National Tax Association

ISSUES IN LAND TAXATION AND PROPERTY TAXATION IN CENTRAL AND EASTERN EUROPE

Author(s): Joan Youngman and Jane Malme
Source: *Proceedings. Annual Conference on Taxation and Minutes of the Annual Meeting of the National Tax Association*, Vol. 91 (1998), pp. 137-143
Published by: National Tax Association
Stable URL: https://www.jstor.org/stable/41954591
Accessed: 27-02-2022 18:25 UTC

JSTOR is a not-for-profit service that helps scholars, researchers, and students discover, use, and build upon a wide range of content in a trusted digital archive. We use information technology and tools to increase productivity and facilitate new forms of scholarship. For more information about JSTOR, please contact support@jstor.org.

Your use of the JSTOR archive indicates your acceptance of the Terms & Conditions of Use, available at https://about.jstor.org/terms

National Tax Association is collaborating with JSTOR to digitize, preserve and extend access to *Proceedings. Annual Conference on Taxation and Minutes of the Annual Meeting of the National Tax Association*

This content downloaded from 149.10.125.20 on Sun, 27 Feb 2022 18:25:53 UTC
All use subject to https://about.jstor.org/terms

ISSUES IN LAND TAXATION AND PROPERTY TAXATION IN CENTRAL AND EASTERN EUROPE

Joan Youngman and *Jane Malme*, Lincoln Institute of Land Policy

As countries in Central and Eastern Europe have developed new fiscal policies and new approaches to property rights over the past decade, taxes on land and buildings have served not only as revenue instruments but also as adjuncts to privatization, restitution, and decentralization. Within the complex and varied national situations in this region, common issues have emerged in the debate over property-based taxes.

LAND TAXATION AND TRANSITION ECONOMIES

The impetus for development of land and building taxes in nations in transition can stem from an array of fiscal, social, and economic factors. 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 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 exists together with an equally strong impetus for development of private business and private ownership of property. Each of these concerns has special implications for land and building taxes.

Real estate taxes have been designated as local revenue sources in many nations of central and eastern Europe, including Hungary, Poland, Romania, Bulgaria, the Czech and Slovak Republics, and the Russian Federation (Bird and Wallich, 1994). Because the immobile physical location of land and most buildings provides the jurisdiction with an underlying tax base that cannot relocate in response to taxation, it permits an independent local revenue source. Times of fiscal stringency at state and national government levels dramatize the importance of such revenue for governmental autonomy. Moreover, the goal of eventual international integration through the European Union and other trade zones encourages development of taxes not subject to international competition.

Two primary difficulties confront efforts to implement land and building taxes in these circumstances. First, in the absence of developed property markets, the tax base requires a choice among formulary values, price approximations, and nonvalue 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 has left many property taxes in the newly independent states at nominal levels. These two problems are closely related, for the lack of reliable market prices, together with the legacy of officially determined price levels, can encourage legislation that assigns specific, sometimes arbitrary—and always low—values to various classes of property for tax purposes. Periods of rapid inflation can then reduce such figures to nominal levels. Given these difficulties, it is of particular significance 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.

Land holds a social and cultural role different from other goods and services, and its taxation raises contentious political issues. Central questions concerning land and building taxation include the role of the property tax as a revenue source for local or other subnational levels of government, the efficacy and desirability of using taxation as a tool for countering land speculation and disruptive fluctuations in land values, the nature of the property tax as a legal enactment, and the justification for and problems presented by a specialized form of wealth taxation.

Although immovable property is often classified as a single entity—land and buildings—there are extremely important distinctions between these two portions of the tax base. The inelastic supply of land offers the potential for a tax that does not carry with it the usual deadweight economic loss that accompanies a distortion in the price signals

This content downloaded from 149.10.125.20 on Sun, 27 Feb 2022 18:25:53 UTC
All use subject to https://about.jstor.org/terms

for supply and demand. Almost alone among potential tax bases, land is both immobile and limited in supply. A tax on land cannot cause the owner to withdraw it from the jurisdiction or shift its production to another location. Unlike a tax on buildings, a land tax does not provide a disincentive to new building, renovation, or more intensive use of the site.[1] Wallace Oates and Robert Schwab of the University of Maryland studied Pittsburgh's experience with a graded tax that has a land rate five times higher than the rate on buildings. They concluded it was not possible to attribute the city's construction boom to the differential tax. However, they did find that the tax played an important role by allowing the city to raise revenue in a form neutral to development—unlike the alternative taxes that might have been used instead:

> The role of land-value taxation is to be understood in terms of the revenue alternatives. Pittsburgh was under severe fiscal pressure in the late 1970s, and some type of tax increase was necessary to restore budgetary solvency. Had an increase in land-value taxation not been introduced, city officials would have turned to another form of taxation: higher taxes on structures, or a major increase in the city's wage tax. . . .
>
> The contribution of land-value taxation is to be understood not in terms of any direct stimulus to development, for there is likely to be little or none if the tax is basically neutral. Rather, land-value taxation provides city officials with a tax instrument that generates revenues but has no damaging side effects on the urban economy. In this way, it allows the city to avoid reliance on other taxes that can undermine urban development. (Oates and Schwab, 1997)

Consideration of these common themes within the array of specific legal, political, and social settings found in transition economies has the potential to enrich greatly the understanding of the appropriate role of land and building taxes in fiscal and land-use policy in others countries, including the United States.

LAND TAXATION AS PART OF PROPERTY TAXATION

In most post-communist countries, property taxation reflects the uncertainties and conflicts inherent in the dramatic economic and social changes under way in all aspects of these societies.

Soviet systems included a confusing set of taxes on property, land rent, and land use, with extensive exemptions. Users were taxed according to land area, geographic location, and type of use. Land in populated areas used for trade and offices was taxed at the highest rate, while land of state-owned industrial enterprises had the lowest tax burden. Taxes on property itself did not include land and distinguished between the property of individuals (often termed physical persons) and enterprises (juridical or legal persons), with the tax on enterprise property covering both movable and immovable elements, including structures and equipment. Some countries assigned the revenues to local governments while others shared them between regional and local governments, in either case under central government control. These taxes were designed to provide low rates of taxation for land in socialized uses, such as state enterprises, and to discourage private uses. The tax was not based on economic value (Ott, 1997). Taxes levied during transition generally have continued to treat land and buildings separately and to assign tax rates on the basis of land or building area, with coefficients to increase or decrease the level of taxation according to usage, population group, or other factors. In most cases, taxes on buildings have been higher than taxes on land. The physical assets of state enterprises, both movable (machinery, equipment, inventory, etc.) and immovable buildings and structures, have been commonly self-assessed and taxed on the "balance sheet" of the enterprise.

Countries in these areas also were influenced by the Soviet model for tax administration. Collection generally was assigned to a state tax inspectorate, and responsibility for land use decisions and data compilation was divided among a state land service, a bureau of technical inventory for building information, and offices dealing with architecture, construction, and housing. Finally, various non-market measures were used as the basis for taxation, including inventory values, insurance values, normative values, and area-based measures.

The administrative costs of establishing an ad valorem tax base when both private ownership and real estate markets were in transition, as well as institutional questions about assignment of functions and development of expertise, have resulted in most governments taking a slow approach to changing their property tax systems. Nevertheless, ad valorem taxation of units of real property is

This content downloaded from 149.10.125.20 on Sun, 27 Feb 2022 18:25:53 UTC
All use subject to https://about.jstor.org/terms

being planned or seriously considered in the Czech Republic, Latvia, Lithuania, Poland, and Russia.

Czech Republic

The Czech Republic is considering incorporating ad valorem elements in its area-based land and building taxes. The emerging real estate sector is cooperating with the Ministry of Finance in developing coefficients that approximate market pricing for location and types of uses. Although the proposal has not yet been adopted, its major appeal is that it is expected to increase taxable values, possibly by a factor of three. This incremental approach is favored in part to avoid tax burden shifts that would result from the more radical change to an ad valorem tax (Bryson and Cornia, 1998).

Latvia

In the past, Latvia had a property tax, with the rate wholly determined by the local government, but not to exceed 1 percent. The land tax was based on area, and the building tax on cost. Last year, Latvia adopted legislation for market value taxation of land, with buildings and other structures to be added to the tax base in 2000. Buildings are taxed on square meters of floor area. Within the past year, a valuation center in the State Land Service announced that it has updated land records, developed mass appraisal methods and models, and valued all taxable urban and rural lands, including agricultural and forest (Latvian State Land Service, 1998).

Lithuania

In Lithuania, the Ministry of Finance has proposed expanding the tax base to include housing and combining land and building taxes into a single tax on real estate, primarily to increase revenues. In 1997, the State Land Cadastre and Register was formed to create and maintain a Central Data Bank of Real Property, including a land inventory, legal registration, and valuation information. A Division of Real Property Valuation and Market Research is working to develop an ad valorem basis that is suitable for taxation.[2]

At present, there is a land tax on privately owned land and a lease tax on lessees of state-owned land, both based on cadastral (normative) values established by the Ministry of Agriculture. The yield of the lease tax is expected to decline as state-owned property is privatized, but under Lithuania's constitution only the state and its citizens may own land, with authorization for long-term leases (up to 99 years) to foreigners. A building tax was imposed on immovable property of enterprises and organizations in 1995, using the "balance sheet" approach. Collection rates on the building tax have been poor, as enterprises have refused or been unable to pay.

