reflect market values. For the area-based components, the amount of property tax due is determined by multiplying the area, total square meters, by the coefficient and the tax rate.

### Adjustment Coefficients

Local governments are authorized to multiply the area of a property (non agricultural land or buildings) by a coefficient based on the population of the municipality in which it is located. See table 5 below for a list of the coefficients:

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<sup>14</sup> Standard property tax exemptions in this review refer to the exemption of property for: government and its agencies; public areas; educational, cultural, historical, health, and social institutions; and religious buildings.

<sup>15</sup> Bryson, Phillip J. and Cornia, Gary C. with Alena Rohlickova Holmes. 2001. "Taxes on Real Property in the Czech Republic" in J. H. Malme and J.M Youngman (eds) *The Development of Property Taxation in Economies in Transition: Case Studies from Central and Eastern Europe* (eds).

**Table 5.**  
**Number of Residents Coefficients**

Residents	Coefficient
Less than 300	.3
300 – 600	.6
600 – 1000	1
1000 to 6000	1.4
6000 to 10,000	1.6
10,000 to 25,000	2
25,000 to 50,000	2.5
50,000 +	3.5
Prague	4.5

*Source: Brown and Hepworth, 2002*

Municipalities have some discretion in determining the coefficient applied. For example, in Prague, the city government can apply a five to certain well-located properties; other municipalities can adjust their coefficients up one level or down three. Information on how these coefficients are estimated is not readily available. Bryson and Cornia, in their review of the Czech Republic, stated that they were unable to determine how these coefficients were established.

For all structures with multiple floors, the tax rates are increased .75 CZK per square meter for each additional floor above the ground level. If a room is used for business purposes, the rate is increased by 2 CZK.

#### Tax Rates

A classified rate structure is used for buildings: tax rates vary depending on the building use. Buildings used for economic purposes are taxed at a higher rate than residential or agricultural land. The range, in Czech crowns (CZK), is from 1 to 10. See table 6 below:

**Table 6.**  
**Tax Rates for Buildings Based on Use in the Czech Republic**

Building Use	Tax Rate Per Square Meter
Residential Buildings	CZK 1
Weekend and Recreation Buildings	CZK 3
Isolated Garages	CZK 4
Buildings used for agricultural production, forestry or water enterprises	CZK 1
Industrial and energy property	CZK 5
Other Buildings used for business purposes	CZK 10
Any other buildings or construction not mentioned above	CZK 3

*Source: Brown and Hepworth, 2002*

# Georgia

## Background

Georgia is a former Soviet Union country. The country gained its independence in 1991.

### Governmental Structure<sup>16</sup>

Georgia is a unitary state and a republic. Georgia does not have a strong history of local governance. Local self-governance exists in Georgia, but its development has been complicated by a number of factors. This combined with the instability and unpopularity of the central government may hamper the effectiveness of local self-governance.<sup>17</sup>

Currently, Georgia has two tiers of sub-national governments: regional and municipal. Georgia's system of local government is similar to the local government structure in Belarus. The first tier, or the municipal level, consists of district-level cities, villages, small rural towns, and communes.

The second tier, or regional level, consists of cities and districts with special status. Tbilisi, the capital city, is granted special status. This level acts as a mediator between the regions and the central government, and has greater power than the local level, or first tier. The executive officials at this level are appointed by and accountable to the president.

The sub-national levels of government are not well established by legislation like the parliament and national government. The regional and local governments are, for the most part, regulated by the national government.

### Property Market

In 1992, the privatization of state owned property was approved by the central government, and the process of privatization has been underway since 1993. In 1998, more than 11,100 units had been privatized, and hundreds of thousands of citizens became private owners.<sup>18</sup> However, as of 1998, the privatization of nonagricultural land had not yet taken effect; the principal concern surrounding the privatization was that municipalities would not sell the land but rather retain it and lease it to generate revenue. Moreover, other factors that were impeding development of property markets at this time were the lack of formal title documents and the need for parcel-based land records to support property and land taxation.<sup>19</sup>

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<sup>16</sup> This section draws heavily from Losaberidge, David, Konstatine Kandelaki, and Niko Orvelashvi. 2001. "Local Government in Georgia" chap 5 in I. Munteanu and V. Popa (eds.), *Developing New Rules in the Old Environment, 2001: Local Governments in Eastern Europe, Caucasus, and Central Asia, vol 3*.

<sup>17</sup> For a more detailed discussion see Losaberidge, Kandelaki, and Orvelashvil, 2001.

<sup>18</sup> Case by Case Privatization (CCP), Ministry of State Property Management of Georgia. 1998. Retrieved from <http://georgia-gateway.org/ENG/Law&Justice/casebycase/excerpts.html>

<sup>19</sup> Almy, 2001.

## Property Tax System

The property tax is a shared national tax: according to the law on Distribution of State Taxes, property tax revenues are shared between the central and local levels of government. There are ten national taxes including the land and property tax (property tax appears as a line-item in addition to the land tax) that appear in the national budget; however, there was no definition of what the property tax entailed (e.g., buildings only or buildings and personal property). Local governments receive about 60 percent of their revenues from national taxes. In 1999, the land tax accounted for 7.7 percent and the property tax accounted for 7.6 percent of local budget revenues.<sup>20</sup>

### Local Authority

The central government sets the property tax policy, although local authorities have some discretion in rate setting.<sup>21</sup> Legally, the municipalities (inventory bureaus) are responsible for identifying taxpayers, inventorying their taxable property, and property assessment. These roles, however, were blurred in 1997.<sup>22</sup>

### Tax Base

The tax base includes land, buildings, and moveable property. As defined by law, there are three categories of taxable property:

- nonagricultural and agricultural land;
- natural persons' property (i.e., buildings, structures, and units in buildings on urban land);
- enterprise property (certain balance sheet items, such as fixed assets, installed equipment, incomplete capital investment, intangible assets).

The owners or principal users of the property pay the land tax.

### Exemptions

The following are exempt from the land tax:

- government and government agencies;
- educational institutions;
- charities;
- cultural and historical properties; and
- public areas

This may not be an exhaustive list of exemptions as information was not available on other property, such as hospitals, religious buildings, and cemeteries.

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<sup>20</sup> Losaberidge, David, Konstatine Kandelaki, and Niko Orvelashvi, 2001.

<sup>21</sup> Local authorities are authorized to set territorial ratios under the tax on nonagricultural land, and may increase or decrease the tax rates on specific agricultural plots by 20 percent, as long as amount of tax revenue for the rural administrative unit is not changed (Almy 2001).

<sup>22</sup> See Almy 2001 for a more detailed discussion.

### Tax Assessment Basis

The taxable base of agricultural and nonagricultural land is determined using an area-based formula with adjustments made for location and soil quality (in the case of agricultural land).

The taxable base of buildings and natural-persons' property is determined by the inventory (insurance) value. Inventory bureaus use Soviet-era insurance cost manuals to assess the value.

The taxable base of enterprise property is determined by the balance sheet residual value.

### **Differentials**

#### Tax Rates

A classified rate system is used for land. For nonagricultural land, tax rates vary based on location: the base rate is .24 laries per square meter, or 2400 laries per hectare. For agricultural land, rates depend on location and soil classification: the range is 6 to 44 laries per hectare.

#### Adjustment Coefficients<sup>23</sup>

Adjustment coefficients in Georgia are assigned to urban settlements based on their ranking relative to the country's capital city, Tbilisi. Tbilisi has the highest ranking, or territorial ratio, of one while all other settlements have a ratio of less than one (the lowest ratio is .25). The settlements are ranked based on factors such as population, type of settlement, economy, elevation, and transportation access.

The urban settlements are authorized to make further differentiations among properties within settlements. For example, a larger settlement would create three zones: middle, outer, and central. The middle zone would have a coefficient of 1, the outer zone would have a lower coefficient, and the central zone would have the highest coefficient. In Tbilisi, six territorial zones have been established. Further information about the methods or formulas used to determine the territorial ratios applied to urban settlements or within the urban settlements is not available in the literature reviewed here.

## **Hungary<sup>24</sup>**

### **Background**

The move toward a more democratic government and market economy in Hungary began in 1989, when the government "abolished censorship, dismantled barriers along the

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<sup>23</sup> Almy, 2001 p. 97

<sup>24</sup> This section draws heavily from Tassonyi, 2002.



Austrian border, and called for the privatization of industry, religious freedom, and free elections.<sup>25</sup>

### Governmental Structure

Hungary is a unitary state and parliamentary democracy. National legislation established local governments, and they are regulated by the central government. The 1990 Act of Local Self Governance substantially transformed the local government system in Hungary by eliminating local councils that acted as agents for the central government and by significantly increasing the responsibilities of local governments.

Hungary's local governmental system includes 19 counties and four types of municipalities:

- 1) 20 urban cities with county rights,
- 2) 173 cities or towns,
- 3) Budapest the capital, which is subdivided into 23 districts; and
- 4) About 2,920 less populated communities or villages.

There is no hierarchical relationship between the county and municipal level governments. Municipalities manage budgets independently of county governments, and they provide different services. For example, county governments are responsible for secondary and vocational education, special health care needs, and student hostels. Municipalities are responsible for numerous tasks such as local development, water management, sewage, local public transport, garbage collection, primary education, fire protection, basic healthcare, and more. There is no overlap in service provisions between county and municipal governments. There is no regional government in Hungary, but sometimes counties may provide services that are regional in nature (i.e. they cover large parts of the county territory)<sup>26</sup>.

### **Property Tax System**

The property tax Law Nr. 100 of 1990 authorizes the plot tax, building tax, and the tourism tax. In 1996/1997, the property tax accounted for 1.07 percent of municipal revenues. Financial transfers (shared taxes and grants) make up the majority of municipal revenues. The plot tax, the building tax, and the tourism tax are forms of property tax.

### Local Authority

The taxable property base and the tax rates are set by the central government. However, local governments in Hungary have a fair amount of authority in determining how the local tax is implemented. For example, local governments have the authority to determine which property taxes to levy, if any at all, to grant exemptions, and to set tax rates within the range established by the central government. Moreover, the local government retains all revenue generated from its jurisdiction. In 1998, 1330 local

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<sup>25</sup> National Geographic Society. 1999. *National Geographic Atlas of the World* (7th ed.), pg. 71.

<sup>26</sup> Tassonyi, 2002.

governments imposed at least one of the three property taxes discussed in this section. Local governments are also responsible for administering the tax, valuation of property, reassessments (which are infrequent), collection, and enforcement.

In the 1990s, the majority of municipalities exempted residential properties, which drew great political support; however, since then, many local officials have had to reinstate the Building Tax, Plot Tax, or Communal Tax to make up for restraints on the amount of transfers from the national government.

Other local taxes that local governments may introduce, according to the law on local taxes, include: a local business tax, a communal tax on private individuals (poll tax), and a communal tax on entrepreneurs (payroll tax).

### Tax Base

The tax base includes:

- Building Tax: privately owned buildings;
- Plot Tax (land parcel tax): undeveloped land situated in central areas within the area of jurisdiction of a local government.
- Tourist Tax: This tax may be levied on any non-resident who spends more than 48 hours in a municipality, or who owns a vacation home that is not used as a primary residence.

For each of these taxes, the owner is responsible for payment.

### Exemptions

Items that are exempt from property taxation include:

- temporary residential buildings;
- buildings used for purposes of social, health care, child welfare, and educational institutions;
- buildings owned by budgetary organs, public service organizations, and the church.<sup>27</sup>

Local authorities also have the power to grant additional exemptions.

### Tax Assessment Basis

The taxable base of property is determined either by the area of property or the market value. For the most part, area is used for the building tax.

The tax assessment basis for the tourist tax is either the number of nights spent in the municipality, the lodging fee for a guest night, or the net floor space of the building.

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<sup>27</sup> Brown and Hepworth, 2002.

## Differentials

### Tax Rates

The national government sets a uniform maximum tax rate for each type of property that is subject to a property tax, but local governments have the authority to determine the tax rate, as long as they do not exceed the maximum set by the central government. Local governments may also chose to levy no property tax, if they so desire. The tax rates for the three types of property taxes subject to a property tax do differ; however, it is not clear whether local governments differentiate the tax rates for properties subject to the same tax within the local jurisdiction, such as buildings, to account for differences in the quality, location, or use of the property. The annual maximum rates for each tax are listed below:

**Table 7.**  
**Annual maximum Tax Rates, Hungary**

Building tax	HUF 900 per sq.m
Plot Tax	HUF per 200/sq.m
Tourism Tax	HUF 900 per sq. m

*Source: Tassonyi, 2002*

If the base of the building tax is value, rather than area, the tax rate is 3 percent of the estimate value of the building.

## Poland

### **Background**

Like the Czech Republic, Poland is also considered one of the most successful transitional countries in Central and Eastern Europe. Since the end of the communist era, Poland has experienced significant private sector growth. Also like the Czech Republic, the country became an OECD member in 1996.<sup>28</sup>

### Property Market

Currently, Poland has a property market, but it is not well developed. Poland did not abolish property rights under communism; however, property rights are still not clearly defined, which makes it difficult to establish a property tax based on market value.

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<sup>28</sup> Malme, J.H. and Jan Brzeski. 2001. "Property Tax Developments in Poland," in J.H. Malme and J.M. Youngman (eds), *The Development of Property Taxation in Economies in Transition: Case Studies from Central and Eastern Europe*.

### Government Structure

Poland is a unitary state and parliamentary republic. Beneath the national government are three tiers of sub-national governments: 1) 16 regional (voivodships), 2) 308 counties (powiats) and 65 towns, and 3) 2,489 municipal (communes) governments. Regional governments are responsible for delivering services such as health care, higher education and welfare. Regional and municipal governments have their own distinct functions; there is no overlap in responsibilities.

### **Property Tax System**

Poland levies a tax on agricultural and non-agricultural land, buildings, and forestry.

The 1991 Law on Local Taxes and Fees authorizes the property tax. Since 1991, this law has been amended several times. The tax on real estate, or the urban tax, includes all land, buildings, and structures that are not taxed as either agriculture or forestry. Taxable structures are defined as plants and machinery (improvements, not buildings, claimed by business for income tax depreciation purposes).<sup>29</sup>

In 1998, property tax revenue accounted for 13.4 percent of local government revenues. The real estate tax, or urban tax, generated the greatest portion (85 percent), followed by the agricultural tax (13 percent) and the forestry tax (2 percent).<sup>30</sup>

A plan for a value-based system for real estate was to be introduced in 1999, but as of 2002, Poland was still using the area-based system. One of the reasons cited for slow progression towards an ad valorem tax is the steady stream of revenue the current area-based system provides. However, revenue from the real estate tax as a share of total local government revenue declined more than 20 percent between the years 1993 and 1997, to less than 14 percent: 14.10 percent in 1995, 11.40 percent in 1996, and 11.20 in 1997. The decline in the importance of property tax revenues as a share of local revenues has been attributed to the lack of elasticity of the area-based taxes.<sup>31</sup>

### Local Authority

The central government determines the property tax policy. Local authorities, however, are responsible for the administration and collection of the property tax. Municipalities also have the authority to set the annual real estate and agricultural tax rates within the range set by the central government. The tax rates are linked to the rate of inflation. Moreover, local governments retain all revenues from the tax.

