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The Development of Property Taxation in Economies in Transition

Case Studies from Central and Eastern Europe

Edited by
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Contents

Foreword vii
About the World Bank Institute and the Lincoln Institute of Land Policy ix
Contributors xi
Preface xiii

1. Introduction 1
Jane H. Malme and Joan M. Youngman
Property Taxation in the Context of Transitional Reforms 1
The Development of Property Taxation 4
Transitional Issues in Property Taxation 6
Ad Valorem Property Taxation: Possibilities and Problems 7
Implementation Challenges and Strategies 8
References and Bibliography 10

2. Property Tax Developments in Poland 11
Jane H. Malme with W. Jan Brzeski
General Background 11
The Development of Ad Valorem Land Taxation 16
Progress toward Ad Valorem Property Taxation 20
Current Issues and Future Developments 23
Appendix: Other Taxes Applicable to Real Property 24
References and Bibliography 25

3. The Land Tax in Estonia 27
Jane H. Malme with Tambet Tiits
General Background 27
The Development of Ad Valorem Land Taxation 30
Current Issues and Future Developments 36
Appendix: Other Taxes and Revenues Applicable to Real Property 37
References and Bibliography 38

4. Taxes on Real Property in the Czech Republic 39
Phillip J. Bryson and Gary C. Cornia with Alena RohlickovÁ Holmes
Historical Background 39
Privatization 41
Fiscal Affairs and Tax Reform 41
The Property Tax 43
Current Issues 48
References and Bibliography 49
Contents

5.5 National Budget, 1993–96 63
5.6 Real Estate Tax, 1993–96 63
6.1 Total Tax Revenue of Corresponding Budgets, 1995–98 70
6.2 Taxes to Become Effective on Adoption of Part II of the Tax Code 71
6.3 Proceeds of Land and Property Taxes, 1995–99 72
6.4 Typical Shares of Land and Property Taxes among Federal: Oblast: Local Budgets, 1995–99 73
6.5 Proceeds of Land and Property Taxes as a Percentage of Budget Tax Revenue, 1995–99 74
6.6 Total Land Tax and Land Rent Revenue of Corresponding Budgets, 1995–99 75
6.7 Estimated Changes in Tax Burdens for Legal Entities, Examples from Novgorod Veliky, 1998 78
6.8 Estimated Changes in Tax Burdens for Individuals, Examples from Novgorod Veliky, 1998 79
7.2 Land Tax Statistics, 1994–98 91
7.3 Property Tax Statistics, 1994–98 92
Foreword

The fall of Soviet communism launched an era of reform throughout Central and Eastern Europe. Countries that came to be labeled economies in transition from command to market systems created institutions that now provide the foundations for pluralistic, democratic regimes. Key among these reforms has been the process of decentralization: the devolution of fiscal powers and responsibilities from central to local governments.

Critical to successful transition will be the citizens’ ability to establish financially sustainable local governments. To do so they must devise a system of local budgets and taxes over which local governments have control. This book focuses on the tax on immovable real property, one of the most important local tax options.

Property tax policies often have long histories that are closely linked to complex systems of land ownership and property rights that have been developed over time. As a result, the task of doing comparative studies on the property tax itself is relatively easy as local fiscal needs change and as the rules of land ownership and property rights that frame a tax system evolve.

In contrast, periods of rapid transition, such as Central and Eastern Europe have experienced since the fall of communism, provide little opportunity for policymakers to undertake comparative investigations of approaches to any specific policy, particularly one as detailed as property taxation.

This volume undertakes exactly that kind of comparative analysis of tax policy formulation in an era of rapid institutional change. It does so through a set of country case studies that provide insights into the policy debates and choices that guide the process of property tax reform. The cases shed light on the entire cycle from initial impetus to resulting legislation and the subsequent administrative challenges of assessment, collection, appeal, and review.