Lithuania has retained much of its centralized governmental structure, and has been slower than other Baltic countries to develop local authority over land and fiscal reforms. Although the central government controls all municipal revenues, in 1997 an OECD/World Bank seminar recommended that 100 percent of revenues from taxes on land and buildings be assigned to local governments as independent revenues (Lithuanian Needs Assessment Seminar, 1997).

Poland

Recognizing the need for decentralization of both revenues and expenditure responsibilities, Poland in 1986 introduced a law on local taxes and fees that provided for a real estate tax. The law was revised substantially in 1991, assigning all revenues from these taxes and fees, as well as from the agricultural property tax and forest property tax, to newly established local self-governments. The taxes were area based, not ad valorem, with considerably higher rates on commercial than on residential properties. Agricultural and forest property taxes are based on measures of productivity. These taxes first had purely fiscal objectives, to expand the tax base beyond income and to capture wealth being diverted into real property assets. After the Soviet period, property taxes were also recognized as appropriate sources for local government revenue. These taxes have been functioning relatively well from a fiscal perspective, providing a higher percentage of local revenues than in many other transition countries.

A consensus may be developing for a shift to market-based property taxation. This was proposed in 1995, but stalled in the face of complexities of land surveying, land registration, and tax administrative functions. Recent efforts have focused on the non-fiscal benefits of ad valorem property taxes, including clarification of real property ownership (and consequent assistance to real estate markets and mortgage credit institutions) and improved urban productivity. A law under consideration in Parliament would allow regions (Poviats) to intro-

This content downloaded from 149.10.125.20 on Sun, 27 Feb 2022 18:25:53 UTC
All use subject to https://about.jstor.org/terms

duce ad valorem taxation in the municipalities within their territories beginning in 2000. A major step has been taken with the creation of a new division of Local Taxation and Cadastre within the Ministry of Finance (Brzeski, 1998).

Russia

The Russian Federation has three major property taxes—on land, on buildings owned by individuals, and on buildings owned by enterprises and other legal entities. The last is part of a more general tax on the balance-sheet value of corporate assets. The land tax is divided between the central and local governments, the tax on buildings owned by individuals is retained by local governments, and the tax on buildings owned by corporations is divided between regional and local governments.

Revenues from these taxes are trivial, comprising less than 1 percent of consolidated government budgets. Some local governments have reportedly refused to collect the tax because yields are so low. At the same time, privatization of housing and business property is proceeding at a rapid pace, often with only a small payment to the state. This situation presents both an unusual opportunity and a difficult challenge for the development of a new property tax system. The opportunity stems from the unique historical moment at which ownership rights are first transferred from the state to private parties. When ownership rights are first defined, initiation of a tax does not upset settled expectations or undermine contrary assumptions that may have guided buyers in bidding for property. This will no longer be the case when the passage of time brings an increasing number of secondary real estate sales and development of an active public market for land and buildings. Moreover, lack of information concerning future tax liabilities is an impediment to large-scale privatization.

Institution of a local government tax is particularly appropriate at a time when basic local services are being curtailed for lack of revenue, when many of these services are property related (such as road maintenance and sanitation), and when devolution of government responsibilities from the center to the localities has not been accompanied by any corresponding transfer of funding sources.

It is critical that any such tax be coordinated with larger economic, legal, and fiscal developments in the Russian Federation. Citizens face "tax fatigue" induced by numerous new and sometimes overlapping levies; at the same time, widespread tax evasion has reached levels that imperil even international monetary assistance. Privatization and the introduction of new taxes must proceed in tandem with wage policies, including housing subsidies, and macroeconomic efforts to control inflation. A comprehensive property tax requires clarification of many current uncertainties as to rights of ownership and many conflicting provisions in existing law.

Payments are so nominal in part because the land tax is set in absolute terms (e.g., kopecks per square meter) rather than as a percentage of market value. These amounts were initially set at low levels, and inflation has left them negligible. The tax on buildings owned by corporations is based on balance-sheet value, with a maximum rate of 2 percent; the tax on buildings owned by individuals is generally based on cost figures unadjusted for recent inflation, with a tax rate of 0.1 percent.