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<sup>29</sup> Bird, Richard. 2002a. "Land and Property Taxes in Poland," in R.M. Bird and E. Slack, *Land Taxation in Practice: Selected Case Studies*

<sup>30</sup> Brzeski, 2003

<sup>31</sup> Brzeski and Malme, 2001

### Tax Base

The tax base includes:

- Real Estate: land, buildings, and structures (plants and machinery) that are not taxed as either agriculture or forestry property. The real estate tax and agricultural tax is the responsibility of the owner.
- Agricultural Land: usable agricultural land exceeding one hectare. The agricultural tax is the responsibility of individual farmers, cooperatives, and state farms.
- Forestry tax: land of at least .1 hectare used for the production of forest vegetation. The forest tax is the responsibility of the owner and occupiers of state or communal forests.

### Exemptions

The following are exempt from taxation:

- Real Estate: The standard exemptions are allowed, except the property of the central government. Government property is exempt only if the local government authorizes the exemption. Other exemptions include farmsteads, international organizations, and structures used for public transport and public utilities. There are also a number of special economic zones that are exempt from property taxation to help encourage development.
- Agriculture: land areas under water, flowing water, reservoirs, flooding dikes, boundary strips, or land damaged by drainage, and specified land classes not expected to generate agricultural income.

### Tax Assessment Basis

The area or appreciated book value of structures used for commercial purposes determines the taxable base of property.

- Real Estate: the basis of the actual land area, useable building areas and or the depreciated book value for structures used for commercial purposes.
- Agriculture: the number of usable hectares, which is determined based upon type, soil, usage, and location within a specified tax zone. There are two land types (arable and pastures and meadows), 14 soil types, and four tax zones (rural localities, cities, and urban districts, depending on economic and production-climatic conditions); and
- Forestry: the number of usable hectares determined by tree type and quality.

## Differentials

### Tax Rates

Real Estate:

A classified rate structure is used to differentiate between property used for economic and non economic purposes.<sup>32</sup> Land and buildings used for economic purposes are taxed at the highest rates, while residential land and buildings are taxed at the lowest rate. See table 8 below for the tax rates by property category:

**Table 8.**  
**Poland Real Estate Property Tax Rates 2001**

Property Category	Tax rates (sum of money per square meter)
Residential Buildings	.11
Buildings used for economic purposes	3.69
Land in residential/non-economic use	.02
Land in economic use	.13
Structures	2% of depreciated book value

Source: Bird 2002

Agriculture:

For agricultural land, the tax rate is the value of 2.5 quintals of rye per conventional hectare. The tax rate is indexed to the average market price per quintal of rye paid on wholesale markets for the first three quarters of the preceding year.<sup>33</sup>

Forestry:

The tax rate is similar to the agricultural rate in that it is set to an average market price. For timber, the rate is the average price of .2 cubic meters of timber per 1 conventional hectare. For land in national parks, natural reservations, and protected forests, the rate is the price of .3 quintals of rye per hectare per half year.

### Adjustment Coefficients

Real Estate: No adjustment coefficients are used.

Agricultural Land: Coefficients relating to the fertility of the land, the location of the farm, and the type of agriculture are multiplied by the area of the property.

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<sup>32</sup> Certain structures such as pipelines and power generation, transportation, and specialized industrial systems, are taxed on depreciation, which is a rate of 2 percent of their book value. Malme and Brzeski, 2001).

<sup>33</sup> Bird, Richard. 2002a. "Land and Property Taxes in Poland," in R.M. Bird and E. Slack, *Land Taxation in Practice: Selected Case Studies*

Forestry: Coefficients relating to fertility of the land and the main species of trees growing on the forest are multiplied by the area of the property.

## **Reform**

There is slow movement towards an ad valorem property tax. In 1999, a new proposal for a unit-value system was introduced. The most recent plan for property tax reform is an area-based system for land that uses location coefficients to better reflect market conditions.

## **Russian Federation**

### **Background**

Prior to the fall of the Soviet Union, property for the most part was nationalized. With the fall of the Soviet Union in 1991, efforts towards large-scale privatization began to take place. As part of this effort, state industrial enterprises and housing were privatized; however, land remained in Government control.<sup>34</sup>

### Property Market

There has been difficulty in establishing property rights in the Russian Federation, which, consequently, hinders the development of a property market. Since 1998, the new federal Law on State Registration of Real Property Rights and Transactions has helped to increase records of property owners and should continue to do so.<sup>35</sup>

### Government Structure

The Russian Federation has three levels of government: the federal, regional, and local. The constitution places ultimate authority in the federal government. The federal level has a strong president with the authority to issue decrees on a wide-range of areas. Below the federal level are 89 subjects of federations (republics, oblasts, okruss, and krais), which act as regional governments. Moscow and St. Petersburg have the status of oblasts.

Regional governments are divided in to districts. Districts have some autonomy, but they are regulated by regional laws.

### **Property Tax System**

A tax is levied on personal property (i.e., enterprise property), land, buildings, and some vehicles. There are three separate legal provisions authorizing the taxation of: 1)

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<sup>34</sup> Malme, Jane H. with Natalia Kalinina, 2001. "Property Tax Developments in the Russian Federation." In J.H. Malme and J.M. Youngman (eds), *The Development of Property Taxation in Economies in Transition: Case Studies from Central and Eastern Europe*.

<sup>35</sup> Malme and Kalinina, 2001.

enterprise property (the balance sheet values of fixed assets, intangible assets, stocks, and inventories), 2) individual property (structures and some types of vehicles), and 3) land (agricultural and nonagricultural). Plans to eliminate these three taxes and introduce a “western-style” real estate tax at the regional level is in the draft *Tax Code*, however, portions of the draft *Tax Code* still need to be discussed and approved by the federal parliament.<sup>36</sup>

Revenues from the individual property tax and land tax have not been significant, despite high collection rates, because of the large number of exemptions, low tax rates, and effects of inflation. In 2000, individual property tax revenue accounted for .26 percent of local revenues and the land tax accounted for 2.21 percent. The enterprise tax generates the most revenue (7.79 percent) despite low collection rates (60 percent).<sup>37</sup>

### Local Authority

Federal tax legislation establishes the basic framework for taxation in Russia. The criteria for determining whether or not a tax is federal, regional, or local are based on the territory covered by the tax and the level of government that introduces the tax.<sup>38</sup> In some cases, the regional or local government has no control over whether or not to adopt a particular tax. This is the case with the land tax. Moreover, the tax revenue is shared among all three levels of governments in proportions set by the federal government. The revenue from the tax on individual property is also classified as a local tax; but in this case, all revenue is retained by the local taxing jurisdiction. This is the only property tax revenue that municipalities do not share.

Tax rates are set by the local government but within the narrow range established by the federal and regional governments.

### Tax Base

The property tax base includes the property of enterprises, individuals, and land, which are defined below:

- Property of Enterprises: balance sheet value of assets (fixed assets, intangible assets, and inventories);
- Property of Individuals: apartments, buildings, construction, motor boats, helicopters, airplanes, and other transport vehicles (except automobiles, motorcycles, and other vehicles with respect to which contributions are made to the road fund). Owners are responsible for the tax.
- Land: agricultural and nonagricultural. Individuals who own, use, or lease are responsible for the tax.

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<sup>36</sup> Timofeev, Andrey. 2002. “Land and Property Taxes in Russia,” in R.M. Bird and E. Slack, *Land Taxation in Practice: Selected Case Studies*.

<sup>37</sup> Malme and Kalinina, 2001.

<sup>38</sup> Timofeev, 2002 pg. 1.



### Exemptions

General exemptions include religious and educational property. As mentioned above, there are numerous property tax relief and exemption mechanisms in place, and not all are listed here. For example, in the case of the land tax, there are 17 different cases for property tax exemption.<sup>39</sup>

### Tax Assessment Basis

The taxable base of agricultural and non agricultural land is determined by area: hectares of ploughed field and square meters.

Enterprise property is the annual average value of the property. This tax is self assessed by the legal entity.

Individual property is the inventory value (cost of reconstruction depreciated for the deterioration of the structure) of all structures in the jurisdiction and owned by one individual. The Bureau of Technical Inventory (BTI) establishes the value.<sup>40</sup>

## **Differentials**

### Tax Rates

A classified rate system is used for land and individual property.

**Agricultural Land:** Tax rates vary by composition, quality, area, and location of ploughed field. The average tax rate (in rubles per hectare) is set for each region in the *Federal Law on Payment for Land*. Based on the average rate, the regional governments differentiate the rates based upon ploughed fields by type of soil, and set rates for differing types of agricultural land (e.g., plantations, hayfields, and pastures). Agricultural land within an urban settlement is taxed at double the rate of agricultural land in designated rural areas in the Russia Federation.

**Nonagricultural Land:** The *Federal Law on Payment for Land* sets the average rates for the eleven economic zones of Russia and ten categories of sizes of urban settlements. Based on the average rate, local governments (rather than regional governments) have the discretion to set local rates for properties based on their location from the downtown, level of development, environment, and geological characteristics. These rates, however, must generate the same amount of total revenue the average rate would if applied to the total area.

Land under residential structures and personal subsidiaries are taxed at three percent of the rate set for a specific urban zone; the law does require a minimal rate be set annually for land with residential structures. In 2000, the minimal rate was RUR .14, or USD .05, per square meter.

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<sup>39</sup> For a more extensive list of exemptions, see Brown and Hepworth, 2002.

<sup>40</sup> Timofeev, 2002

Enterprise and Individual Property: A fixed rate determined by the regional government, which cannot exceed the maximum set by the federal government, is applied to enterprise property. The maximum rate is 2 percent.

**Table 9.**  
**Federal Limits for the Individual Property Tax**

Total Value of Property	Tax Rates
Below 10 thou. USD	Up to .1 percent
From 10 thou to 17 thou USD	.1-.3 percent
Over 17 thou.	.3-2 percent

*Source: Timofeev, 2002*

#### Adjustment Coefficients

Rates have been increased by annual coefficients to increase revenues during times of monetary inflation. Coefficients are also applied to resort and recreational arrears. Further information regarding the use of coefficients to adjust for factors such as the location, land use, or quality of property are not available in the literature reviewed here.

## **Slovak Republic**

### **Background**

The Slovak Republic, or Slovakia, gained its independence in 1989. At that time, they were part of a federation with the Czech Republic, Czechoslovakia. The federation split in 1993, which resulted in the independent Slovak and Czech Republics.

Since independence in 1989, local governments have been reestablished.

### Property Market

Under communist rule, all property was state owned. Since independence, several efforts have been made to privatize property, such as the implementation of a restitution program.<sup>41</sup> The amount of privatized property increased from 29 percent in 1994 to about 50 percent in 1996.<sup>42</sup>

According to Bryson, Cornia, and others, Slovakia's property tax system had not achieved the following criteria necessary for a well functioning real estate market: 1) a banking system that has the capacity to fund real estate mortgages, 2) the elimination of price controls in the housing market, 3) the private ownership of property, 4) an active real estate market in all principal types of properties, or 5) the elimination of subsidies

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<sup>41</sup> See Almy, 2001

<sup>42</sup> Bryson, Phillip J. and Cornia, Gary C. with Sona Capkova and Milos Koncek. 2001a. "Land and Building Taxes in the Republic of Slovakia" in J. H. Malme and J.M Youngman (eds) *The Development of Property Taxation in Economies in Transition: Case Studies from Central and Eastern Europe* (eds), pg 54.

(such as housing and utilities). All of these factors affect the real estate market and make it difficult to accurately determine the market value of property.<sup>43</sup>

### Governmental Structure

Slovakia is a unitary state and a parliamentary republic. There are two levels of government: national and local. As of 2002, there were 2,871 municipalities in Slovakia. Most of the municipalities have a population of less than 500, but a few cities have a population of over 50,000. The capital, Bratislava, has a population of 452,000.

The majority of local government revenues come from shared taxes (i.e., income tax and road tax) (22.7 percent) and grants and transfers (17.5 percent). The remaining revenues come from local government sources such as the real estate tax and loans.

### **Property Taxation**

The property tax system in Slovakia is similar to the system in the Czech Republic. Slovakia levies a tax on land and buildings, which are assessed and taxed separately. Act 317/1992 regulates the land and building tax. The property tax is not a significant source of revenue for local governments. In 1998, it accounted for 12.4 percent of local government revenues.<sup>44</sup>

### Local Authority

The property tax policy is determined by the central government, but local authorities have the authority to adjust property tax rates and coefficients within the range set by the national government. Moreover, local governments perform most administrative tasks, except tax collection.

### Tax Base

The tax base includes agricultural and nonagricultural land and buildings.

The owner of the property is responsible for the tax. If the property is owned by the state, then the user of the property is responsible for the tax.

### Exemptions

The standard property exemptions are allowed for both land and buildings (i.e., government and its agencies; public areas; educational, cultural, historical, health, and social institutions; and religious buildings). In addition, the following exemptions also apply:

- Land and buildings used for public transport;
- Developed areas that are built up by constructions which are subject to the tax on buildings.
- Buildings used for ecology

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<sup>43</sup> Bryson, Cornia, et al. 2001a pg 57.

<sup>44</sup> Malme and Youngman, 2001, pg 3.

- Building such as barrages, water supply systems, sewers, energy constructions, and public thoroughfares.

#### Tax Assessment Basis

The taxable base of nonagricultural land and buildings is determined by the area (square meters) of the property. The taxable base of agricultural land varies depending upon its use – there are 11 classifications for land, eight of which affect the taxable base.<sup>45</sup>

For buildings it is the number of square meters of a structure’s floor space, including the land area under the buildings. The area of the building is then multiplied by an adjustment coefficient to account for the population density of the locality. This is discussed in more detail below.

The taxable base of agricultural land is determined by its sale price.

#### Adjustment Coefficients

Adjustment coefficients are applied to the area of buildings based on the density of the locality within which it is located. The more densely populated the locality, the higher the coefficient that is applied to the area of the building. See table 10, below.

**Table 10.**  
**Density Coefficients Applied to Building Area, Slovakia**

<b>Coefficient</b>	<b>Density of Municipality</b>
0.3	In municipalities with not more than 300 inhabitants
0.6	In municipalities with not more than 600 inhabitants
1.0	In municipalities with not more than 1000 inhabitants
1.4	In municipalities with not more than 6000 inhabitants
1.6	In municipalities with not more than 10,000 inhabitants
2.0	In municipalities with not more than 25,000 inhabitants
2.5	In municipalities with not more than 50,000 inhabitants
3.5	In municipalities with more than 50,000 inhabitants
4.5	In Bratislava

*Source: Brown and Hepworth, 2002*

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<sup>45</sup> Bryson, Cornia, et al, 2001a.

### Tax Rates

Tax rates vary depending upon the use of the land and buildings. The highest tax rates are applied to commercial and industrial buildings, while the lowest is applied to residential buildings. See table 11, below.

**Table 11.**  
**Tax rates for Buildings by Use**

Type of Buildings	Tax Rate Per Square Meter
Residential	SKK 1
Weekend and recreation	SKK3
Used for agricultural production, forestry or water enterprises,	SKK 4
Industrial and energy property	SKK 5
Other buildings used for business purposes	SKK 10
Other construction or buildings not mentioned above	SKK 3

*Source: Brown and Hepworth, 2002*

Tax rates on buildings are increased by SKK 0.75 per square meter for each floor above the ground floor. In addition, for a room in a house that is used for business purposes the tax rate is increased by a maximum of SKK 10.0.

