Market Value-Based Taxation of Real Property

JOSEPH McNIFF

Public officials from Lithuania and Lincoln Institute faculty members met at Lincoln House in February to learn from each other about market value-based taxation policy and plans for introducing property taxation in Lithuania.

Delegates from Lithuania: Arturas Baksinskas, Vice-Minister of Finance; Dalia Bardauskiene, Advisor to the Prime Minister on Rural and Urban Development and Planning; Algirdas Butkevicius, Member of Parliament on Budget and Finance Committee; Rimantas Ramanauskas, First Deputy Director, SLCR; Albina Aleksiene, Advisor to the General Director on Property Valuation, SLCR; Arvydas Bagdonavicius, Deputy Director, SLCR; Algimantas Mikenas, Deputy Head of Property Valuation and Market Research Department, SLCR.

Lincoln Institute Faculty: Joan Youngman, Senior Fellow and Director, Lincoln Institute Tax Program; Jane Malme, Fellow, Lincoln Institute Tax Program; Dennis Robinson, Vice President, Lincoln Institute; Richard Almy and Robert Gloudemans, partners, Almy, Gloudemans, Jacobs and Denne, LaGrange, Illinois; John Charman, Consultant Valuation Surveyor, London; David Davies, Director of Information Technology, Massachusetts Department of Revenue; Jeffrey Epstein, Consultant, Quincy, Massachusetts; Sally Powers, Former Director of Assessment, City of Cambridge.

Jane H. Malme

Over the past decade of transition from communist to market economies, property taxation has taken on economic, political and legal importance as the countries in Central and Eastern Europe have developed new fiscal policies and new approaches to property rights. Taxes on land and buildings have served not only as revenue instruments but also as adjuncts to decentralization and privatization. In spite of the complex and varied national differences in this region, a number of common issues have emerged in regard to property-based taxes.

A period of transition places a premium on revenue sources that impose a minimum burden on the functioning of nascent market economies. Many of these postcommunist nations seek to strengthen local government, and all must adjust their tax systems to account for emerging markets for land and buildings at a time when state administrative capacity is challenged by the introduction of new income and consumption taxes. There is often strong support for retaining a public interest in land as a fixed, nonrenewable element of the common heritage which, once sold, cannot be reproduced. This sentiment coexists with an equally strong impetus for development of private business and private ownership of property. Each of these concerns raises special questions with regard to the role of land and building taxes in the transition.

Such taxes on land and buildings have already been designated as local revenue sources in many nations of Central and Eastern Europe. As a tax base that cannot relocate in response to taxation, real property permits an independent local revenue source. Times of fiscal stringency at national government levels dramatize the importance of such revenue for local governmental autonomy. Moreover, the goal of eventual international integration through the European Union and other trade arenas encourages development of taxes not subject to international competition.

Two primary difficulties confront efforts to implement land and building taxes in these countries. First, in the absence of developed property markets, the tax base requires a choice among formulary values, price approximations, and non-value means of allocating the tax burden. Second, times of financial hardship present special problems in imposing taxes on assets that do not produce income with which to pay the tax. This dilemma has left many property taxes at nominal levels.

These problems are closely related because the lack of reliable market prices, together with the legacy of officially determined price levels, can encourage legislation that assigns specific, sometimes arbitrary values to various classes of property for tax purposes. Given these difficulties, it is particularly significant that many of these nations have either adopted or are seriously considering some form of value-based taxation of immovable property as a source of local government finance.

The Case of Lithuania

Since declaring its independence from the USSR in 1991, the Republic of Lithuania has made rapid strides in economic reforms, privatization and government reorganization. Its plans for market value-based taxation of land and buildings reflect the country's transition to a market economy and private ownership of property. Municipalities will receive the revenues from the new tax and will have the power to choose the tax rate, subject to an upper limit set by the national government. The Lithuanian Parliament has recently prepared draft legislation for this tax which assigns responsibility for developing a valuation system to the State Land Cadastre and Register (SLCR).

The SLCR was created in 1997 to consolidate a number of functions: registration of property rights, maintenance of a cadastre of property information, and valuation of real property for public purposes, including taxation. Since then the agency has organized a central data bank for legally registered property rights, land and building information, and Geographic Information System (GIS) maps. The data bank currently holds information on more than four million land parcels and structures, and it is linked to mortgage and other related registers and to branch offices throughout the country.

The proposed market value-based real property tax will replace two existing taxes on real property commonly found in post-Soviet systems: a land tax on privately owned land and a property tax on buildings and other property (not including land) owned by corporate entities, enterprises and organizations. Taxable values are currently set by the SLCR through application of varying "coefficients" that adjust base prices to reflect land use and location. The resulting values do not reflect current market prices. The tax rate of 1.5 percent of the taxable value for land and 1 percent of the taxable value of property yielded represent approximately 7 percent of local budgets and 2.5 percent of the national budget in 2000.

Lithuania's growing demand for market-based property valuation data requires an increase in professional appraisal skills and experience with assessment administration. To address these needs, an Association of Property Valuers and a system of professional certification were established in the mid-1990s, in collaboration with

other international valuation associations. Lithuania has also joined Estonia and Latvia in publishing periodic reviews of real estate markets in the Baltic states. Information regarding market activity is posted on the SLCR's website (www.kada.lt).

Lincoln Course

The Lincoln Institute has taught courses on property taxation in transition countries for nearly a decade, and in February the Institute collaborated with SLCR to develop a curriculum for seven senior public officials from Lithuania. The week-long program was based on the course that the Institute presented, in cooperation with the Organisation for Economic Cooperation and Development (OECD), in the Lithuanian capital of Vilnius in December 1997, for government officials from Estonia, Latvia and Lithuania. Recognizing the importance of this year's program to Lithuanian public policy, the United Nations Development Programme (UNDP) provided support for the delegation's travel to Cambridge.

The program offered a policy-oriented analysis of issues relating to market-based tax systems. It included guidance in developing a strategic plan and a legal and administrative framework for a computer-assisted mass appraisal (CAMA) system suitable to Lithuania. Technical subjects were presented in the context of larger economic and political issues in land and property taxation. The course combined lectures, discussions with experienced practitioners, case studies, and field visits to state and local agencies in Massachusetts. Lectures addressing introductory, policy-focused subjects were supplemented by more specialized presentations covering market value appraisal techniques, mass appraisal, CAMA and tax law.

The Lincoln Institute will offer similar courses to public officials from other transition countries, and is continuing to develop other educational programs with Lithuania and its Baltic neighbors.

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