The two major land taxes, for non-agricultural and agricultural land, are denominated as a set amount per unit area; therefore, what is often termed the tax "rate" is actually the amount of tax (e.g., in rubles per square meter). In each case, the amount of the tax is related, although sometimes tenuously, to the quality and location of the land, and to that extent it carries an ad valorem component, but market values do not enter into the calculation of these taxes. Because formal ownership rights in land often are uncertain and land registration is not well established, these taxes resemble user fees or rental charges as much as taxes on ownership. In fact, the use of the land is one element considered in setting the tax "rate."

Recent efforts to develop a pilot project for market value-based real property taxation in two cities, Novgorod and Tver, illustrate both the potential and the frustration of basic tax reform in the current Russian fiscal climate. The program began with funding from USAID in 1995, and federal enabling legislation authorizing the "experiment" was enacted in 1997.

Working groups of local officials in each city, with the guidance of technical advisers, developed administrative strategies to organize data collection, information management, and other activities. Valuation models were established, based on extensive research of the developing real estate markets in the locales. Local officials received training in all aspects of mass appraisal and assessment administration. The project included Russian professionals to provide expert assistance

This content downloaded from 149.10.125.20 on Sun, 27 Feb 2022 18:25:53 UTC
All use subject to https://about.jstor.org/terms

to other jurisdictions that may undertake implementation in the future. Before the most current fiscal crisis in the Russian Federation, Novgorod anticipated implementation of a new tax in 1999 to replace the three existing non-value based taxes on land, property of individuals, and property of enterprises. Extensive public information and fiscal impact analysis was in preparation, and local officials were discussing tax rates and tax burdens. Whether these local officials will consider it worthwhile to take the risk of implementing this new levy under current circumstances is unclear.[3]

Estonia: Land Taxation as Land Policy

Estonia adopted a land tax within two years of declaring its independence from the Soviet Union. The tax was viewed as an essential element of the larger land reform program that included restitution, privatization, and market development. The tax base was limited to land, not including structures or other improvements. This was intended to stimulate efficient use of land, and particularly to encourage the pre-Soviet owners with restitution rights, whether residing within or outside of the Estonia, "to develop the property or sell it" (*Economist*, 1998).

Assembling the information needed for taxation of land and buildings within a reasonable period of time was regarded as nearly impossible. A land tax was also thought to impose a lesser burden on residents with limited cash income with which to pay taxes.

With a strong ideological commitment to a market economy, but with minimal market activity in evidence, Parliament made the extremely bold decision to base the tax on market value. At the time (1992), most issues of legal ownership remained unsettled, and real estate markets were tentative and experimental. This choice was based in part on the hope of gathering market data and improving the government's understanding of real estate markets as they developed. This was a remarkable decision.

Valuation responsibility was assigned to the National Land Board, a land survey agency that had recently shifted from the Ministry of Agriculture to the Ministry of Environment. The first valuation for land taxation faced enormous obstacles. The basic tools of valuation—appraisal expertise, ad valorem methodology, appropriate and accurate land and price information—were either nonexistent or in short supply, and the legal framework was incomplete. The Land Board had little staff and few financial resources. Expertise was sought from other countries, and these were provided primarily by OECD and the Finnish and Danish governments, which contributed training and technical support throughout the process.

The Land Board's ambitious goal was the development of a market value-based mass appraisal system that was understandable to taxpayers and feasible to implement in a year's time at reasonable cost. The first valuation assigned price zones to each assessment area, with the understanding that this methodology would be refined as markets matured. The hope that the land tax would be the catalyst for new land records, sales registries, and cadastral maps has on the whole been realized, for it led to development of a national land cadastre, which was utilized in a second mass appraisal to update land tax values in 1996. Considerably more market information was available for analysis at that time, and the revaluation increased urban land values and decreased rural values.

The Land Board commissioned three surveys of public opinion concerning land reform and taxation issues: the first in May 1992; the second in August 1993, shortly after the land tax law was implemented; and again in November 1993, when taxes were payable for the first time. In the earlier surveys, responses generally supported restitution and privatization and indicated an understanding of location and quality of area as important factors in determining relative land values, but recorded a substantial negative reaction to taxes on land. By November 1993, two-thirds of all responses were favorable or neutral, and only 2 percent were strongly negative on the land tax. The Land Board believes an extensive public education program, combined with valuation elements understood by the general public, was instrumental in the eventual public acceptance of the land tax.