Slovakia is examined in more detail in the case study presented in the next chapter.

## **Ukraine<sup>46</sup>**

### **Background**

The Ukraine, a former Soviet Union country, has struggled economically since the fall of communism; and like other former Soviet countries, it has struggled to establish clear property rights.

### Property Market

As of 2002, the Ukraine was still working to develop well-defined property rights in order to facilitate market activities.

### Government Structure

The Ukraine is a unitary system of government; however, it also has sub-national levels of government. There are 27 regional level (oblast) governments, 500 district (rayon) governments – which are considered lower level regional governments – municipalities, and settlements. Oblasts are subordinate to the central government and rayons are

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<sup>46</sup> This section draws heavily from Richard Bird's "Property Tax in Ukraine". See Bird, 2002b.

subordinate to the oblasts. Local governments (municipalities and settlements), however, are controlled by locally elected councils (radas).

The Ukraine's new constitution, adopted in 1996, recognizes local levels of government; however, as of 2002, local governments did not have significant taxing authority.<sup>47</sup> They received the majority of their revenue from the central government. The little taxing authority they do possess, authorized by the 1993 decree On Local Taxes and Duties, generates minimal amounts of revenue (i.e., own-source revenues typically account for no more than 3 percent of total local revenues).<sup>48</sup>

### **Property Tax System**

The Ukraine levies a tax on land and buildings, which are assessed and taxed separately. These taxes are national taxes. The 1992 law On Payment for Land authorizes the taxation of land for legal entities and landowners. In 1998, the local share of the national land tax accounted for 8 percent of total local revenues. This was a jump from previous years: in 1993 and 1994, it accounted for less than 5 percent of total local revenues.

#### Local Authority

The property tax system is highly centralized. The central government determines the property tax policy and is responsible for all administrative tasks. Moreover, the revenues are shared between the national and local governments, with the national government determining the proportions received by each. Local radas are authorized to levy surcharges up to twice the established rate, but this is the extent of their authority.

#### Tax Base

Agricultural and nonagricultural land is the principal property tax base in the Ukraine. Buildings are subject to a small local fee based on the capital value of the building.

Owners and land users are identified as taxpayers.

#### Exemptions

Exemptions include government property; cultural, education, and healthcare organizations; and charities. Like other countries, the Ukraine also exempts certain areas that are designated as "development" or "economic" zones.

Two tax laws introduced in 1998 serve as alternatives to the land tax for small businesses and agricultural enterprises if certain conditions are met.<sup>49</sup> These tax laws are 1) On Simplified System of Taxation and Registration and Reporting of Small Business Entities and 2) On Fixed Agricultural Tax. The first tax, simplified system of taxation, is used for small businesses. About 45 to 60 percent of small businesses are eligible for this

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<sup>47</sup> See Parkhomenko, et al, 2003

<sup>48</sup> Bird, 2002b.

<sup>49</sup> See Bird, 2002b for a more detailed discussion of these alternate tax options.

alternative and about half choose it. This is not a significant source of revenue; in 2000, total collections were UAH .5 million.

#### Tax Assessment Basis

For land, either the value or the area (if value is not available) is used to determine the taxable base of land.

Buildings are assessed based on capital value.

### **Differentials**

#### Tax Rates

A classified rate system is employed to account for the specific attributes of property and the population density of the locality within which it is located.

Agricultural land: Tax rates vary depending upon 1) the use or type of land (e.g., arable land, plantations, hayfields, and pastures) and its fertility. Fertility is determined by the land cadastre, a division of the central government.

Nonagricultural land: Tax rates vary depending upon 1) the number of inhabitants in the locality and 2) its location within the locality. See table 12 for examples of taxes rates used for nonagricultural land in 1999:

**Table 12.**  
**1999 Ukraine Taxes Rates for Nonagricultural Land**

Population less than 200	.015 per sqm
Cities with Pop over 1 Million	.21 per sqm

*Source: Bird, 2002*

If value is available, land is taxed at 1 percent of its value.

Buildings: Buildings are taxed at 1 to 2 percent of their capital value, or replacement cost.

### **Reform**

There have been some attempts to implement a market value-based real estate tax, but they have been unsuccessful. There is also language in the Ukraine's *Draft Tax Code* for the implementation of an ad valorem real estate tax, which would replace the land tax. Given the potential difficulty of implementing an ad valorem tax in the Ukraine at this time, it does not seem likely that the Ukraine will do so. However, there has been discussion of implementing a unit value assessment system (i.e. the assessment rate per square foot is adjusted to reflect location, quality of the structure, or other factors).

## **EAST AFRICA**

### **Kenya<sup>50</sup>**

#### **Background**

Kenya gained its independence in the early 1960s. Following independence, Kenya emerged as the one stable economy in East Africa.<sup>51</sup>

#### Governmental Structure

Kenya is a unitary state and a republic. Local governments are established by and derive their power from The Local Government Act (Cap 265). There are three types of local authorities in Kenya: municipal councils, town councils, and county councils. Local authorities are responsible for providing administrative, community, social, and economic services to their residents.

#### Property Market

A property market exists in Kenya.

#### **Property Tax System**

The Rating Act (cap 267) of 1972 authorizes local governments to levy a property tax on either land or land and improvements; however, currently only land is taxed in Kenya.

Property taxes provide a notable amount of revenue for local authorities. In 2000/2001, property taxes accounted for 25 percent of municipal local own-source revenues and 4 percent of town and county local own revenue sources. Property tax revenues have declined slightly as a percentage of aggregate local (municipal, county, and town) own-source revenues, from 26 percent in 1991 to 20 percent in 2000/01.<sup>52</sup> Municipalities tend to be urban while counties tend to be considered rural.

#### Local Authority

Local Authorities are responsible for property tax administration, which includes collection, enforcement, assessment, and maintaining valuation rolls. However, for the most part, valuation rolls are maintained and updated by the Rating Department under the Ministry of Lands. Local authorities typically do not have the resources to maintain valuation rolls, which are maintained manually.

#### Tax Base

The tax base is agricultural and nonagricultural land.

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<sup>50</sup> This section draws heavily from, Kelly, Roy. (2002a). "Property Taxation in Kenya" in R.M. Bird and E. Slack, *Land Taxation in Practice: Selected Case Studies*

<sup>51</sup> Kelly, Roy. 2000. "Property Taxation in East Africa: The Tale of Three Reforms".

<sup>52</sup> Kelly, 2002a.



### Exemptions

Kenya provides standard tax exemptions. In addition, most local authorities exempt freehold land, especially agricultural freehold land. Government land is exempt from the land tax, but according to the Rating Act, Contributions in Lieu of Rates (CILOR) must be paid to local authorities. These payments, however, are not regularly collected on government property, but collection rates are improving.

### Tax Assessment Basis

The Rating Act (cap 268) allows for three types of property assessment methods: area rating based on size and use, valuation rating, or a combination of the two. As of 2001, 75 local governments were using valuation rating, 55 area rating, and 29 a combination. Area-based assessment is used most frequently for agricultural land. Counties, which tend to be rural, use area rating more often than municipalities or towns. For example, of the 55 local authorities using area rating, 35 (or a little over 60 percent) were counties.

### **Differentials**

#### Tax Rates

For the most part, local authorities tend to use a uniform area rate rather than a classified rate structure. Nairobi and Mombasa are examples of the few local authorities that use differentiated rates to account for differences in property. Nairobi adjusts tax rates based on land use, and Mombasa adjusts tax rates based on location.

### **Plans for Reform**

The Kenya Local Government Reform Program (KLGRP) is currently underway, and in the context of property tax reform, the emphasis is focused on administrative reforms, such as the improvement of collection and enforcement and the mobilization of political will. An evaluation of the property tax system showed that these administrative problems were affecting the amount of tax revenue generated.<sup>53</sup>

## **Tanzania**

### **Background**

Property taxation in Tanzania was established in 1946 but was abolished in 1961 when Tanzania gained independence. Following independence, Tanzania adopted a form of “African Socialism” that significantly changed the government structure: in 1967, all land was nationalized, and in 1972, all local governments were abolished. The property tax system was abolished along with local governments. The elimination of all local governments was not successful, and they were reestablished in 1978. Local

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<sup>53</sup> Kelly, 2002a

governments became fully functional in 1982 with the passage of the Local Government Finance Act of 1982.<sup>54</sup>

### Governmental Structure

Tanzania is a unitary state and a republic. Local authorities became fully functional in 1982 with the passage of the Local Government Finance Act of 1982.

### Property Market

The property market is not well developed in Tanzania. Local governments are authorized to use market value to assess property; however, because of the perceived lack of market information, most property is assessed using the replacement-cost method. As of 2000, land was nationalized in Tanzania.

### **Property Taxation**

The Local Government Finance Act of 1982 and the Urban Authorities Rating Act (UARA) of 1983 provide the legal basis for the property tax in Tanzania.

The Local Government Finance Act of 1982 gave local governments the authority to raise revenue through property tax, user charges, and other revenue sources. The 1982 law authorized local governments to administer a flat rate property tax on buildings. A flat rate tax is similar to a hut tax: a single tax amount to be paid on a building. This amount may be uniform across all buildings or may differ according to building use, size, or location.

By 1983, the government passed the Urban Authorities Rating Act, which authorized the use of an ad valorem property tax on buildings in either urban or township authorities; however, where market data are not available, a flat tax rate could be levied. This law does not apply to districts and village councils. Districts and councils are authorized to levy only a flat rate tax.

### Local Authority

The central government determines the property tax base and rates. Local governments are responsible for assessment, collection, and enforcement. Local urban and township authorities are also authorized to implement either a value-based tax or a flat tax rate depending upon the availability of market data. However, as mentioned above, districts and councils may levy only a flat rate property tax.

### Tax Base

The tax base in Tanzania is limited to only buildings, structures, or similar developments. As of 2000, land was not taxed under the property tax since all land belonged to the State. In 1999, Land Act No. 4 was enacted, which deemed that land would have value, and therefore, would need to be reflected in all transactions involving land. As of 2000, an

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<sup>54</sup> [Kelly, Roy and Zainab Musunu. 2000. "Implementing Property Tax Reform in Tanzania".](#)

effective date for this law had yet to be determined.<sup>55</sup> This law makes it possible to include land in the property tax base, and is an important step towards the development of a property market for land.

### Exemptions

Property tax exemptions include property personally occupied by the President, properties used for public utilities, public worship, public libraries, museums, cemeteries, crematoria, civil and military aerodomes, sporting facilities, railway properties, and any such property as the Minister responsible for Local Authorities shall prescribe.

### Tax Assessment Basis

The taxable base of property in urban areas and townships is determined either by the capital market value of the building, or where market value data are not available, the replacement cost approach. The replacement cost approach is defined as the replacement cost of buildings, structures, and other developments, adjusted for depreciation (the maximum depreciation rate is 25 percent).

As of 2000, because of limited market data, all valuation for rating in urban areas and townships was being done by the cost replacement approach. Legally, the property tax roll should be valued every five years.

Local authorities may also levy a flat rate property tax, which is a single tax amount to be paid on a building. Districts and councils are required to levy a flat tax; this amount may be uniform across all buildings or may differ according to building use, size, or location.

## **Differentials**

### Tax Rates

As a result of the inequities that result from a flat tax system, the tax rate structure in Tanzania has evolved in order to better capture the market value of buildings by making adjustments for size and location.

The capital city of Dar Es Salaam is an example of a locality with a tax rate structure that evolved significantly over time. Initially, the city was divided into eight zones with a specific unit amount applied to each building within a certain zone. See table 13 below for the list of zones and tax rates:

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<sup>55</sup> Kelly and Musunu, 2000

**Table 13.**  
**Flat Tax Rates for Dar Es Salaam (1988-1996)**

<b>Area Unit</b>	<b>Description</b>	<b>Rate per year (Tshs)</b>
1	Residential Unsurveyed Areas	200
2a	High Density Residential Surveyed Area	300
2b	High Density Residential Surveyed Area in City Centre	10,000
3	Medium Density Area	1,000
4	Low Density Area	2,000
5	Industrial Area	10,000 – 50,000
6	Unsurveyed Commercial Area	500
7	Surveyed Commercial Area outside City Centre	1,000

*Source: Kelly and Musunu, 2000*

This eight-zone system was in place from 1988 to 1996. In 1996, Dar Es Salaam adopted an even more detailed and comprehensive tax rate system. The new system consisted of 52 zones, with adjustments made for population size of the area and building use. Other municipalities (Tanga and Tabora) also use the 52-category flat rate system.

## **Reform**

In 1993, with financial assistance from the World Bank, the Government of Tanzania began a tax reform project. As of 2000, Tanzania's property tax reform strategy focused on moving towards a market value-based system.<sup>56</sup>

## **Case Study of a Developed Country: Israel<sup>57</sup>**

### **Background**

Israel differs from the other countries in this review in that it has a very well-developed economy and property market. Israel gained its independence from the British in 1948.

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<sup>56</sup> See Kelly and Musunu, 2000 and Kelly 2000 for a more detailed discussion of the property tax reform efforts in Tanzania.

<sup>57</sup> See Darin, Dan. 1999. "A Politician's Appraisal of Property Taxation: Israel's Experience with the *Arona*" Working Paper. Cambridge, MA: Lincoln Institute of Land Policy.

### Governmental Structure

Israel is a parliamentary democracy. The Municipalities Order, which was introduced by the British and adopted by the Israeli government in 1948, establishes local authorities and regulates the *arnona* system.

### Property Market

Israel has a well-developed property market.

### **Property Taxation**

Israel's property tax system is called the *Arnona* and is regulated by The Municipalities Order. The current system that is in place was adopted in 1970. The *Arnona* is levied on both land and buildings. The current system adjusts property tax rates based on the measured land area of property. Prior to 1960, the rental value of property was used to determine the value of property.

Between 1960 and 1970, the *Arnona* system was changed to use the number of rooms in the structure as the assessment basis of property. The move from rental value to the number of rooms as the assessment basis resulted because of a substantial increase in the number of public housing units introduced into the property market at that time to provide housing for new immigrants.

The property assessment method was subsequently changed in 1970 from the number of rooms in a structure to the measured surface area of a structure. This was done because of equity concerns raised by the public; for example, residents complained that using the number of rooms to determine property tax rates discriminated against large families who were often lower income than smaller families with fewer rooms.

The measured surface area of property alone does not better reflect ability to pay; however, local governments are authorized to make adjustments to property tax rates based on four factors: location, actual use (as opposed to permitted use), property type, and age of property. The property assessment method is discussed in more detail below.

### **Local Authority**

Unlike the other countries in this review, the *Arnona*, is a critical source of revenue for local authorities. In Tel Aviv, for example, the property tax accounted for about 56 percent of the city's annual budget in 1997.<sup>58</sup> The property tax policy is determined by the central government, but local governments retain all local revenue and have the power to, and do, make adjustments to the property tax rates, within the range established by the central government, to reflect differences in the characteristics of properties.

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<sup>58</sup> See Darin, 1999 p. 4

Local authorities are not authorized to grant tax breaks unless approved by the ministry of the interior.

