Developments in Value-Based Property

The unique Triple Bridge links Prešernov Square and Old Town in Ljubljana, Slovenia.

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The development of new land and tax systems in countries in political and economic transition in Central and Eastern Europe reflects a unique array of historical, social, political, and economic circumstances. While all transitional countries seeking admission to the European Union (EU) have initiated comprehensive reforms to encourage free markets and democratic governments, the three Baltic nations—Estonia, Latvia, and Lithuania—made privatization and restitution of property rights a prime objective immediately after their independence in the early 1990s. These actions, together with a desire to stimulate real estate markets and capture tax revenues for improved public services, made them the first of the transitional countries to introduce value-based taxation of real property.

The Baltic nations were admitted into the EU in 2004. Their economies have grown in recent years at twice the EU average, and their strong real estate markets have been attractive to international investors (Baltic Property Expert 2008). The property tax has served as both a fiscal instrument and as a means of advancing privatization, restitution of property rights, decentralization, and market development (see table 1).

The Lincoln Institute offers opportunities for sharing information and learning from these international experiences in its courses for public officials of countries considering or implementing property tax reforms (see box 1, page 12).

Taxation in Central and Eastern Europe

The Land Tax in Estonia

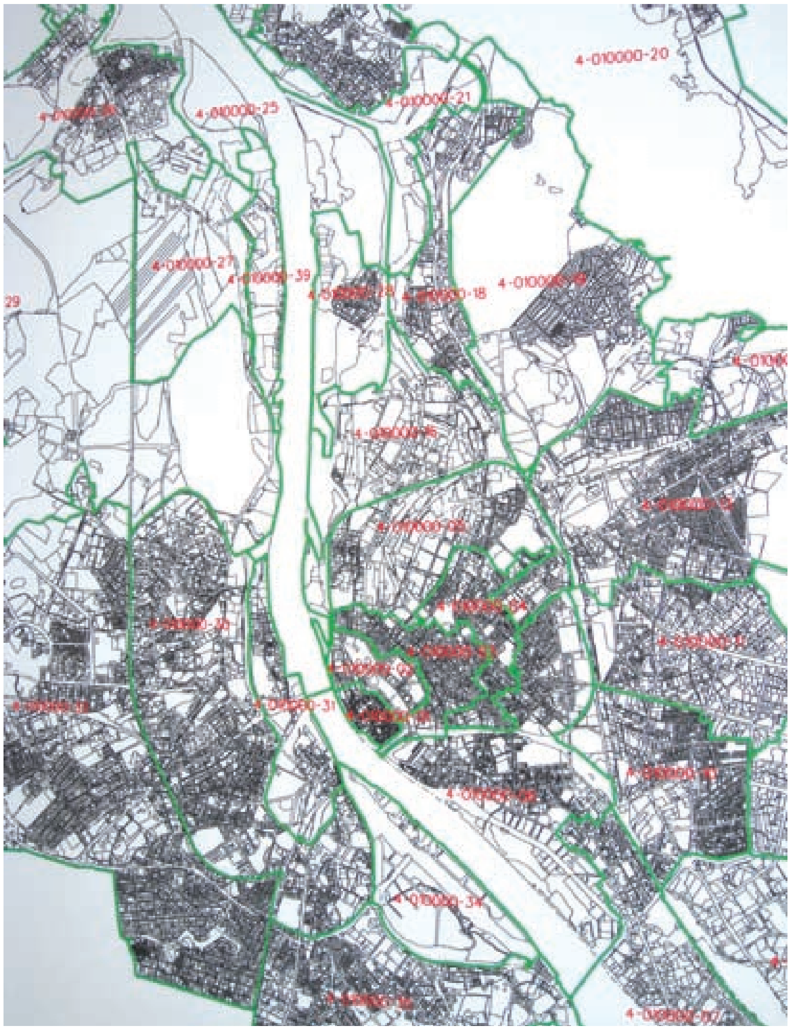
The Lincoln Institute's work in transitional countries began in Estonia when officials there sought an accurate valuation base to enhance their ability to analyze and track the developing real estate sector. A tax on land was also a component of Estonia's land policy and economic reforms, because it did not penalize renovation and new construction, but rather encouraged productive land use by pre-1940 owners and their heirs who had recovered land through restitution.