Because a property tax serves multiple roles—as an instrument of decentralization, an element of property rights, an adjunct to privatization and restitution, and a source of revenue—considering its development in multiple contexts is appropriate. Accordingly, the cases range from the first generation reformers in Poland, Estonia, Slovakia, and parts of the Russian Federation to later efforts in the Czech Republic and Armenia. The cases are not intended to identify any single path to the development of a successful system of property taxation, but rather to broaden our understanding of the available alternatives and their relationship to specific political, legal, and economic settings.

The book, a collaborative effort of the World Bank and the Lincoln Institute of Land Policy, is the third in a World Bank Institute series of studies on fiscal policy, decentralization, and urban governance. We are pleased to make this volume available to all, generalists as well as specialists, who are interested in how fiscal systems change within the context of broader, and in this case, often sweeping, economic and institutional reforms.

Vinod Thomas  H. James Brown
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World Bank Institute  Lincoln Institute of Land Policy
About the World Bank Institute
and the Lincoln Institute of Land Policy

The World Bank Institute

The World Bank Institute (WBI) provides training and other learning activities that support the World Bank’s mission to reduce poverty and improve living standards in the developing world. WBI’s programs help build the capacity of World Bank borrowers, staff, and other partners in the skills and knowledge that are critical to economic and social development.

WBI is located at World Bank headquarters in Washington, D.C. Many of its activities are held in member countries in cooperation with regional and national development agencies and education and training institutions. The Institute’s distance education unit conducts interactive courses via satellite links worldwide. While most of WBI’s work is conducted in English, it also operates in Arabic, Chinese, French, Portuguese, Russian, and Spanish. Although WBI’s publications are designed to support its training activities, many are of interest to a much broader audience.

WBI delivers nearly 600 training activities a year in 150 countries through face-to-face and distance learning. Its programs center on core policy courses that address issues central to poverty reduction and sustainable development, drawing on the World Bank’s comparative advantage of multicountry operational experience and in-house expertise.

Across the world, a wide range of people take part in these activities. They include policymakers and development practitioners in government, academics, members of civil society organizations, journalists, and people from private industry. Through their work, participants affect a country’s choices among economic and social policies, influencing economic growth, living standards and opportunities, and the condition of the environment. WBI also provides professional development training opportunities for World Bank staff. Whenever possible, the Institute integrates staff and client learning, to promote the exchange of knowledge and experience between these groups and to ensure the operational relevance of Bank staff skills.

The Lincoln Institute of Land Policy

The Lincoln Institute of Land Policy is a nonprofit and tax exempt educational institution established in 1974 to study and teach land policy, including land economics and land taxation. The Institute’s goals are to integrate the theory and practice of land use and taxation and to share understanding about the multidisciplinary forces that influence public policy. The Institute focuses its educational programs in the areas of valuation and taxation and planning and development.

The Lincoln Institute seeks to improve the quality of debate and disseminate knowledge of critical issues in land use and tax policy by bringing together scholars, policymakers, practitioners, and citizens with diverse backgrounds and experience. The Institute does not take a
particular point of view, but rather serves as a catalyst to facilitate analysis and discussion of land and tax issues.

The Institute takes a wide-ranging approach to studying land and tax policy that recognizes the effects of globalization and urbanization on land uses, land markets, and fiscal decentralization. It has established important affiliations with academic institutions, community organizations, and government entities throughout the world. In Central and Eastern Europe, the Institute works with officials from the public and private sectors to study and offer guidance on land and tax reforms in those emerging market economies. The Institute sponsors a wide variety of professional development courses, national and international conferences, curriculum development projects, and publications to learn from and share its work with colleagues worldwide.

Publication of this volume, edited by Lincoln Institute faculty, signifies that the Institute believes that its contents are worthy of public consideration, but does not imply endorsement of the conclusions or recommendations or of the other organizations that contributed to the research.
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Preface

Taxes on land and buildings can serve important economic, political, and legal objectives in developing new fiscal policies and new approaches to property rights in postcommunist countries. The Lincoln Institute of Land Policy is particularly interested in the complex debate over property-based taxes and how they are being implemented during the transition to democratic societies and market economies.