### Tax Base

Buildings, unused undeveloped land, and agricultural land are included in the tax base. Unused, undeveloped land is taxed by the national government.

The user of the property is responsible for payment of the property tax.

### Exemptions

Tax reductions are provided based on the socioeconomic status of the user, such as invalids, newlyweds, senior citizens, new immigrants, and residents in high density apartments. Only one category can be applied per user. Local governments can add discounts only if they are approved by the ministry of finance.

### Tax Assessment Basis

The assessment basis is the measurable surface area of land and buildings. There is no precise definition for “measurable surface area”; consequently, local governments define the terms for themselves. For instance, some municipalities include common space in the area measurement while others do not. The definition of “measurable surface area” varies across municipalities.

## **Differentials**

### Tax Rates

The maximum and minimum tax rates are established annually by the central government (Knesset finance committee). The government adjusts the *arnona* rates according to annual inflation, by linking the rate to the consumer price index.

Local governments then further adjust the rates, within the range established by the central government, based on four criteria: location of the property in the municipality, actual use of the property, type of property, and age of the property. Location is the most important criterion for determining the assessed value of property. The basis for each criterion is described below:

- Use: There are two primary uses of property: residential and nonresidential. There are over thirty different categories for nonresidential property. Some of these include: offices and commerce; warehouses; industry; hi-tech; banks; insurance companies; cultural institutions; schools; museums; cinemas; hotels; restaurants; and theaters.<sup>59</sup>
- Location: Location of property within the municipality carries the heaviest weight in terms of determining the assessed base. Municipalities divide up properties into zones, or *arnona zones*, based on their use category and location

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<sup>59</sup> See Darin, 1999 p. 6 for a more exhaustive list

within the municipality. For example, in Tel Aviv, there are five residential zones and five nonresidential zones. Zone 1 is the most desirable and zone 5 is the least desirable.

- Type: In Tel Aviv, the type of property is determined by the zone and the size of the property. For instance, in zone 1, the best zone, where 25 percent of all residential units and 33 percent of residential area are located, there are four types of residential property: 1) individual houses over 11 sq. m.; 2) apartments larger than 180 sq. m.; 3) apartments between 100 and 180 sq. m.; and 4) all other housing units.

There is only one type of property in zones 3, 4, and 5 because of the low rate. These zones account for 41 percent of residential units and 34 percent of residential areas.

For nonresidential units, the types of buildings vary according to land use, and size is the only criterion for division.

- Age: There are seven age categories for residential property and three for nonresidential property.

Nonresidential property is taxed at a higher rate than residential property.

### **Reform**

As of 1999, there was no formal plan for property tax reform. However, Dan Darin, in his political analysis of Israel's property tax system, notes that there is some public discontent with the *arnona* system; for instance, local residents often express annoyance with the fact that there is no correlation between services delivered in a specific neighborhood, or *arnona* zone, and the amount of tax paid.<sup>60</sup> Moreover, complaints are also expressed regarding inequities that arise from the seemingly arbitrary boundaries of the *arnona* zones.

Legislation has been introduced to reform the property tax system; however, no legislation has been approved that would dramatically overhaul the system.

### **Summary**

This review outlines the property tax systems in countries that use measures other than market-value, seeking to answer several questions: What type of non-value-based assessment methods are used? What, if any, adjustments are made to the taxable base of property to better reflect value? How are these adjustments factors determined? Twelve

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<sup>60</sup> See Darin, 1999 p. 17

countries are examined: 11 transitional and developing countries from Central and Eastern Europe and East Africa, and one developed country, Israel.

## **Property Tax Base and Non-Value-Based Assessment Methods**

### Property Tax Base

For the most part, the countries reviewed here levy a tax on both land and buildings. Nine countries in this review levy a property tax on both land and structures. In each case, the land and improvements components of the tax base are estimated and taxed separately. Tanzania limits its tax base to buildings only because, as of 2000, all land was owned by the state. At the other extreme, Kenya and the Ukraine levy a tax on land only (small local fees are levied on buildings in the Ukraine).

### Assessment Basis

The most commonly used non-value-based method of assessment is the area-based method, which levies a tax per square meter, or hectare, of property. Eleven of the 12 countries use area as the assessment basis at least to some extent. Tanzania is the only exception: in the absence of data on value, a flat tax rate – i.e., amount of tax per structure – is used.

Kenya is the only country in this review to use, for the most part, a value-based assessment method for urban land. Urban areas in Kenya use market value or some combination of value and area to determine the assessed value of property. Area is used primarily for agricultural land in Kenya.

## **Differentials**

The use of differentials (adjustment coefficients and/or tax rates) is common among the countries reviewed here. Ten of the 11 countries use some type of differential to account for different property characteristics.

A classified tax rate structure is the most commonly used method to account for these differences. All of the ten countries that use differentials employ some type of classified rate structure. Most commonly, tax rates are used to differentiate between residential and business property, urban and non-urban property, and property in high density and low density communities. There are instances of countries using differentials to measure factors such as quality (Croatia), ownership (Croatia), and services (Tunisia). Croatia and Tunisia were not discussed in this review. Croatia was excluded because of its limited use of property taxation (Croatia levies a property tax on only country cottages used for holiday), and Tunisia was excluded because of a lack of information available on its property tax system.

The four countries (Czech Republic, Georgia, Russia Federation, and the Slovak Republic) that use adjustment coefficients in addition to a classified rate structure were all influenced by the former Soviet Union. The Czech Republic, Slovak Republic, and Georgia apply coefficients based on the population size of the municipality within which



a property is located. Georgia also applies coefficients to adjust for other factors, such as economy, elevation, and transportation within an urban settlement. Russia applies coefficients to recreational areas and resort property. Russia has also used coefficients to increase revenues during times of monetary inflation.

Kenya and Hungary do not use differentials. Kenya was the only country to use a value-based assessment method for urban, nonagricultural land; therefore, differentials are not as necessary because the market-value of property more accurately reflects differences in property.

### Adjustment Criteria

What is considered desirable? Overall, there were three principal criteria that result in higher tax rates or adjustment coefficients applied to the property base: the population density of the locality within which the property is located, the use of the property (residential or nonresidential), and, in the case of agricultural property, soil quality and use (hayfields, meadows, etc.). Property that is used for economic purposes or that is located in densely populated areas, or urban areas, is generally taxed at substantially higher rates than residential property or property located in rural areas. Other factors such as the quality or age of property are also used, but not as frequently as population and use.

### **How are adjustments determined?**

While many countries employ differentials, little information is available regarding how the different rates or coefficients are determined and weighed. In their review of the Czech Republic, Bryson, Cornia, and others note that, while these coefficients are used by localities, the authors were unable to find information as to how the values for the coefficients are determined. This was the same finding in the case study of Slovakia (covered in a separate paper that is part of this fellowship report). Consequently, it is unclear whether or not the adjustments made to the assessed value of property are arbitrary, and therefore, whether they improve the approximation of differences in market value.

In many of the countries (nine of 12), the differentials that are established by the central government may be further adjusted by the municipalities before they are applied to individual properties or property zones within the municipality. For instance, in Georgia and the Russian Federation, the literature notes that property zones are established within the localities based on criteria such as economic activity, access to transportation, and geological characteristics; however, little more is available on how these localities define these areas. Israel's localities also establish local property zones, or *armona* zones, to differentiate among properties. Dan Darin, in his review of Israel's property tax system, provides some insight into the categories used in Tel Aviv to group properties, but he notes that the methodology, or process, by which these divisions are made is not clear; and it is difficult to determine which criteria are weighed most heavily and why.

Further research to determine how differentials are determined, and the extent to which they actually reflect differences in market values, would be beneficial as transitional and developing countries attempt to move towards an ad valorem tax. For example, Poland and the Ukraine have discussed plans to, eventually, move toward an ad valorem tax system, and are considering, as an interim step, the use of coefficients to adjust for factors such as location and use.<sup>61</sup>

One of the disadvantages commonly cited regarding non-value-based methods of assessments is that the system is not equitable because it is not able to capture differences in property that may affect the value; as a result, the tax burden is not allocated based upon ability to pay, which is an important criterion for public acceptance of the property tax. Understanding the effectiveness of local governments in making further adjustments to the national tax rates to better allocate property tax burden within their jurisdiction would be beneficial for countries and their localities, until information on property values are available.

### **Local Authority and the Property Tax**

In all of the countries in this review, the central government possesses ultimate authority, and local governments are established by the government and are generally subject to national laws and regulations. The central government may delegate powers to sub-national governments, but the central government has the authority to limit or recall these powers. Moreover, the central government determines the property tax policy and in several cases performs the administrative functions as well. In this review, the property tax is considered a local tax if all property tax revenue is retained by the taxing municipality. Seven of the countries reviewed, have a local property tax – Czech Republic, Hungary, Israel, Kenya, Poland, Slovak Republic, and Tanzania. Moreover, the local governments in 10 of the countries are authorized to adjust property tax rates within the range set by the central government. These ten countries include the Czech Republic, Hungary, Israel, Kenya, Poland, Russia Federation, Slovak Republic, Tanzania, and the Ukraine. The Appendix at the end of this review provides detailed information on each country's tax on immovable property, as well as some related information.

#### Property Tax Revenue

Property tax revenue as a percentage of total local revenue is an indicator of the importance of the property tax for local governments. Non-value-based systems are less buoyant than value-based systems and, thus, may not provide a stream of revenue for local governments that keeps up with rising prices and growth in demand for services.

In this review, property tax revenue as a percent of local government revenue was substantially higher in Israel than any other country in this review. The property tax share of local revenue for Tel Aviv in Israel was more than twice as high as its share of local revenue for other countries.

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<sup>61</sup> See Bird 2002a and 2002b for a discussion of property tax reform in Poland and the Ukraine.

Kenya (20 percent), Albania (15 percent), Poland (13.4percent), and the Slovak Republic (9 percent) followed Israel (55.8 percent). Data are not for the same years for all countries, but the information still provides some insight into the significance of the tax for local governments in each country. See table 14 below.

**Table 14.**  
**Property Tax as a Percent of Total Local Revenue**

Country	Year	Pct of Local Govt Revenue
Albania	1999	15%
Belarus	N/A	N/A
Czech Republic	1998	2.5%
Georgia	1999	7.7% (land only)
Hungary	1996/97	1.07%
Israel <sup>1</sup>	1997	55.8%
Kenya	2000/01	20%
Poland	1998	13.4%
Russian Federation	2000	2.21% (land only)
Slovak Republic	1998	12.4%
Tanzania	N/A	N/A
Ukraine	1998	8% (land only)

*Source: See footnotes in each country section.  
(1) This number is for Tel Aviv*

Kenya's property tax revenue share was the second highest, although it has been declining as percentage of total local revenue: in 1990/1991, it was 26% and in 2000/01 it was 20%.<sup>62</sup> Kenya uses a value-based method for urban property; this may account for the larger percentage of revenue when compared with other countries. A close examination of the property tax system in Kenya showed that the primary obstacle to increasing revenue was weak administration and lack of political will, not property assessment.<sup>63</sup>

Transfers and grants from the central government account for the majority of local revenues for most of the local governments in the study countries, other than Israel.

## Conclusion

Area as the tax base of property combined with adjustments for location, population, use, or soil quality is the most common non-value-based assessment practice used in the countries in this review. Property that is located in a highly populated, or urban, area and is used for economic purposes is generally taxed at the highest rate. However, as noted

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<sup>62</sup> Kelly, 2002a

<sup>63</sup> Kelly, 2002a

above, it is not clear either how the tax rates or adjustment coefficients are calculated by the central or local governments, or which criteria are weighted most heavily in determining property assessment.

There is not much mention in this literature of localities using proximity to public services (e.g., transportation, refuse collection, parks, or other amenities) as a factor for increasing the desirability of property. It may be possible that local authorities are taking access to public amenities into account, but there is little detailed information available on the way in which localities determine property tax rates or coefficients. Population density is most commonly used as a proxy for market pressure; this leads to higher rates in these areas, which helps fund the higher level of public services generally provided in urban areas, compared to rural areas.

Israel is an interesting example for countries that are attempting to implement a non-value-based property tax. The tax generates a significant amount of revenue for municipalities: the central government links the Arnona to a cost-of-living index, which helps ensure a rising flow of revenue.<sup>64</sup> Moreover, the municipalities have the ability to adjust property rates based on four criteria: location of property within the locality, actual use, property age, and type of property. However, like other countries in this review, it is still not clear exactly how the location boundaries and other factors are determined and weighted.

Israel's system also differs from the other systems in this review in a couple of important ways. First, there is a history of property taxation: the property tax system was introduced in the 1930's by the British and has remained in place since its inception. Generally, the countries in Central and Eastern Europe introduced their property tax systems in the early 1990s, and in East Africa, the property tax was introduced in the 1970s and 80s. Second, the property tax is well enforced, which improves collection rates and can be as problematic for revenue collections as a non-value-based assessment method.

Further research on the methodology for determining adjustment factors and, specifically, those made by local governments, is needed in order to better understand whether or not these adjustment coefficients and rates improve the relationship between tax liability and property value, and thus distribute the tax burden more equitably. A transparent and equitable property tax system is critical to ensure that the tax is accepted by the public as a legitimate source of local government financing.

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<sup>64</sup> Darin, Dan 1999 p.15

**Table 15.**  
**Local Government Authority in Property Tax System**

<b>Country</b>	<b>Ability to Adjust Rates or Coefficients<sup>2</sup></b>	<b>Allocation of Property Tax Revenue</b>
Albania	No	Shared <sup>1</sup>
Belarus	No	Shared
Czech Republic	Yes	Local
Georgia	Yes	Shared
Hungary	Yes	Local
Israel	Yes	Local
Kenya	Yes	Local
Poland	Yes	Local
Russia Federation	Yes	Shared (land tax)
Slovak Republic	Yes	Local
Tanzania	Yes	Local
Ukraine	Small surcharge	Shared

<sup>1</sup>Property tax revenues are shared between different levels of government.