A land tax also allowed an accurate tax base to be assembled within a reasonable time, since land and buildings had been recorded separately under Soviet systems. With little sales evidence available, the Estonian National Land Board created a value map with comparable price zones, and invited citizen comments on these boundaries during a series of public meetings. When high duties on property transfers resulted in under-declaration of sales prices, Estonia reduced its stamp duty to less than 1 percent of sale price, as low as 0.5 percent for many parcels, to ensure reliable price information for future valuations. The tax revenue received from the land tax has been a modest but stable source of revenue for local governments for more

TABLE 1
Demographic and Economic Data for the Baltic Countries and Slovenia

	Estonia	Latvia	Lithuania	Slovenia
Population	1,307,605	2,245,423	3,565,205	2,007,711
Area	45,226 sq. km.	64,589 sq. km.	65,299 sq. km.	20.273 sq. km.
GDP per capita; % Growth (2007)	US$21,100; 7.1%	US$17,400; 10.2%	US$17,700; 8.8%	US$27,200; 6.1%
Tax on Real Property	Land tax	Real estate tax (land and nonresidential buildings)	Building tax on property in commercial use; Land tax (not value-based)	Tax on buildings, land (built upon or buildable)
Tax Base	Market value	Market value-based mass (cadastral) value	Buildings: Average market value based on mass valuation; Land: Normative value	Points per sq. meter; Value-based Property Tax Law pending
Tax Rate	0.1%–2.5%; 0.1%–2.0% for agricultural land	1% (reduced from 1.5% in 2007)	Buildings: 0.3%–1%; Land: 1.5%	Buildings: 0.1%–1.5%, based on use; Land: 2%
Tax Rate Determination	Central Government (sets limits); Municipality (within limits)	Central Government	Central Government (sets limits); Municipality (within limits)	Central Government (sets limits); Municipality (within limits)
Tax as % of Local Tax Revenue (2007)	14% (2005)	9.5%	9.4%	12.2 %
Tax as % of All Local Revenue (2007)	7.2% (2005)	5.2%	4.6%	8.2%
Number of Local Governments	256	26 regions, 548 municipalities	60 local authorities	210
Transfer Tax	0.3%–0.5%	0.5%–3%	0.3%–1%	2%
Valuation Administration	National Land Board	State Land Service	State Enterprise Centre of Registers	State Surveying and Mapping Authority
Tax Administration	National Tax and Customs Board	Municipalities	State Tax Inspectorate	Municipalities

Sources: Country Reports; Baltic Property Expert 2008; CIA World Factbook 2008; RICS Foundation 2004.



Cadastral maps such as this one of the City of Riga, Latvia, are used in developing values for property taxes on land and buildings.

than a decade, and has the potential for considerable future growth (Tiits 2008).

Cadastres and Information Systems in Latvia and Lithuania

The Latvian and Lithuanian Parliaments recognized the importance of a strong institutional framework for property information as they expanded land privatization and restored property rights to those who had owned land prior to Soviet occupation. Latvia's State Land Service and Lithuania's State Land Cadastre and Register were established in the 1990s to collect data on property location, ownership, construction, and condition. They later added information on real property market transactions to expand their capacity to value real property for taxation and other public purposes.

These systems were developed in the belief that accurate records of real property ownership, use, and value were essential to privatization and rapid market development. The systems also assigned "normative" values, drawn from legal formulas for municipal taxation of land and buildings. This process demonstrated how far these "values" were from actual market prices.

Market-based mass valuations have been undertaken in Latvia since 1998, with value-based taxation introduced incrementally, first on land in 2000 and then on commercial buildings in 2002. The Lithuanian Parliament approved a value-based tax on buildings in commercial use in 2005, after withdrawing its support for a value-based land tax when an initial review of valuation results in 2003 indicated significant changes from the current normative values. Neither country currently includes housing in the property tax base.

In both countries, mass (cadastral) valuation is used for a variety of purposes by other state agencies, such as the Latvian Central Bank and the Central Bureau of Statistics. In Lithuania the data is used for estimating social welfare subsidies and developing rent and sales prices for land still in state ownership. Valuation services also are made available to private users for a fee.

These institutional reforms have helped reduce the impediments to value-based property taxation faced by many transitional countries, such as lack of market information and a shortage of professional appraisers. In addition, new technology has permitted the compilation, integration, and analysis of vast amounts of data that is well-suited to mass valuation techniques. Online public access to property information has the potential to increase taxpayer confidence in the accuracy of property valuations and acceptance of value-based taxes.

Sharing Experiences and Data

The three Baltic central land agencies collaborate in producing periodic *Baltic Property Market Reviews,* which disseminate sales and rental information along with demographic and economic data and information on tax systems and the investment climate. Information indicating market yields greater than in other parts of Europe helped stimulate foreign investments in commercial real estate between 2000 and 2006 (Baltic Property Expert 2008).