Over the past eight years, the Institute has undertaken a series of educational programs to help public officials and business leaders understand the underlying principles and practical examples of property taxation and valuation. The Institute’s interest was stimulated by participation in a conference in Tallinn, Estonia, in September 1993 with the Paris-based Organisation for Economic Co-operation and Development (OECD). Estonia was the first of the new independent states to recognize the benefits of land taxation, which it was then in the process of implementing. Thereafter, the Institute presented courses relating to land reform and property taxation in Estonia, in other Baltic countries, and in OECD centers for training financial officials from transitional countries. These course participants expressed interest in the experiences of other transitional countries and the unique circumstances under which property taxation has arisen at this unprecedented point in history. This interest led the Institute to sponsor research for the case studies in this volume.

The development of these case studies also drew on the experiences gained in the preparation of the 1994 publication *An International Survey of Taxes on Land and Buildings* (Kluwer Law and Taxation Publishers, Deventer, Netherlands), which used a questionnaire to bring consistency to the reports prepared by correspondents from each of the countries in that survey. Tambet Tiits in Estonia and W. Jan Brzeski in Poland offered valuable advice in creating a survey instrument suited to this review of developments in transitional economies. The survey information, however, served only as a base for exploring the unique and varied reform agendas of each country.

The contributors from each country were critical to the development of these studies, but they served in their individual capacities, not as representatives of their respective countries’ governments. Without their ability to collect and interpret information and statistics from as yet undeveloped official reporting sources, providing comparative data on property taxes would have been impossible. Reliable independent publications of financial statistics are available only for some transitional countries. For example, the OECD publishes revenue statistics of its new member countries, the Czech Republic and Poland, including revenue from recurrent property taxes. Local government financial data is particularly difficult to obtain.

The revenue statistics in this volume, which primarily represent data recorded prior to 1999 when these case studies were prepared, reflect only a moment in time in the rapidly changing environments of these countries.

The organization of this volume was determined in part on the basis of chronology, from Poland’s introduction of property taxes in the mid-1980s before the end of communism to Armenia’s tax reforms undertaken in the mid-1990s. It also made sense to run successively the
chapters on the Czech and Slovak republics, which began the transition together. The introductory chapter provides context and comparison.

Each of the country chapters describes the context within which policy decisions for the property tax system were made and objectives determined, and how these have evolved as part of the transitional reforms still in process. Transitional countries have received considerable guidance and, in many cases, international assistance and support in undertaking property tax reforms. This publication offers an opportunity to review their experiences in initiating and implementing this unique fiscal instrument in the midst of the enormous transformations during the past decade. Each of the countries studied here offers important lessons to other nations confronting the basic issues of property tax design and implementation.

We are grateful to the Fiscal Affairs Division of the OECD, particularly Michael Engelschalk for his interest and encouragement. The OECD contributed to funding the Russian case study and was instrumental in securing sponsorship of this publication under the Fiscal Decentralization Initiative for Central and Eastern Europe.

We thank the Lincoln Institute of Land Policy for its support and patience in seeing this project through, with special appreciation to Ann LeRoyer for her careful preliminary editorial reviews and to Kathryn Foulger for her editorial assistance. Dennis Robinson, who served as an adviser to Poland on fiscal cadastres, was helpful in expanding our knowledge of this important facet of property tax administration. Harvard Law School student Nikolai Mikhailov’s research was invaluable in keeping us up-to-date on the rapidly changing transitional environment, and his insightful reviews helped us gain a better understanding of the Soviet systems and the legacy into which these new measures are being set.

In addition, we gratefully acknowledge the assistance of Christopher Marks, U.S. Agency for International Development adviser to the Ministry of Finance in Poland; Natalia Kornienko, attorney in the Center for Real Estate Analysis in Moscow; Lemmi Oro, deputy head of the Tax Policy Department in the Estonian Ministry of Finance; and Aivar Tomson, AS Kinnisvaraekspert, Tallinn, Estonia, for contributing information during the preparation of the case studies. The authors were also fortunate to have the benefit of careful reviews of the manuscript by Michael Bell and John Bowman, whose expertise and insightful comments greatly improved the book. We appreciate Joan Casey’s able editing assistance in preparing the manuscript for publication by the World Bank.