<sup>2</sup> Within the range set by the central government

### Country Information Sources

<b>Country</b>	<b>Information Sources</b>
Albania	Almy, 2001; Brown & Hepworth, 2002; CIA World FactBook, 2004; National Geographic Atlas of the World, 1999;
Belarus	Almy, 2001; Brown & Hepworth, 2002; CIA World FactBook, 2004; Kobasa, Karamyshev, and Dritz, 2001;
Czech Republic	Almy, 2001; Brown & Hepworth; Bryson and Cornia, 2001; CIA World FactBook
Georgia	Almy, 2001; Brown & Hepworth, 2002; CIA World FactBook, 2004; CCP. 1998; Losaberidge, Kandelaki, Orelashvil, 2001.
Hungary	Almy, 2001; Brown & Hepworth, 2002; CIA World FactBook, 2004; National Geographic Atlas of the World, 1999; Tassonyi, 2002.
Israel	CIA World FactBook, 2004; Darin, 1999
Kenya	CIA World FactBook, 2004; Konyimbih, Tom; Kelly 2000; Kelly, 2002a;
Poland	Almy, 2001; Bird, 2002a; Brown & Hepworth, 2002; Brezksi, 2003; CIA World FactBook, 2004; Malme and Brzeski, 2001;
Russian Federation	Brown & Hepworth, 2002; CIA World FactBook, 2004; Malme and Kalinina, 2001; Timofeev, 2002;
Slovak Republic	Almy, 2001; Brown & Hepworth, 2002; Bryson, Cornia, et al, 2001a; CIA World FactBook, 2004;
Tanzania	CIA World FactBook, 2004; Kelly and Musunu, 2000; Kelly, 2002b;
Ukraine	Almy, 2001; Bird, 2002b; Brown & Hepworth, 2002; CIA World FactBook, 2004; Parkhomenko, et al., 2003

## Section II: Area-Based Property Taxes in Slovakia: A Case Study

### Introduction

It has been estimated that as many as 75 or 80 countries around the world are exploring how to implement a system of fiscal decentralization. In order to realize the perceived benefits of fiscal decentralization initiatives, certain prerequisites need to be in place in a local community. For example, one factor necessary for a fiscal decentralization scheme to realize its full potential is that decision makers at the local government level must have adequate information to make policy decisions and allocate limited resources most effectively. [Yilmaz, Hegedus, and Bell, 2003, p. 2] Similarly, Putnam finds that local government institutions work best when there is a strong civic infrastructure. [Putnam, 1993] In addition, Bahl argues that fiscal decentralization requires significant local government own-source taxing powers. [Bahl, 1999] To fully realize the perceived efficiency benefits of fiscal decentralization, autonomous local governments need to generate adequate own-source revenues to provide the level and quality of services demanded by residents and businesses.

Bahl reviews the potential strengths and weaknesses of various tax instruments from the perspective of local governments. He concludes that “the property tax is a most appropriate source of local government revenue, and it is a revenue source used by local governments in most countries in the world.” [Bahl, 1999, p. 8] Similarly, Litvack, Ahmad, and Bird conclude that in designing a system of fiscal decentralization economic and administrative efficiency concerns suggest that local governments should tax immobile factors such as land and real estate. [Litvack, Ahmad and Bird, 1998, p. 11] Shah also argues that efficiency in tax administration suggests that subnational governments should levy taxes on immobile factors, e.g., property taxes. [Shah, 1999, p. 26]

Not surprisingly, then, the property tax is the single most important local own-source tax in developing countries. [Bahl and Linn, 1992, p. 79] Internationally, over 130 countries have some form of tax on property, albeit the relative importance varies substantially across countries. [Eckert, 1990, p. 6]

Unfortunately, however, in developing and transition countries, the property tax often does not realize its full revenue potential producing low yields because of administrative problems and historical precedents. For example, in many countries of the former Soviet Union, Central Asia, and Africa there is often either no privately owned property or, when there is private property, there is often no well-developed real estate market. As a result, market values for individual properties cannot be determined and there is only a weak foundation for an *ad valorem* type property tax typical in the West. This undermines the ability of local governments to fulfill their obligations under a system of fiscal decentralization.

A similar situation has emerged in some rural areas in South Africa. In December 2000, municipal boundaries were extended to include the entire land area of South Africa. All

land in the country now is contained within the boundaries of a municipality. Also, each municipal area must develop and implement a property tax system throughout its area. Many of these new municipalities contain within their boundaries large areas of tribal lands. This presents a problem because, in tribal areas, property is owned communally with occupancy rights assigned by the chiefs; property markets simply do not exist, and will not develop in the near future.

In rural areas, there basically are now, as some Africans put it, "two bulls in one kraal." There are two governance structures covering the same physical area – a "western style" elected municipal government and a system of traditional leaders. Each bull has its own constituency (support base), and also its role to play in the governance of rural areas of South Africa. This situation creates a tension between traditional authorities and municipal structures which was explicitly acknowledged in the White Paper on Local Government. Extending the local property tax to include traditional tribal lands is one of the main points of contention in this tension. [Ministry of Provincial Affairs, 1998, p. 77]

In summary, the task confronting local officials in newly created municipalities in many rural areas of South Africa is to bring into the property tax base large tracts of land where private ownership is either a foreign concept or simply does not exist, and where, as a result, there are no private land markets. In this context, the challenge in rural areas is to determine a basis for tax purposes *without undermining traditional land tenure systems*. Finding such a solution may provide a significant contribution toward relieving some of the tension between traditional leaders and municipal authorities. The literature review summarized in Chapter 1 was a general reconnaissance of what information is currently available about what other countries have done to implement a local property tax when there is no well functioning real estate market. The purpose of this chapter is to present the following case study of the Slovak Republic which provides more detailed insights into how a country embarking on a fiscal decentralization strategy could create a local property tax in the absence of well-functioning real estate markets.

### **The Slovak Republic**

Fifteen years ago, there was essentially no private property in Slovakia. Even today, according the Ministry of Finance, implementing a land tax in Slovakia is hindered because ownership of many pieces of land has not been sorted out yet. In fact, a significant portion of land is still owned by the government in Slovakia. [Bryson *et al*, p. 64] Since the Velvet Revolution, then, municipalities in Slovakia charged with administering the property tax have had to resort to what Malme and Youngman describe as "a choice among formulary values, price approximations, and nonvalue means of allocating the tax burden." [Malme and Youngman, 2001, p. 1] But, if the development of a local property tax in developing and transition countries is an evolutionary process, lessons from Slovakia may help inform policy discussions about the design and implementation of a local property tax in rural areas of South Africa with competing governance structures, or other countries just starting a process of fiscal decentralization.



As described by Bryson *et al.*, the property tax policy in Slovakia is established by the Ministry of Finance, but the day-to-day administration of the property tax is done by municipalities, most of which are very small. Land and buildings are taxed separately and the tax on each is based on area *with adjustments* for the location of land and buildings and for the utilization of the taxed units. According to the authors, “These piecemeal efforts to approximate a property’s actual value for tax purposes represent a limited substitute for market valuation.” [Bryson *et al*, 2001, p. 58]<sup>65</sup>

To understand better how these adjustments are made, a case study of local property taxes in the Slovak Republic was undertaken to describe how land area data are adjusted to approximate actual value, how those adjustments are determined, and who makes them. The study was conducted in country, in Bratislava. We interviewed the directors of finance from two municipalities and a councilperson from another municipality. We met with the Union of Towns (primarily larger cities in Slovakia) and the Association of Towns and Communities (primarily smaller jurisdictions). This paper summarizes what we learned from the case study and describes the techniques used to adjust land area to more accurately reflect market values.

The framework for the current municipal property tax in Slovakia is provided in legislation drafted by the Ministry of Finance and passed by Parliament in 1992 (Public Law 317/1992). As a first effort to differentiate the area of land and buildings for property tax purposes, the law identifies three major categories of real estate subject to taxation – land, buildings, and flats (apartments in large apartment buildings which are typically owned by the occupants). Each category is broken down into the subcategories shown in Table 1.

**Table 1.**

LAND USE TYPES FOR MUNICIPAL PROPERTY TAXES SLOVAK REPUBLIC		
Land	Buildings	Flats
Vineyards/arable lands	Residential	For living
Pasture	Agricultural	For business
Gardens	Recreation cottages	Rental properties
Forest	Garage	
Fish ponds	Industrial	
Vacant building lot	Other industrial/commercial	
Other building lot	Other buildings	
Other remaining lots		

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<sup>65</sup> It should be noted that as this paper is being written the Ministry of Finance in the Slovak Republic is drafting a new municipal finance law that would move toward a value-based property tax. For our purposes, however, we are interested in initial efforts to implement a property tax when there was no private property and no well-developed real estate market.

The law then specifies a target tax rate to apply to each category of land, buildings, and flats within a given municipality. However, municipalities have discretion to increase the actual rate on each category of property by 100 percent, or reduce the tax rate by up to 50 percent, so the actual pattern of relative rates can differ considerably across properties within a given municipality, and that pattern probably will not be the same across municipalities as a result of this allowed discretion. Decisions to adjust the tax rate for specific land use categories are made by the city council and are conveyed to the general population through advertising and other means. Table 2 gives the target tax rates included in the legislation by the Ministry of Finance for each category of land and buildings.

The first thing to notice is that four of the land use categories have rates that are expressed as percent of value, while all the other categories have a tax rate expressed in terms of Slovak Crowns (sk) per square meter of area. The Agriculture Institute, within the Ministry of Agriculture, has extremely detailed data on the quality and potential productivity of agricultural lands, and adjacent parcels can have substantially different estimated productivity. [Bryson *et al*, 2001, p. 60] These data are used to estimate the potential income to be generated from individual parcels, which in turn, is used to estimate the agricultural value of land for property tax purposes.<sup>66</sup> While these agricultural values may be reasonable estimates of market value in rural areas, they will not be reasonable estimates of market value in urban areas (or areas where vacation cottages are being developed) where there is pressure to convert agricultural lands into residential or other urban land uses.

**Table 2.**

LEGISLATED TAX RATES FOR EACH LAND USE CATEGORY SLOVAK REPUBLIC					
Land		Buildings (per square meter)		Flats (per sq. meter)	
Vineyards/arable lands	0.75%	Residential	1.00sk	For living	1.00sk
Pasture	0.25%	Agricultural	1.00sk	For business	10.00sk
Gardens	0.10sk p.s.m.	Recreation cottages	3.00sk	Rental properties	10.00sk
Forest	0.25%	Garage	4.00sk		
Fish ponds	0.25%	Industrial	5.00sk		
Vacant building lot	0.10sk p.s.m.	Other industrial/commercial	10.00sk		
Other building lot	1.00sk p.s.m.	Other buildings	3.00sk		
Other remaining lots	0.10sk p.s.m.				

<sup>66</sup> It is not clear how often the values are updated to reflect changes in market prices. While some arable land is valued at 10 or 12 sk per square meter, most such land is valued at less than 5sk per square meter and most pasture land is valued at less than 1sk per square meter (when this study was undertaken \$1 USD equaled 32 sk).

In addition to varying the tax by land use category within a municipality, the legislation also makes allowance for differences in the level of taxes across municipalities, with adjustments based on the size of the municipality where a particular parcel is located. The legislation stipulates specific coefficients that are to be used when calculating the property tax liability; the coefficients currently in effect are summarized in Table 3. For properties located in the smallest municipalities the coefficient is 1.0; for identical parcels in district seats or spa towns the coefficient is 3.5; for identical parcels in regional centers the coefficient is 4.0; and for identical parcels in the capital of Bratislava the coefficient is 4.5.

**Table 3.**

Coefficients for Municipalities Based on Population Slovak Republic	
Population Size	Coefficient
1,000 or less	1.0
1,001 to 6,000	1.4
6,001 to 10,000	1.6
10,001 to 25,000	2.0
Over 25,000	2.5
Seat of District (89) and Spa Towns	3.5
Seat of the Region (8)	4.0
Bratislava	4.5

We tried, but failed, to obtain information from the Ministry of Finance to explain how these coefficients were determined. For example, why is there a 4.5 to 1 ratio between Bratislava and the smallest municipalities? Also, when we were in Bratislava, legislation was being developed to increase the coefficient for Bratislava from 4.5 to 13.0. We wanted to understand why it was 13 and not 12 or 15. We did not get an explanation of how these coefficients are calculated, albeit one Ministry of Finance staff person said, off the record, that they were probably calculated based on how much money municipalities needed to generate to balance their budgets.

Again, however, individual municipalities have discretion in how they apply the coefficient for their city. They can apply the coefficient uniformly across all land use types in the city, which was typically done until January 2004 when municipalities were allowed more discretion in applying the coefficients. Alternatively, they can apply the coefficient differentially spatially across the municipality and/or differentially across land use classes within the municipality.

We talked to the finance director of a regional center and to a finance director for one of the 17 boroughs within Bratislava and to a council member from another of the 17 boroughs in Bratislava (each of which has its own city council and mayor). In the case of the regional center, the finance director indicated that the coefficient was applied differentially across land use types in an effort to make sure no land use type had an

excessively high property tax burden. These decisions were made by the city council and communicated to the entire community in an open and transparent manner. In this case, however, the differential application of the coefficients represents a political effort to obtain a desired distribution of property tax liabilities across land uses, not an effort to reflect market pressures on individual parcels of land.

In the case of one of the boroughs of Bratislava we were told that the coefficient was applied differentially across different neighborhoods in the borough based on the availability and quality of infrastructure services, especially gas and transport. These decisions were made by the professional staff within the finance office based on objective criteria for gauging the level and quality of infrastructure services available in a neighborhood. While these adjustments were made in an effort to reflect market influences on individual parcels, not all land uses within the neighborhood received a differential benefit (i.e., lower taxes). Typically, the benefit was targeted on residential properties. In another borough the coefficient was applied uniformly because all areas of the borough have adequate levels of infrastructure services.

In the case of another borough, a combination of approaches was used in applying the coefficient differentially. There was a reduction in the coefficient for residential properties in neighborhoods with inadequate or non-existent infrastructure services. In addition, since this borough had a population of only 6,000 inhabitants, they wanted to protect the small businesses servicing the community from excessive property tax burdens so these land uses also received some benefit from the differential application of the coefficient. Again, these decisions were made by the city council and publicized widely in the community.

In sum, Slovakia, like many other countries in Central and Eastern Europe, apply adjustment coefficients to the measures of area of individual properties to influence property tax liabilities. These adjustment coefficients, as we have seen in Slovakia, are applied differentially across neighborhoods and, in some cases, do reflect market influences, and in other cases do not. Specifically, while the typical rationale for such coefficients is to adjust for market influences, their differential application to keep property tax liabilities of certain taxpayers low undermines that objective by responding to certain political objectives about how the property tax burden should be distributed across individual properties. This type of application does not reflect market pressures; rather it responds to specific political pressures.

An example will help illustrate how the property tax is administered in Slovakia. The example is based on a residential property with a residential building of 100 square meters, a garden of 400 square meters, and a garage of 25 square meters.<sup>67</sup> The property is located in one of the spa towns with a coefficient of 3.5. In this example, we see that the city council decided to increase the tax rate on residential buildings by 43 percent over the rate spelled out in the legislation for this land use. Similarly, the city council

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<sup>67</sup> Each landowner completes and submits to the government a form that describes the land and buildings on the parcel subject to taxation. In other words, the initial information is self-reported by the landowner.

increased the rate on gardens by 50 percent and the rate on garages by 27.5 percent. The 3.5 coefficient for the spa municipality is applied uniformly across all land use types.

**Table 4.**

Example of Property Tax for Residential Property in Regional Center Slovak Republic					
Land Use	Area	Legislated Rate per Square Meter	Council Approved Rate Per Square Meter	Increased 3.5x by the Coefficient	Property Taxes Due
Residential Building	100 sq. m	1.00 sk	1.43 sk	5.005 sk	500.50 sk
Garden	400 sq. m	0.10 sk	0.15 sk	0.525 sk	210.00 sk
Garage	25 sq. m	4.00 sk	5.10 sk	17.850 sk	446.25 sk
Total					1,156.75 sk

The data in Table indicate that the owner of this residence would pay the city 1,156.75sk in local property taxes. Nearly 39 percent of the property taxes are attributable to the small one car garage on the property – a proxy for wealth because not everyone in the community will own a car, and not all of those who do will have garages. If the exact same property were located in Bratislava the coefficient would be 4.5 and the total tax liability would be 1,486.25sk – an increase of 28.5 percent – assuming Bratislava adjusted the basic rates for residences, gardens, and garages in the same manner as in the Table 4 example.