Although property markets in the Baltic states have slowed during the current global downturn, there is still demand for retail and industrial property markets in the capital cities of Riga, Tallinn, and Vilnius, and new interest in smaller cities with lower prices (Baltic Property Expert 2008). The development of central databases has also aided

European cooperation in data sharing and improving real property information systems. For example, the Lithuanian Centre of Registers entered into agreement in 2006 with the European Land Information Service (EULIS) to share real property information online with other countries.

The Baltic experiences may be useful to the Republic of Slovenia, part of the former Yugoslavia until 1991. Slovenia has experienced rapid economic growth, and was the first of the states joining the EU in 2004 to adopt the Euro as its currency. The Slovenian Parliament considered a property tax based on market value in 1996, but decided first to improve its real estate cadastre and mass valuation system. In 2006 the country passed a Property Mass Valuation Law officially adopting the legal, methodological, and administrative framework prepared in anticipation of mass valuation of real property for taxation. A draft Property Tax Law awaits Parliamentary approval upon completion of the first valuation roll. To address taxpayer concerns as to valuation accuracy and tax burdens, the Valuation Office has initiated a public information program and a valuation appeals process in all 210 of the nation's municipalities.

Fiscal Decentralization

With small populations, ranging from 1.3 million in Estonia to 3.5 million in Lithuania, fiscal and governmental decentralization has been a lower priority for these nations than implementing and integrating the rapid changes necessary for transition to a market economy and accession to the European Union.

In the first years after independence, property tax revenues were assigned to local governments in hopes that central grants to municipalities could be decreased (Šulija 2008). There was no expectation that localities could operate independently, and these taxes supply only a small proportion of municipal revenues—less than 5 percent in Lithuania and 8.2 percent in Slovenia. Most local services are funded by the national government through assigned shares of VAT and income taxes, together with grants and transfers.

In Estonia only 10 to 20 percent of all municipalities are financially self-supporting. Although the majority of local governments need financial support from the central government, reform of local government finances is still not high on the political agenda (Tiits 2008). Under these circumstances, locally elected officials and taxpayers do not yet experience either the benefits or obligations of an autonomous revenue source. However, the past decade's rising standard of living, greater familiarity with a market-based economy, and progress in privatization may strengthen the property tax as a local fiscal instrument. As residents seek improved local services, a value-based property tax has the potential to provide the means to pay for them.

Lessons and Challenges

Each of the Baltic nations has taken significant steps toward establishing stable property tax systems based on uniform and equitable value-based assessments. The accomplishments of Lithuania's Centre of Registers in this respect have been recognized by awards from the International Association of Assessing Officers (IAAO) in North America and the Institute of Revenues, Rating and Valuation (IRRV) in Great Britain. These countries now face the challenge of maintaining and improving these systems as markets mature. This will require a clear legal and policy framework for taxation, together with strengthened taxpayer acceptance and understanding, in order to realize the potential of the tax for improving local government services.

Revaluation. One important aspect of establishing a full and accurate tax base is implementing a system of periodic revaluations. Without this, over time it becomes more difficult to muster the political

Renovated and unrenovated buildings exist side-by-side, posing challenges for mass assessment in Riga's historic district.

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will to revalue, since a long-delayed revaluation will result in dramatic shifts of the tax burden.

Latvia and Slovenia already provide for revaluations every four years with interim adjustments. Lithuania values both land and buildings in commercial use annually, although only the buildings are now taxed according to value. Estonia was the first to adopt a value-based tax on land in 1993, but no reassessment has been authorized since 2001. In some areas values have increased four-fold, with wide variations by location, so current assessments are neither accurate nor equitable (Tiits 2008). The Estonian law leaves the revaluation decision to the Minister of Environment, and does not mandate a specific timetable.

Taxes on Housing. The exclusion of housing from the tax base in the Baltic countries reflects earlier stages of the transition when the standard of living was low and a less mobile citizenry was housed mainly in Communist-era flats. Changing conditions have not changed political reluctance to tax housing, but this is an important issue for future decentralization. Local residents can best decide the level and quality of services offered by their local governments and, in order to make those decisions responsibly, must fund a portion of these services with their own taxes.

Inclusion of residences in the tax base provides a means for homeowners to compare their payments to the quality of services they receive, and promotes accountability in fiscal decisions. In addition, housing will broaden the tax base and increase tax revenue without increasing the burden on local business and industry.

New or Changed Taxes. New taxes are never politically popular. They require a clear rationale for any change, transitional measures to blunt shifts in tax burdens, and targeted relief for needy taxpayers. Lithuania's experiences offer some lessons in this regard. The "severe reaction from the media and the public" that greeted new values from an official mass appraisal of land resulted in Parliament withdrawing authorization to use these values for tax purposes (Aleksienė and Bagdonavicius 2008). These values were significantly higher than the normative values used for taxation, and no provision for tax relief had been proposed.