We have been privileged to collaborate with the contributors to this volume, all of whom have been generous with their time, efforts, and talent in bringing this undertaking to fruition. Although the responsibility for the information and views expressed rests with the authors of the separate chapters, we accept overall responsibility for the quality of the publication.

Jane H. Malme and Joan M. Youngman
Introduction

Jane H. Malme and Joan M. Youngman

As Central and Eastern European countries have developed new fiscal policies and new approaches to property rights during the past decade, property taxation has taken on new importance, serving not only as a revenue instrument, but also as an adjunct to decentralization and privatization. Despite the complex and varied national differences in this region, common issues have emerged with 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 that, once sold, cannot be replaced. At the same time, there exists an equally strong impetus for developing 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.

A number of considerations led to the designation of such taxes as local revenue sources. An immovable tax base offers the possibility of independent local revenue, even as times of fiscal stringency at national government levels dramatize the importance of some measure of fiscal autonomy. Moreover, the goal of eventual entry into the European Union and other trade arenas encourages the development of taxes not subject to international competition.

Two primary difficulties have confronted efforts to implement land and building taxes. First, the absence of developed property markets requires a choice among formulary values, price approximations, and nonvalue means of allocating the tax burden. A lack of reliable market prices, together with a legacy of officially determined price levels, has often encouraged the assignment of specific, sometimes arbitrary, property values for tax purposes. Second, periods 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. 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.

Property Taxation in the Context of Transitional Reforms

Poland, Estonia, the Czech and Slovak republics, Russia, and Armenia are in different stages of economic, fiscal, and political transition, yet each has taken steps toward establishing local governments supported by taxes on land or property.

Decentralization

Nearly all these nations have transferred some measure of assets and spending responsibilities, particularly social welfare programs, to subnational governments. The exception is Estonia, where
the national government still funds almost all social benefits. In other nations, these unfunded mandates have overwhelmed many local governments and led to deficit spending. In addition, the transfer of assets to municipalities, ostensibly to encourage privatization from which local governments might benefit, often imposes additional financial burdens for maintenance and repair of long-neglected buildings and infrastructure. These burdens have grown heavier as privatized industrial enterprises have relinquished their communist era roles as providers of education, health, housing, and other social services.

After so many years of central political and administrative control, it is not surprising that fiscal and organizational relationships between central and subnational governments are unclear. National laws that provide for election of local officials sometimes severely limit their authority. New government units require time to develop administrative and financial capacity, particularly in small communities without administrative experience. The future role of regional governments, obviously critical in these cases, is still uncertain. The most effective subnational units are found in larger, more diverse countries with regional urban centers.

Among the countries studied here, the Russian Federation is the only unitary state and by far the largest, with 89 regional units and 2,000 local governments. Four of the other five nations have essentially two levels of government, national and local. Local governments, often reconstituted towns and villages of the pre-Soviet era, are predominantly small communities with limited administrative capacities and resources. Soviet-era regional entities serve as administrative agents of the central government, but not as independent entities. Poland has attempted to reduce local fragmentation by establishing two new tiers of regional self-government (wojewodships and powiats) to assume certain current national responsibilities and to coordinate local services. Decentralization is under way to varying degrees in each country, and will be enhanced as local governments establish independent revenue sources (see Dunn and Wetzel 2000 on the status of decentralization efforts).