Table 5 presents statistics on total property tax collections in two jurisdictions – Trnava, one of the eight regional centers, and District 1, Old Town, in Bratislava. The data are broken down into taxes paid by individuals and businesses with a further breakdown of each category into the three land use types specified in the legislation. The data indicate that individuals pay between one-fifth and just over one-fourth of property taxes, while businesses pay the remainder. Interestingly, in both communities, for both individuals and businesses, land accounts for a relatively small share of property taxes. Specifically, land owned by individuals accounted for 2.8 and 3.9 percent of property taxes in Trvana and District 1 of Bratislava, respectively; while land owned by businesses accounted for 7.1 and 2.4 percent of property taxes in Trvana and District 1 of Bratislava, respectively. Alternatively, buildings owned by individuals accounted for 16.7 and 16.3 percent of property taxes in Trvana and District 1 of Bratislava, respectively, while buildings owned by businesses accounted for 71.9 and 67.8 percent of property taxes in Trvana and District 1 of Bratislava, respectively. Based on ratios of land value to improvements value that we have encountered in various places, these land shares of tax seem low.

**Table 5.**

Property Tax Collections by Land Use Type and Owner In Trnava and District 1 of Bratislava				
Category	Trnava		Bratislava – District 1	
	Slovak Crowns	Percentage	Slovak Crowns	Percentage
Individuals	16,868,560	20.1	14,779,237	26.9
Land	2,330,009	2.8	2,125,249	3.9
Buildings	13,922,776	16.7	8,925,346	16.3
Flats	615,775	0.7	3,728,642	6.8
Businesses	66,683,737	79.8	40,084,075	73.1
Land	5,928,862	7.1	1,342,041	2.4
Buildings	60,039,285	71.9	37,221,521	67.8
Flats	715,589	0.9	1,520,513	2.8
Total	83,552,297	100.00	54,863,312	100.0

These findings are consistent with more general information from the Ministry of Finance showing that, overall, industrial and commercial buildings produce much greater revenues per square meter of area than do agricultural or apartment buildings. [Bryson *et al*, 2001, p. 60] Bryson *et al* point out that

Apartments and agricultural buildings provided services and products, which were viewed as necessities of life in the communist era and were subsidized to keep their prices, and thus their taxes, very low. By contrast, industrial and commercial buildings were the sources of governmental revenue, and that tradition continues. [Bryson *et al*, 2001, p. 60]

Ideally, it would have been useful to collect information on actual sales prices of individual properties and compute some effective tax rates to see how uniformly the property tax is being applied. This was not possible, however, in large part because municipalities do not collect information on property sales. While there is a transfer tax assessed against the sales price of a property,<sup>68</sup> that tax is administered by the central government.

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<sup>68</sup> The base of the transfer tax is the higher of either the reported sales price or the assessed price as determined by a small corps of fee appraisers who report their values to the cadastre. The appraised values, however, are typically very low because the cost tables used by the appraisers have not been updated in decades. The reported sales price, while typically higher than the assessed value of the property, may not reflect the full price paid since reporting a lower price will lower the tax liability. As mortgages become more important in purchasing property, however, there is a tendency to report a higher sales price than might otherwise be reported since the amount of the mortgage is based on the reported sales price. Even when a mortgage is involved in the purchase of a property, the full sales price may not be reported; rather, only a price high enough to qualify for the necessary mortgage will be report.

## Strengths and Weaknesses Of An Area-Based Property Tax

Generally, a desirable local revenue source would generate a revenue stream that is relatively productive and stable over time, is relatively neutral with regard to its impact on private economic decisions, is simple to determine, and is equitable. A local property tax generally scores well on these criteria, but there are trade-offs across these criteria depending on how the property tax is administered.

### Revenue Productivity

Revenue productivity has three important dimensions. First, local governments need to have access to a revenue source that is going to be relatively stable over the course of the business cycle. Second, local governments need to have access to revenues that they can predict with some certainty. Third, local governments need access to a revenue source that will produce adequate revenues for them to meet their expenditure needs.

A stable tax generates revenues that change relatively more slowly than income. Real estate markets reflect long-term asset values, which tend to respond more slowly to annual changes in the level of economic activity than economic flows like business turnover or wages. Therefore, the property tax is regarded as a relatively stable revenue source – especially when compared to other potential local tax sources such as wage or turnover taxes. This would certainly be the case for an area-based tax as well.<sup>69</sup>

Predictability of revenues is critical feature for a local revenue source. Such predictability enable accurate and timely revenue forecasting which, in turn, facilitates certainty in budget planning and is critical for financing long-term debt obligations. Both a property tax based on market value and one which uses measures of area as the tax base score well on predictability.

Finally, revenue adequacy is another concern with local own-source revenues. The issue is the extent to which local own-source revenues generate funds adequate to finance needed local goods and services. While an *ad valorem* property tax can be a powerful local revenue source, an area-based tax may not generate adequate revenues to fund locally provided goods and services – especially in the early years when the tax rate is traditionally relatively low and people are becoming accustomed to paying a property tax. Also, as discussed above, an area-based property tax is a relatively stable tax changing slowly in response to changes in income. Expenditure needs, however, are more responsive to changes in incomes, thereby resulting in a potential imbalance between relative growth in expenditure needs and property tax revenues as income changes.

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<sup>69</sup> This assumes that the specific rates of an area-based property tax would not be changed often. The record for taxes such as gasoline taxes suggests the assumption is likely correct.

## Neutrality

Neutrality in taxation requires that taxes have a minimal unintended influence on private economic decisions. The individual or firm that pays the tax may be able to adjust behavior in ways that shift the ultimate burden of the tax to others or avoids the tax entirely. To the extent that economic actors adjust their behavior to shift or avoid the tax, the tax has distorted private economic decisions.

Taxes that are difficult to avoid have less of an impact on private economic decisions. For example, in the U.S. the property tax typically is assessed against real property – both land and improvements. Land is in fixed supply and landowners who are using their land in the best way possible cannot change their behavior to avoid paying the tax. Thus, a tax on land is generally thought not to cause any distortions in economic behavior. The situation is somewhat different for the component of the property tax on improvements. In the short-run, improvements may be relatively immobile and there is little that owners can do to avoid the tax. Over the long run, however, resources needed for maintenance of existing structures and construction of new structures will be diverted from high-tax to low-tax jurisdictions.

The manner in which a property tax is administered, both an *ad valorem* and area-based tax, will influence the ultimate impact the tax will have on private economic decisions. To illustrate, we see that in Slovakia, as in other countries of former Soviet Union, the property tax is administered in such a way that the vast majority of the tax falls on structures, not land. For example, for the two jurisdictions reported in Table 5, property taxes on land accounted for less than 10 percent of total property tax collections, with the rest of the tax being assessed against structures. This provides an incentive for people to try to avoid the tax by changing their behavior – in this case, but reducing the area of buildings subject to the tax. Similarly, a value-based property tax that taxes land and improvements will have similar adverse incentive effects when it comes to maintaining the quality of structures. In the value-based model, however, a person can simply let the property run down and the tax liability would be reduced from what it otherwise would be. But the overall area of the building would be unchanged, only the condition of the building. In this sense, an area-based tax may be somewhat more neutral with regard to the portion of the tax falling on structures. As a result, an area-based tax that taxes buildings at a much higher rate may have less of a distorting impact than an *ad valorem* property tax, where incremental changes in the value of property can be accomplished by deferring maintenance, using lower-quality materials, etc.

## Simplicity

Taxes may cause distortions in the allocation of economic resources if they are complex and difficult to implement. These distortions arise from the substantial resources taxpayers may have to spend to comply with the tax law, *compliance costs*, and from the resources required by the government to administer and enforce the tax, *administrative costs*. Relative to other potential local tax sources with tax bases that are annual flows that must be monitored and verified, the property tax is easy to administer – especially an



area-based property tax. The relative importance of compliance costs borne by taxpayers and administrative costs borne by the government depends, in part, on how the tax is administered. For example, if in the initial years of an area-based property tax the government relies on some form of self-assessment, the compliance costs will be somewhat higher for the taxpayer – albeit they will not be too high because the taxpayer merely has to provide some initial measurements of the land and buildings on her parcel.

## **Equity**

In public finance there are two perspectives on this equity issue – the ability-to-pay and the benefits-received principles of taxation.

The ability-to-pay principle of taxation stipulates that the burden of financing general community services should be distributed across property owners in relation to the value of their property, which is a proxy for ability-to-pay, with greater shares being allocated to those with greater ability to pay (vertical equity). Also, similar properties should be treated equally (horizontal equity).

A property tax based on market values generally scores well on both vertical and horizontal equity grounds. However, an area-based property tax generally scores poorly on fairness grounds when the policy objective is to distribute the property tax burden across individual properties based on the ability-to-pay principle of taxation. An area-based tax that makes no adjustment for quality of materials, state of repair, location, and other influences on value will score poorly on horizontal, and vertical, equity – if one thinks value is the best yardstick with which to measure equity among taxpayers; not all houses of a given size will not have the same value. One approach to overcome such limitations would be the application of coefficients that reflect market differences, not political objectives.

Alternatively, the benefits-received principle of taxation stipulates that the costs of community services should be allocated across individuals according to the benefits they receive. Local governments provide a variety of goods and services to their citizens and different goods and services are financed by different funding mechanisms. Some services have private good characteristics and are funded through direct charges – or tariffs – based on the level of service consumed. Individual usage is monitored and bills are sent to residents based on how much they actually consume. Water, sewerage, and solid waste collection and disposal systems are examples of such services.

In addition, local governments provide a wide array of services that benefit the community in general. Such community services include, but are not limited to, fire protection, primary health clinics, parks, libraries, street lighting, storm-water drains, traffic police, roads, and the like. These services benefit everyone in the community and they need to be funded through general taxes paid by everyone. The property tax is the way that most people pay for these general community services.

In this context, an area-based property tax scores somewhat better from the perspective of the benefit principle of taxation, especially when the coefficient is applied differentially across neighborhoods to reflect the level and quality of infrastructure services being provided. In such cases, the adjustments could be refined beyond the relatively limited adjustments made in Slovakia.

In conclusion, as summarized in Table 6, based on traditional criteria for evaluating a revenue system, an area-based local property tax scores relatively well on revenue stability, predictability, neutrality and administrative simplicity while an *ad valorem* property tax scores better on revenue productivity and equity based on an ability-to-pay principle of taxation. The manner in which the property tax is administered, however, greatly influences its productivity, neutrality, simplicity, and equity.

**Table 6.**

Criteria for Evaluating a Revenue Source		
Criteria	Area-Based Tax	Value-Based Tax
Revenue	+	+
Productivity	-	-
Neutrality	+	+
Simplicity	+	-
Equity	-	+

### Conclusion

As developing and transition countries experiment with fiscal decentralization, the role of the local property tax becomes critical as a source of revenues controlled by the local government. In countries where there is either a history of no private property, or where there are no well-developed real estate markets, the development of a vibrant and credible property tax should be viewed as an evolutionary process. While the ultimate objective is to move toward an *ad valorem* property tax, the strategy of achieving that objective must consider the starting point of the country undertaking fiscal decentralization. Thus, in many cases, the first step in the process of developing a local property tax might involve establishing an area-based property tax, based on self-reported data from the taxpayer, with adjustments to reflect differences in land use types and locations.

Such an approach, as we see in Slovakia, has the advantage of being relatively simple to administer – the initial description of the property is provided by the taxpayer and relatively little data are collected. But the precedent of providing information to the government for tax purposes has been established so that more information could be collected at later stages of the evolution of the property tax toward an *ad valorem* tax.

While an area-based tax might be administratively simpler than an *ad valorem* tax, it might be criticized as being less fair because the tax liability is not being distributed

across properties in a clear relationship to ability to pay. The most important feature of any property tax is that the tax paying public must view the tax as fair – it must have legitimacy with the tax paying public. This is particularly difficult when there has been no property tax previously.

In this context, it is important to note that the finance directors and councilors we talked to indicated that their collection rates ranged from 80 to over 95 percent. In the case where the collection rate was only 80 percent, the finance director said that was a direct result of the relatively heavy tax on commercial and industrial buildings and the relatively high rates of business failures in their community. Most of the uncollected taxes were due from firms going out of business, which were simply not able to pay their taxes. Overall, one would have to say that collection rates were relatively high across the jurisdictions we examined. This suggests the local population generally accepts the tax as fair and legitimate.<sup>70</sup> This seems to be a critical accomplishment before moving on to a more complex system of property taxation based on market values.

Bryson *et al* recognize that moving to market valuation of properties could enhance the equity and efficiency of the property tax system. They acknowledge, however, that such a move is hampered by the lack of market data. They conclude that, in the absence of market data, it is possible and advisable to refine the existing valuation process by better accounting for the location and quality of assessed properties. [Bryson *et al*, 2001, p. 60]

In this context, it seems a couple of things could be done. First, there should be a review of the coefficients with an explicit justification provided as to the value of each coefficient for each municipal category. Second, there should be some criteria spelled out to guide the differential application of the coefficient across areas of a municipality. For example, if areas have poor or nonexistent infrastructure services, they should be “valued” at a lower level than comparable properties in neighborhoods with better infrastructure services. Third, using the differential application of the coefficient as a means of targeting property tax relief on those in need should be stopped. Alternative means of targeting tax relief on those taxpayers most in need should be developed. Fourth, coefficients could be developed for the larger cities that vary across neighborhoods or boroughs to better reflect differences in things that ultimately affect property values. Finally, where appropriate, estimates of the agricultural productivity of parcels should be used to estimate the agricultural values of parcels in rural areas.

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<sup>70</sup> It could also reflect the fact that property taxes are relatively low and fall primarily on commercial and industrial buildings. But for all the jurisdictions we examined it seemed that elected officials were very aggressive in communicating with the public about the property tax – the rates set, the differential application of the coefficient, and the resulting distribution of property tax liabilities across different land uses and owners.

### Section III: Factors Influencing the Desirability of Tribal Land in South Africa

#### Introduction

The final stage of reinventing local government in South Africa extended the institution of municipal government to all areas of the country, including rural, traditional tribal areas. These new municipal structures have the authority to implement a local property tax as a means of generating revenues to provide local services. But these laws do not make any distinctions between applying the property tax in urban areas, where there is along history of private property and property taxation based on market values, and rural areas, where land is often held in common and there are no functioning real estate markets.

In traditional tribal areas the problems are particularly acute. A property tax based on market value is rooted in a specific form of land tenure, freehold tenure. In tribal areas, however, a more complex system of land tenure exists, ranging from open access commonage to specific Permissions (or Permits) to Occupy (PTOs) or Certificates to Occupy (CTOs). Allocation and control of these mechanisms of distributing land rights typically rests with tribal or traditional leaders, who make them in accordance with local customs and social hierarchies. Introduction of a property tax based on market value threatens drastic and wholesale change in this set of tenure arrangements, and constitutes an effective challenge to the authority of traditional leaders.<sup>71</sup>

One indication of the importance of bringing tribal area lands into the property tax is the significance of these lands in some municipal government areas. For example, officials in Thulamela municipality – a local municipality in a rural area of Limpopo province – estimated that about 90 percent of the land area in the municipality is traditional land held in common for the tribe, and not now included on the property tax rolls. There is limited private ownership and no well-developed real estate market outside a few urban agglomerations. Another indication is provided by 1996 census estimates by Statistics South Africa, which count over 15 million South Africans – about one-third of the total population – in the tribal areas of the country. Nearly 12 million of these are in just three of the nine provinces: Eastern Cape (3.7 million), Limpopo (4.1 million), and KwaZulu-Natal (4.1 million).