Table 1

Property Tax Revenue as a Percentage of Total Tax Revenue Selected Transition Countries

	1994	*1995*	*1996*
Estonia	1.03	0.99	1.12
Latvia	3.59	3.50	4.08
Lithuania	0.76	2.20	2.03
Poland	2.91	3.03	3.03
Czech Republic	1.32	1.37	1.36

Source: International Monetary Fund, *Government Finance Statistics 1997.*

This content downloaded from 149.10.125.20 on Sun, 27 Feb 2022 18:25:53 UTC
All use subject to https://about.jstor.org/terms

Table 2
Local Government Revenues from Property Taxes Selected Transition Countries

Country	*Recurrent Taxes on Real Property*	*As Percent of All Local Revenues*	*Share of Tax Proceeds*
Czech Republic (1996)	Real Estate Tax	2.5%	Local–100%
Estonia (1996)	Land Tax	From 2% (urban)-25% (rural)	Local–100%
Lithuania (1995)	Land Tax Land Lease Tax Building Tax	0.6% 2.3% 1.2%	Local–100%
Poland (1996)	Real Estate Tax Land Tax (Agric.) Land Tax (Forest.)	13.9% (combined)	Local–100% (all)
Slovak Republic (1996)	Real Estate Tax	11.4 percent	Local–100 percent

Note: With the exception of revenue statistics printed in the Lithuanian Needs Assessment Seminar (1997), these figures were provided to the Lincoln Institute by the research associates from each country.

The land tax rate is modest, initially set at 0.5 percent, with proceeds shared equally by national and local governments. In 1996, all land tax revenues were assigned to local governments, which may choose a tax rate within prescribed limits. Initially set between 0.8 percent and 1.2 percent of value in 1995 and 1996, these limits were broadened to 0.5 percent and 2 percent in 1997. Agricultural land is subject to a separate tax at lower rates (0.3-0.7 percent). Most municipalities have selected tax rates near the upper limits. Tax collections, although steadily increasing, are modest at 212M EEK (approximately US$17 million) collected in 1996. The land tax comprises only 5 percent of municipal revenue in Tallinn, the capital, and somewhat more in rural municipalities.

A 1998 report concluded, "The land tax in Estonia is in many ways a success story. The revenue has been increasing consistently and collection performance has improved. Estonia has been a pioneer among the transition countries by basing the land tax on market values of land and by giving the municipalities considerable freedom in deciding the local tax rates" (Phare Program Report, 1998).

Although the Estonian example is the most dramatic, each of these transition economies offers lessons to the United States and other nations as they confront basic issues of property tax design and implementation. The technical assistance the donor community has extended in these efforts may be repaid by study of innovative tax policies.

Notes

[1] Note that this assumes that the land value assessment does not increase according to the use of the parcel. An increase in land value assessment because of activity on the site would discourage more intensive use, just as would a tax on the building itself.

[2] Interviews with Land Cadastre officials, Vilnius, December 1997.

[3] Jane Malme served as legal adviser to this property tax project. Dr. Natalia Kalinina is the Russian professional now working with city officials on the program.

References

Bird, Richard M., and Christine Wallich. "Local Finance and Economic Reform in Eastern Europe." *Environment and Planning C: Government and Policy* (1994): 263-277.

Bryson, Phillip J., and Gary C. Cornia. "Case Study: Property Taxation in the Czech Republic." Report prepared for the Lincoln Institute of Land Policy, Cambridge, 1998.

This content downloaded from 149.10.125.20 on Sun, 27 Feb 2022 18:25:53 UTC
All use subject to https://about.jstor.org/terms

Brzeski, W. Jan. "Making the Case for Ad Valorem Reform in Transition Economies: The Non-Fiscal Benefits." *Proceedings of the Annual Conference of the International Association of Assessing Officers*. Chicago, 1998.

Latvian State Land Service, Real Property Valuation Centre. *Assessment of Land Cadastral Value in 1997*, 1998.

Oates, Wallace E., and Robert M. Schwab. "The Impact of Urban Land Taxation: The Pittsburgh Experience." *National Tax Journal* 50 (1997): 1-21.

OECD/World Bank. Lithuanian Needs Assessment Seminar, Fiscal Decentralization Initiative of the Council of Europe, 1997.

Ott, Attiat F. "Land Taxation and Tax Reform in the Republic of Estonia." Cambridge: Lincoln Institute of Land Policy, 1997. Working Paper.

Phare Program. *Taxation of Land and Buildings in Estonia—Present and Future,* 1998.

"Unlikely Icon." *The Economist*, February 28, 1998, p. 78.

This content downloaded from 149.10.125.20 on Sun, 27 Feb 2022 18:25:53 UTC
All use subject to https://about.jstor.org/terms