In an instructive contrast, Lithuania's introduction of a tax on commercial buildings was successful. It was presented as a means of balancing taxes on labor and on capital, with income tax rates reduced from 33 percent to 24 percent over a two-year period. The initial property tax rate was 1 percent, but municipalities were given the option of adjusting it in the future to between 0.3 percent and 1 percent. In addition, the Parliament extended the time and expanded the appeal rights of property owners to challenge the new values.

Determination of Tax Rates. Another important challenge concerns determination of the tax rate. Currently, rates are set by national law in the Baltic countries, although local governments re-

BOX 1

The Lincoln Institute in Central and Eastern Europe

In its work with nations in political and economic transition, the Lincoln Institute has had the opportunity to contribute to the development of new land and tax systems in a vibrant and rapidly changing part of the world. Since 1993 the Department of Valuation and Taxation has designed and presented courses for public officials in transitional countries on value-based taxation of land and buildings. These courses address the political, legal, and administrative issues raised by implementation of a new tax, with particular attention to establishment of mass appraisal systems for property valuation.

For example, a week-long course, titled Market Value Taxation of Real Property: Lessons from International Experience, was held in collaboration with the Center of Excellence in Finance (CEF) in Ljubljana, Slovenia in April 2008. Lincoln Institute faculty included Tambet Tiits, director of Baltic Property Expert in Estonia, and Albina Aleksienė and Arvydas Bagdonavicius, senior officials from the State Enterprise Centre of Registers in Lithuania, all of whom have been deeply involved in their countries' transitional land and tax reforms. Other faculty included U.S. mass valuation expert and international consultant Sally Powers and Dusan Mitrovic from the Valuation Office in Slovenia's Surveying and Mapping Authority, who reported on the mass valuation system under development there. Public officials representing state and municipal offices in Kosovo, Latvia, Lithuania, Serbia, and Slovenia attended the course and shared information and experiences concerning property taxation in their countries.

In June 2008 the Institute sponsored a course in Riga, Latvia, in collaboration with the State Land Service of Latvia. The faculty included Robert Gloudemans and Richard Almy, international experts in mass appraisal and assessment administration, and Albina Aleksienė from Lithuania. The sessions addressed professional mass appraisal methods, model building, and performance measurement, as well as legal, political, and social issues related to taxation of property in the context of international experience.

ceive the tax revenue. While guidance from the national government may have been helpful in the early years, the rate bears no relationship to the costs of government services; when property values increase, so do taxes, unless Parliament adjusts the rate on a nationwide basis.

For example, Latvia reduced its tax rate from 1.5 percent to 1 percent in 2007 to reflect rising values, but the effect of this reduction will not be uniform throughout the country because value increases have varied widely in different areas. Furthermore, concern about rising property values and price volatility resulted in a requirement that the Cabinet of Ministers approve the values determined by the State Land Service. This produces a potential conflict between accurate valuation of the tax base by a professional administrative agency and decisions by a government entity likely to be influenced by revenue and political concerns.

Estonia, Lithuania, and Slovenia have established an upper and lower range within which local officials select a tax rate. In Estonia, municipalities may also adjust the rate according to value zones. This option has been used by a few communities to reduce taxes for land in zones with rapid price appreciation. This helps mitigate volatility on a short-term basis, but if made permanent it risks inequities and regressivity by taxing high-value property at lower rates.

Local flexibility in determining tax rates allows local taxpayers some choice in the level of services they receive, and a voice in their tax burden and government revenue. The ability of local officials to adjust rates annually to reflect budgetary decisions, and to allow property values to rise and fall to reflect market changes, enhances accountability and transparency. To advance the goals of fiscal decentralization, local governments in these advanced transitional countries will need increased authority over the rate and level of taxation.

Increasing Local Autonomy. As these local governments gain more fiscal and political autonomy, they can assume more responsibility for tax assessment and administration. Currently, local governments have only minor involvement in the preparation of the tax base or the collection of taxes. National governments can provide central databases, as well as professional and technical services, guidance, and oversight. However, the availability of online linkage and mass valuation software offers opportunities for local officials to participate more actively in assessment and tax administration in the future.

Summary

The extraordinary political and economic changes underway in transitional countries vividly illustrate the dual revenue and land policy functions of a tax on property, and the role it can play in clarifying property rights, encouraging efficient land use, and stimulating market development. The property information and mass valuation systems developed in the Baltic countries and in Slovenia provide a strong foundation for future land and tax policies. As they reap the benefits of membership in the European Union and face the challenges of international competition, these countries will benefit from a well-functioning tax on immovable property to strengthen their own societies. Their experiences offer important lessons for others in earlier stages of the process of change.

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