We selected a rural area in Limpopo province for this project. David Solomon, our colleague on earlier phases of our work on South African property taxation, has been working on land tenure issues in the area and has been assisted by Tinyiko Chauke, one of his students (a recent graduate) at the University of the Witwatersrand in Johannesburg who comes from the rural area.

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<sup>71</sup> David Solomon with Ndumiso Gola, Mbulelo Ngxesha and Wycliffe Ndlela, “Tribal Land and the Property Tax” Chapter 11, in Michael E. Bell and John H. Bowman (editors), *Property Taxes in South Africa: Challenges in the Post-Apartheid Era*, Lincoln Institute of Land Policy, 2002.

The rural area we visited for this study is located in the former Venda Bantustan. The people in the region come primarily from the Tsonga and Shangaan tribes. We were told that the head of this Bantustan and many of the chiefs in this area, who were actually appointed by the apartheid government, cooperated with and received support from the apartheid government. We had a sense that things in this area were somewhat better developed than some of the rural areas we have visited in the Eastern Cape. In part, this could be because this area was cooler and perhaps wetter than in the Ciskei region of the Eastern Cape. For example, we drove by many mango orchards and banana plantations, which we have not seen in the Eastern Cape. In part, however, the feeling of relative prosperity in this region could reflect the fact that the chiefs in Venda had a better working relationship with the apartheid government than King Sandile in the Eastern Cape and, as a result, received more infrastructure investment and support, albeit not all of that additional support was used to benefit the people of the region. Another possible explanation may be different levels of revenue from the Regional Service Council (RSC) levies, to support district council governments. It is stressed, however, that the impression gained was one of only relative prosperity, not of absolute prosperity. Descriptive statistics below make this clear.

### **Local Governments in Study Area**

Under the local government reorganization put into effect in December 2000, the area we visited is Vhembe District Municipality – a Class C municipality according to the Municipal Structures Act.<sup>72</sup> A Class C municipality is one that has one or more constituent municipalities within its borders.<sup>73</sup> Vhembe has a population of about 1.2 million people, which is a rough count because it is very difficult to get an accurate census in rural areas.<sup>74</sup> There are 51 district councilors; 43 are elected by proportional representation (from the party list assembled at the central government level) and eight represent the chiefs in the area. There are approximately 40 tribal chiefs in the area of Vhembe municipality, and those cooperating with the municipality choose the eight serving on council (not all 40 cooperate with the municipal government and its officials).

Vhembe is in the northern part of Limpopo province, which is the northern-most province in South Africa, as shown by the accompanying map. It borders on Botswana, Zimbabwe, and Mozambique (although Kruger National Park lies between Vhembe Mozambique. The map also shows that within the boundaries of Vhembe district

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<sup>72</sup> The Municipal Structures Act of 1998 (Act No. 117, 1998) and subsequent amendments are available under Documents on the Department of Provincial and Local Government website [<http://www.dplg.gov.za>].

<sup>73</sup> Class C and B municipalities, since the December 2000 restructuring of local governments, are found only outside the country's metropolitan areas; each of the seven metropolitan areas has a Class A municipality, a single-tier local government structure.

<sup>74</sup> This population figure, and the other population, demographic, and socio-economic statistics in this section, are from the 2001 census, as reported in the Municipal Profiles section of the national Demarcation Board website [<http://www.demarcation.org.za/infoIndex.aspx?type=PROVINCE&Prov=Limpopo&frm=home>]. This site also provides local government budget data.

municipality there are four local municipalities – Class B municipalities according to the Municipal Structures Act; moreover, each of the local municipalities has villages within its boundaries, although the map does not show them. The four local municipalities are Thulamela, Makhado, Musina, and Mutale. These four local municipalities cover the entire territory of Vhembe. We were there more than three years after the new system of municipal government was put into place, and there were no service agreements between Vhembe and its local municipalities. Within Vhembe, we focused particularly on Thulamela.

### **Socio-economic Overview of Study Area**

As noted, the population of Vhembe is about 1.2 million, and that of Thulamela is about 585 thousand, based on the 2001 census. The overwhelming majority of the population is African (98.5 percent for Vhembe, 99.6 percent for Thulamela); whites account for just over 1 percent of Vhembe's and only 0.1 percent of Thulamela's. In each, females account for over 55 percent of the total population, and the young greatly outnumber the old. In both Vhembe and Thulamela, those under 15 years of age make up about 40 percent of the population, while those over 65 account for only about 6 percent. Educational attainment is low. Of those over 20 years old, about 30 percent have no schooling, and less than one-fourth have at least 12 years' schooling. On the other hand, 80 percent of those in the 5-24 age group currently attend some sort of school.

During apartheid, the two official languages were Afrikaans and English. These are the languages of only a very small minority of the residents of our study area: 1.5 percent in Vhembe and 0.3 percent in Thulamela. The major language is Tshivanda, the language of roughly two-thirds in each municipality.

Attachment to the formal labor force is low in both Vhembe and Thulamela, which have labor force participation rates of about 45 percent. In part, this may be because of the importance of the informal economy in South Africa. On the other hand, high rates of unemployment – 53 percent in Vhembe, and nearly 60 percent in Thulamela -- may help explain low labor-force participation. (The labor force includes both those who are employed and those who are unemployed, which essentially entails seeking work; otherwise, one is outside the labor force.)

The people are poor, especially as indicated by data from the 2001 census. These data, however, are provided with the following caveat on the Demarcation Board website: "Users are warned to use this variable with caution and to be aware of its limitations. Census 2001 collected income information from one question on individual income without probing about informal income, enterprise profits or income in kind. As a result, the census income is understated for most of the population. Further direct comparisons with other data sets cannot be made. The main reason for releasing this variable in the data is to show patterns and trends, rather than precise estimates."<sup>75</sup> With this caveat in mind, we note that a significant portion of households reported zero income: 20.3

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<sup>75</sup> <http://www/demarcation.org.za/municprofiles2003/index.asp?type=munic&Prov=Limpopo&municode=>

percent in Vhembe and 15.1 percent in Thulamela. The data also indicate significant income inequality. For example, at the upper end, some households reported annual income of over 1.23 million rands (over \$200,000): 562 (0.2 percent) households in Vhembe, including 214 in Thulamela.

Other indications of the standard of living are found in statistics concerning housing and services. Although small shares of the households live in informal housing (2.6 percent in Vhembe, 1.7 percent in Thulamela), the dwellings generally are small and many are not equipped with modern utility services. With regard to size, 13 percent of Vhembe households and nearly 10 percent of those in Thulamela live in one-room dwellings, and the modal number of rooms in each is four (over one-fifth of households in each). Electricity is in approximately 60 percent of all dwellings, and only about 10 percent have flush toilets. In fact, a large fraction of households occupy dwellings with no toilet facilities at all (25.8 percent in Vhembe, 31.2 percent in Thulamela), even though about 40 percent in each municipal area have water in either the dwelling or the yard (most in the yard). At the other extreme, about 28 percent have access to water only at a community water stand that is over 200 meters away. Over two-thirds of households dispose of their refuse in their “own dump.” Finally, only about six percent of households have a standard phone in the dwelling, although about 25 percent have cell phones.

### **Government Budgets in Study Area**

Vhembe has an annual budget of approximately 225 million rands.<sup>76</sup> Approximately 25 million rands are generated by the RSC levies – turnover and payroll taxes – from businesses in the municipality. Vhembe has no local property tax, and no plans for one. The remainder of the budget, approximately 200 million rands, comes from a variety of central and provincial government grants – the equitable share grant designed to provide resources to municipalities to provide basic services to indigents (about R50 million), and other targeted capital and operating grants. The main responsibilities of the municipality are to provide infrastructure services – mainly water and roads – as well as fire protection.

Many of the 40 chiefs in the Vhembe district municipality do not cooperate with the new municipality, because they see the municipality as a threat to their power. Chiefs cooperating with the municipality will verify the information on the application forms submitted by residents to qualify for free services to indigents. In addition, there is some cooperation on land use issues. The cooperation needed is for the municipal government to issue an official permit to occupy (PTO) land, once the chief has granted authority to

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<sup>76</sup> The budget data given here were obtained in interviews with local officials in Vhembe and Thulamela. They do not always line up well with budget data given in the Demarcation Board’s municipal profiles; however, that source shows considerable differences from year to year for the few years reported, and the data for some years appear to be incomplete (e.g., total expenditures or revenues substantially exceed the sum of the separate categories). We have concluded that budget data – not unlike the population data – must be used with caution, and the recognition that there may be errors.

do so. This seems to encroach upon chiefs' authority, and cooperation is less consistent here than on certifying residents eligible for services to indigents.

Local officials in Thulamela reported an annual budget of approximately 165 million rands.<sup>77</sup> Approximately 70 to 80 percent of the budget comes from grants from the central and provincial governments, including over 50 million rands from the equitable share grant program to provide services to the poor. We are not clear on just what services are provided by the local municipality, but it has a somewhat varied system of own-source revenues.

The largest portion of own-source revenue comes from municipal services, principally water. While these services bring in a large share of the municipality's revenue, the service revenues do not cover costs of provision, so all run at a deficit. The municipality also generates revenues from licenses and fines. In addition, Thulamela collects about 3 to 4 million rands from property taxes, which is only 20-25 percent of the R15 million billed. The base of the property tax is land (site) value only, and it currently is levied against only privately owned properties in the urban agglomerations. The municipality relies on outside valuers for the determination of values for properties on the tax roll.<sup>78</sup> Finally, there is a general levy of 10 rands per house assessed against houses in the rural (tribal) areas. Very little of these revenues are collected and a large portion of the municipality's equitable share grant is used to finance these levies (as an offset against the uncollected amounts) for the poor living in rural areas.

### **Property Taxation Views and Approaches**

We were told that it is difficult to justify a property tax in the rural areas because there are limited, if any, services provided to those areas. As noted above, only about 10 percent of the area of Thulamela is included on the property tax rolls, and the rest is in traditional tribal areas. We also were told, though, that business properties in rural areas are private – deeds have been recorded in the national deeds registry – and that, once private ownership is established, the property comes on the tax roll. Business properties, however, account for a small portion of rural properties. At this time, not taxing all properties in these areas seems generally consistent with the benefits-received view of the local property tax – you pay for what you get (and, conversely, you don't pay for what you don't get).

Another view is that the local property tax is a general levy based on ability to pay, and is appropriately used to support general services that cannot be attributed to specific parcels of property. With this in mind, we note that in driving through the rural areas we observed many well-built, substantial houses that were clearly more valuable than the traditional rondavell (a rather small round structure with a thatched roof) of the poor

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<sup>77</sup> The population figure is from the 2001 census, as reported on the national Demarcation Board site [<http://www.demarcation.org.za/infoIndex.aspx?type=PROVINCE&Prov=Limpopo&frm=home>] while the budget figure is from our interviews with local officials. The budget figure is close to the 2001-02 operating budget figure of 156.5 million rands reported on the demarcation site (same URL), but the 2002-03 figure on that site is much lower, and seems incomplete. Breakdown of expenditures is not detailed.

<sup>78</sup> Thulamela uses C.P. deLeeuw in Polokwane (formerly Pietersburg) for valuation services.



living in rural areas. Because these more substantial houses are located on traditional lands in the rural areas, they are not included on the municipal property tax roll. Thus, the administration of the municipal property tax is not consistent with the ability-to-pay principle of taxation. A first step in strengthening the local property tax base in the rural areas would be to find a way to bring the most valuable properties onto the tax rolls. This will become more important as the new national Municipal Property Rates law [Act no. 6, 2004] is implemented, for structures will have to be taxed, along with land.<sup>79</sup>

One approach to bringing more properties onto the tax rolls, at relatively little cost to the municipality, is to adopt some form of area-based property taxation as discussed in the literature review and the Slovak case study in the previous chapter. While an area-based property tax does not score well on the equity criterion for evaluating a potential revenue source, it does score well on administrative simplicity and does get people used to the idea of paying a property tax. If some form of self-assessment is used, as is the case in Slovakia, data on land area, building area, and even building material can be collected at a relatively modest cost to the municipality.

An area-based tax, while not scoring high on equity grounds, could be considered as a first step in bringing tribal areas, where there is no real estate market, into the tax base. Arthur Lynn has argued that there is sort of a life cycle to the implementation of a property tax. He argues that as an economy develops the property tax moves from being a specific tax to being an *ad valorem* tax, and from being a tax on land to being a tax on all or most types of property. Eventually, the tax is reduced to one on realty only.<sup>80</sup>

This life-cycle perspective has been followed, to some extent, in the U.S. For example, in the early nineteenth century, new states – including Kentucky, Illinois, Indiana, and Ohio – relied primarily on a land tax assessed at a flat rate per acre, although with some variation for the fertility of the land. These area-based taxes were replaced with *ad valorem* taxes after 1825, in an effort to capture the benefits of canals being financed by public funds.<sup>81</sup>

Other mechanisms have been used to implement a local property tax when no real estate market exists. For example, in Sudan local governments have access to a real estate tax, generally referred to as the House Tax or House Rates. In the rural communities it is not likely that revenues are collected from the house tax, but in urban areas, the tax is supposed to be based on the number of rooms in the house and the quality of building

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<sup>79</sup> Historically, South African local governments have chosen from among three property tax variants: flat rating (uniform taxation of land and improvements); site rating (taxation of land value only); and composite rating (taxation of both land and improvements, but at differential effective rates. These approaches, the extent to which each is used, and factors affecting this choice are explored in Michael E. Bell and John H. Bowman, *Property Taxes in South Africa: Challenges in the Post-Apartheid Era* (Cambridge, MA: Lincoln Institute of Land Policy, 2002), chapters 3, 4, and 6.

<sup>80</sup> Arthur D. Lynn, Jr., *Property Tax Development: Selected Historical Perspectives*, in Richard W. Lindholm (editor), *Property Taxation USA* (Madison, WI: University of Wisconsin Press, 1969), p. 16.

<sup>81</sup> John Joseph Wallis, *A History of the Property Tax in America*, in Wallace E. Oates (editor), *Property Taxation and Local Government Finance* (Cambridge, MA: Lincoln Institute of Land Policy, 2001), p. 135.

materials. In practice, the tax often is based only on the type of building material – mud, red brick, or cement. Land is not part of the base of the tax.<sup>82</sup>

The current view of Thulamela, the local municipality in our study area, is that properties in tribal areas are not likely to come into the tax base as long as they are in tribal areas – i.e., not until the areas where they are located are proclaimed. This involves surveying individual parcels and issuing deeds; once this is done, the land ceases to be under tribal authority. Such change is, of course, a significant source of the friction between municipal governments and tribal leaders.

We were told that when a municipal property rates policy has to be drawn up, under the terms of the new national property tax legislation, the tribal areas would be included in the plan, but then excluded, either on the basis of low values or differential services. The low-value rationale, however, seems inappropriate, since many of the properties in the tribal areas are said to have land values well above the R20 thousand thought to be the upper level of relief. When conversion to a tax on both improvements and land values occurs (also provided for by the new national legislation) it will be even harder to justify not taxing the more substantial residences. With regard to the service differentials rationale, it is noted that the unproclaimed areas within the municipality get only road blading (grading of dirt roads) and water supply from the local municipality. Although some homes have water piped into them and are on meters, most do not; residents of the latter must go to standpipes, which often are not very numerous or close, as noted above. The lower levels of services would justify lower taxes – although probably not zero taxes for all properties in the tribal areas. Also, as services are improved, to be consistent with this rationale, the tax would need to be adjusted to reflect the changes.

Under the old (apartheid) government, proclaiming lands was said to have been easy, in part because the tribal chiefs were part of the government. The new government structures, though, have made proclaiming controversial because it reduces the range of the chiefs' authority. With increased controversy, proclaiming land areas has come to be a lengthy process (up to two years, we were told), and one that is not used much.

### **Traditional Authorities in the Study Area**

Finally, we talked to one of the chiefs from the Thulamela area – Chief Manganyi, head of the Mavemba tribal authority. The chief has responsibility for 10 villages, including Makumeke, the site of the workshop described below. The traditional authority does very little in the way of providing municipal-type services. The primary responsibility of the chief is the allocation of residential housing sites and the management of common pasturelands. The traditional authority is also involved in enforcing cultural traditions through a tribal court system that hears civil cases.

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<sup>82</sup> Michael E. Bell and Medani Ahmed, "The Government of Sudan: Intergovernmental Policy Note, Discussion Draft." Prepared for the World Bank, August 2004, mimeo.

Funding for the traditional authority comes primarily from the provincial government. In addition, the traditional authority collects money from fines from civil cases, payments for authority to have a fruit stand, payment for some development activities (e.g., irrigation projects), and for granting Permissions to Occupy residential sites.

Typically, in the case of residential sites, a person will approach the chief for permission to occupy the requested site. If the chief determines the person is part of his tribe and has a right to occupy the land, then he may allocate a residential site to the person. For this, the person makes a one-time payment to the traditional authority and the amount is negotiated, in part to reflect the relative desirability of the site. This one-time fee could be as high as 1,000 rands. Once approval is obtained from the chief, the person takes the completed Permission to Occupy form (form GK-56) to the municipal authority, which registers the site in the person's name. The municipality basically rubber-stamps the decisions of the chief. Permission to Occupy cannot be taken away, if the holder abides by the conditions agreed to when it was granted. One is to commence to build a structure within six months, and another is to occupy the land. Violation of the terms can result in the land being reallocated. This does not often happen, and the chief stated that there are currently about 2,000 people waiting to obtain Permissions to Occupy.

For agricultural land suitable for commercial activities, the chief may make the initial allocation of land, but the occupant can then petition to obtain title deed to the land. Again, a payment may be made to the chief for his approval. The chief maintains control over some marginal pasturelands that are used to graze the cattle and goats of the community, but most agricultural land is now private.

At this time, the traditional authority does not pay property taxes to the local municipality. The future is uncertain, however, since the local municipality will be formulating a property rates policy, as required by the new national property tax legislation.

Traditional authorities in this area seem to be somewhat different from the traditional authorities we have dealt with in the Eastern Cape. The major difference is how they emerged and operated under the apartheid government. In the region of Limpopo visited for this study, the chiefs used to be under the Venda Bantustan government. In this region, the apartheid government had installed some sympathetic chiefs and paid them during their tenure. The Venda government and many of the traditional authorities had good working relationships with the apartheid government. As a result, the apartheid government was more likely to invest resources in these areas than in areas where the chiefs and Bantustan authorities were less accommodating to the apartheid government, e.g., the Ciskei Bantustan in the Eastern Cape. On the other hand, however, these traditional leaders do not have the same credibility and legitimacy with the general population. Traditional culture was less evident in the villages we visited in Vhembe than in the villages we have visited in the Eastern Cape.

## The Workshop

The challenge in rural areas with extensive traditional tribal lands is to develop a property rates policy, as required by new national property tax legislation, and those policies will have to deal with traditional tribal lands, which are not currently part of the tax base. As mentioned earlier, one option would be to simply privatize the land, let private markets develop, and use the values that emerge in determining taxable values. This approach is unacceptable to those supporting traditional authorities, because it would undermine their authority and legitimacy.

A second possibility would be to simply exempt such land from property taxation. However, such blanket exemption could be a source of inequality since there are some rather substantial housing units located in rural areas, which should pay property taxes when structures become part of the tax base under the new national legislation. The data on income disparity noted above also suggest blanket exemption would be inappropriate.

A third alternative was also discussed: an area-based property tax with self-assessment. This could create some inequities in the system since properties currently on the property tax roll are assessed based on market value. As discussed earlier, this approach to property taxation does not perform well in terms of distributing the property tax burden across property owners in a manner consistent with objectives of horizontal or vertical equity. Such inequity would be less objectionable if the use of area-based taxes in the newly taxable areas were a temporary stage in the transition to value-based taxation. One way to move toward a property tax system based on market value is to provide adjustments to area-based measures through the application of coefficients designed to reflect market pressures, as discussed in the previous chapter on the Slovak case study.

The purpose of this study is to explore how such coefficients could be developed in traditional tribal areas in South Africa as an alternative approach that could determine the value of traditional tribal lands held in common for tax purposes, without undermining the traditional tribal land tenure system. The approach proposed here is based on a bottom-up approach that works with residents in the community to identify attributes of land that affect its desirability. Once those attributes are identified, they can be ranked and used to evaluate the relative attractiveness of various parcels. A final step would apply those attributes to other erven (parcels) in the community that are valued on the basis of market information, and from this determine the relative contributions of such attributes to market value. The first step in this process is to organize a community workshop to identify and rank the attributes of land that contribute to its attractiveness, or value. We scheduled such a workshop for March 12, 2004.

In preparation for the workshop on Friday, March 12, a team visited the area. Tinyiko Chauke and Benny Makena spent four days in the region in late February. They visited Thulamela municipality, the traditional authority, and four villages – Mavambe, Makumeke, Gandlanani, and Jerome. They met with the key stakeholders in each village, including the headman of Makumeke, to talk about our project and prepare the local community for our visit and workshop. An important part of their message was that

our visit would be part of a research effort – that we are not part of the government, and thus are neither involved with implementing a property tax in the tribal areas nor able to assist them in their dealings with government. The stakeholders were told that new national law envisions extending the property tax into all parts of South Africa, including tribal authority areas, and that our interest is in finding a way to bring such areas into the tax base with minimal disruption to traditional land tenure systems. Twenty-five key stakeholders from the four villages were invited to attend the March 12 workshop. Actual attendance reached 37 adults and 2 children, although some of these were not present at the beginning of the workshop. In addition, five or six women from the village were involved in preparing and serving the meal for workshop participants, but they did not participate in workshop deliberations.

A very hard rain the night before made the dirt roads into the villages very muddy, and barely passable in places. A taxi (van) had been engaged to bring people to the site of the workshop in Makumeke from other sites; it got stuck in the mud and arrived more than an hour past the scheduled time for starting the workshop, but the dozen or more who had arrived early waited patiently for the others.

David Solomon, a professor at the University of the Witwatersrand (Wits) conducted the workshop using a modified Delphi Technique. Tinyiko Chauke, who comes from the village of Makumeke and recently graduated from Wits, served as an interpreter, because not all workshop participants knew English (see the earlier data on language). The first part of the workshop identified the attributes of land that the stakeholders feel make land desirable. Our intent was to establish a list of criteria to be used in valuing land, but because of the lack of a real estate market in the tribal areas, the focus was on desirability – what makes land “good” – rather than on value. After this list was established, workshop participants were asked to rate five specific plots of land on the basis of the top three criteria. A clear ranking emerged from this process, and the ranking seemed to be accepted by the participants. The ability to establish relative desirability is an important step, but it falls short of establishing values that can be used as the base of the property tax. That next step remains to be taken.

### **Determining Criteria of Goodness (Value)**

In the first part of the workshop, each participant was given three pieces of paper (roughly 5x7 inches, and with self-adhesive backs) and was asked to write on each piece of paper some attribute of land that the person felt made land desirable, or good. Because most village residents have to carry their water in from some distance, and water for the fields or garden plots is generally hard to access, it was expected that water would be a primary concern, so this was given as one example of what might make a particular plot of land valuable. Tinyiko Chauke and some other residents of the villages who understand English well talked individually with participants who were unsure of what was sought, and after several minutes everyone seemed to understand what they were to do.

Once they had been filled in, the pieces of paper were collected and stuck on the wall at the front of the room where all could see them. The papers were grouped into categories that were suggested by what was written on the papers. As each paper was posted, David Solomon and Tinyiko Chauke stated what it said and, if there was ambiguity, sought clarification from the contributor; this clarification sometimes was needed to determine whether the idea was the same as that represented by an existing group, or whether it was a new idea. Approximately 90 pieces of paper were collected and posted, and they were grouped under eight general headings, or criteria. To no one's surprise, the one mentioned most often was access to water. Other headings that included at least 20 pieces of paper were soil quality or fertility, and location out of the reach of flooding and where drainage following a rain is good. Transport, or location near roads, is a criterion identified by several participants, as well. Other criteria that emerged are grass; trees; plowing of the soil; and services (school, clinic, and clean water were listed). After establishing these eight groups as separate criteria, workshop participants were given the chance to determine whether anything else important had been omitted, or if any changes seemed appropriate. No changes were made.

Having established the criteria, the next step was to rank them. Ranking is the result of a separate voting process, not just the number of times each was mentioned in the first step. Because eight criteria had been identified, each participant was given eight self-stick red dots, about a half-inch in diameter. Participants were told they were to vote for the criteria they thought were most important, that they could divide the red dots in any way they wished among the eight criteria, and that they should use more dots for those criteria that they considered more important. The criteria (categories) were then considered one at a time, and the dots (votes) collected and stuck on a card at the front of the room labeled for that criterion.

This voting produced different rankings among the criteria than what was indicated just by the number of times each criterion was mentioned in the first stage of the process, underscoring the importance of considering the relative importance of each criterion once the list had been established. Access to water remained the number one criterion, with 91 out of 242 votes.<sup>83</sup> Soil fertility or quality remained strong as well, coming second with 61 votes; however, well-drained soil not prone to flooding, which in the first stage was mentioned about as many times as soil quality, fell to sixth place (14 votes). Conversely, services – mentioned by only three people in the first stage – rose to third place in the voting, with 36 votes. Perhaps initially most people were not thinking in terms of government service availability as making land desirable, but after location near schools, clinics, and clean (drinking) water were put on the list, many clearly decided these are important attributes of the location of a plot of land. The fourth and fifth most important criteria were transport and plowing of soil, each receiving 20 votes. Plowing is another dimension of soil quality, concerned with the ability to plow land easily. The other two criteria listed – grass and trees – received no votes in this round. Thus, the top three criteria that emerged are access to water, soil quality, and services.

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<sup>83</sup> Note that counting the dots quickly may have allowed some minor errors to be made; David kept the sheets that had been at the front of the room, and said a more precise count could be made later.

## Rating Specific Plots Using the Criteria

After gaining agreement as to the three most important criteria in determining the desirability of plots of land, workshop participants were told that the criteria would be used to evaluate several specific plots in their villages. Five volunteers briefly described their own plots of land. For each, other workshop participants were asked by David Solomon and Tinyiko Chauke if they were familiar with the plot described; there seemed to be general familiarity, which satisfies the condition of using the ranking procedure in a knowledgeable group. Three of the plots were agricultural in character, and two were residential; it is important to note, though, that residential plots routinely are also used for gardens, and the gardens often are rather substantial areas.

The letters O, Z, T, J, and C were used to identify the five properties; the first three are agricultural plots and the last two are residential. Because water was the number one criterion for determining land desirability, participants were given a larger number of votes (paper dots, as before) for it than for the other two criteria. Specifically, participants were given eight dots and were told that they could allocate them among the five plots in any way they saw fit, with more dots going to plots that were better in terms of water access. For the other two criteria, a total of four votes were allotted to each participant. The instructions were the same as before, except this time the votes could be divided between two criteria, as well as among the five plots. These votes were taken by a show of hands, due to shortness of both time and paper dots. This probably compromised, to some extent, the accuracy of the counts. The results are shown in the table below.

Plot	Criteria			Total
	M (mati; water)	N (nona; soil)	K (services)	
O	16	9	0	25
Z	146	35	0	181
T	24	29	0	53
J	59	12	10	81
C	31	12	0	43
Total	276	97	10	383

These results were displayed and explained to the workshop participants, and discussed briefly. There seemed to be general acceptance of their validity.

The next table displays the characteristics of these five properties, in terms of these criteria. It was developed after the workshop, and is part of the basis on which further efforts can build, ultimately to develop values for properties with varying characteristics.

<b>Features of the Five Plots Evaluated in Makumeke Workshop</b>					
<b>Criteria</b>	<b>Plot O</b>	<b>Plot Z</b>	<b>Plot T</b>	<b>Plot J</b>	<b>Plot C</b>
<b>Water</b>	Far away	Next to river	Next to river	good	Poor
<b>Soil fertility</b>	Poor	Good	Good	Fair	Poor
<b>Type of soil</b>	Rocky soil,	Loam	Loam	Loam	Clay
<b>Plowing</b>	Difficult	Easy	Easy	Difficult	Hard
<b>Services</b>	None	None	None	Fair	None
<b>Transport</b>	Far	Good access	Poor	Good	Fair
<b>Trees</b>	Bushes	Fruit trees	None	None	None
<b>Equipment</b>	No	Pumping	None	None	None
<i>Exhibits: Map reference, scores on criteria, plot use, and plot user</i>					
<b>Score</b>	25	181	53	81	43
<b>Map reference</b>	Makumeke Map 23B	Makumeke Map 23B	Makumeke Map 23B	Jerome Map 24D	Makumeke 23D
<b>Use</b>	Agricultural Mielies	Agricultural Fruit trees, vegetables Mielies	Agricultural Vegetables, Mielies	Residential Mielies	Residential Mielies
<b>User</b>	Mr. Simango	Mr. Minyuku	Mr. Masonganyi	Mrs. Maboko	Mr. Samango

### **Conclusion**

We are satisfied that the method used is workable for identifying features of land that make it desirable and applying those features to rank the relative attractiveness of alternative plots of land. The expert group assembled, despite their relative lack of sophistication, was able to generate a quite credible set of criteria for determining value, to rank these criteria, and to apply them consistently to a sample of properties. The illiteracy of some participants was not a problem.

Participants were able to contribute to the outcome anonymously, in ways that were not dominated by local leaders or opinion makers. The outcome was a result of a range of inputs, not of the judgment of a single person. The anonymity, and the technical nature of the process, allowed inputs to be given freely and prevented domination by leaders or opinion makers.

A clear consensus was generated, but it is not the end result needed. The ability to establish relative desirability is an important step, but it falls short of establishing measures that can be used as the base of the property tax. However, criteria for adjusting area measures were developed. They could be applied in cooperation with the traditional authorities, which would be instrumental in identifying individual plots and helping apply the adjustment criteria as appropriate for each plot. This would also strengthen linkages between the municipal government and the tribal authorities.