Fiscal decentralization requires that subnational governments be given responsibility for determining the level and quality of services to be provided and for raising a substantial portion of the funds to finance these services (Bell and Adams 1999; Oates 1972). Local governments in these countries have not yet achieved control over expenditures or revenues, and assignment of land or property tax revenues to them is a significant step in this direction. Poland has moved furthest in making property taxes an important source of local revenue and permitting some local control over tax rates.1 Estonia has granted municipalities discretion in selecting land tax rates within limits imposed by national law, but these taxes are only a minor part of municipal budgets (table 1.1).2 Development of local property taxes can contribute to a well-functioning intergovernmental system.3

**Privatization**

The dismantling of centralized ownership and the opening of a competitive property marketplace have been crucial transitional reforms. The initial period of rapid privatization has yielded

---

1. Taxes on real estate, agricultural, and forest property have raised 14 percent of local revenues annually. Maximum rates are established by the Polish parliament.

2. National law limits land tax rates from 0.5 to 2 percent. Land tax revenues make up only 2 percent of the budget of the capital city of Tallinn, although they make up a larger share of rural revenues.

3. Bird, Ebel, and Wallich (1995, Preface), conclude that a well-functioning intergovernmental system may be key to establishing major reform goals, such as macroeconomic stability, privatization, and the maintenance of a safety net that is robust enough to make reform palatable to the population. They also note that local finance is not merely a local matter.
Table 1.1. Revenue from Land and Building Taxes, 1998
(percent)

<table>
<thead>
<tr>
<th>Country</th>
<th>Recurrent taxes on real property</th>
<th>As a percentage of total tax revenue</th>
<th>As a percentage of subnational revenues</th>
<th>Total allocation to local governments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Armenia</td>
<td>Land tax</td>
<td>2.3</td>
<td>26.3a</td>
<td>95</td>
</tr>
<tr>
<td></td>
<td>Building tax (combined)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Czech Republic</td>
<td>Real estate tax</td>
<td>0.8</td>
<td>2.5</td>
<td>100</td>
</tr>
<tr>
<td>Estonia</td>
<td>Land tax</td>
<td>1.11</td>
<td>6.5</td>
<td>100</td>
</tr>
<tr>
<td>Poland</td>
<td>Real estate tax</td>
<td>4.3</td>
<td>13.4</td>
<td>100</td>
</tr>
<tr>
<td></td>
<td>Land tax (agriculture)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Land tax (forest)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Russian Federation</td>
<td>Land tax</td>
<td>2.0</td>
<td>2.0</td>
<td>70 (regional and local)c</td>
</tr>
<tr>
<td></td>
<td>Tax on property of enterprises</td>
<td>8.4</td>
<td>14.9</td>
<td>100 (regional and local)</td>
</tr>
<tr>
<td></td>
<td>Tax on property of individuals</td>
<td>0.1</td>
<td>0.2</td>
<td>100 (local)</td>
</tr>
<tr>
<td>Slovak Republic</td>
<td>Real estate tax</td>
<td>1.9</td>
<td>12.4</td>
<td>100</td>
</tr>
</tbody>
</table>

a. 1996.
b. Land tax and land rent revenues are combined in Russian Federation tax reporting.
c. Land taxes are divided 30 percent-20 percent-50 percent among federal, regional, and local budgets, and taxes on the property of enterprises are shared 50 percent-50 percent between regional and local governments. All are subject to some regional variation.

Source: Official country sources.

varied results, affected by the openness of the process, the entry of new owners, and the extent of economic reform. By mid-1995, the private sector’s share of gross domestic product was estimated to be greater than 50 percent in five countries: the Czech Republic (70 percent), Estonia (65 percent), Poland (60 percent), the Slovak Republic (60 percent), and the Russian Federation (55 percent) (Zecchini 1997, table 3). In Armenia the share was 45 percent. In all six countries, significant amounts of housing and small economic units have been transferred from the public to the private sector, generally for nominal sums.

The restitution of pre-Soviet title, the privatization of municipal property, and the creation of transferable ownership rights are under way in each of these countries. The Estonian land tax was explicitly made part of this process, and was established, among other things, to encourage productive use of restituted land and privatization of municipal landholdings.

As the Estonian example indicates, a property tax can play a significant role in defining property rights, one that may be overlooked when the tax is considered solely as a fiscal instrument. A period of privatization and restitution presents critical choices as to the division of public and private rights in property. The economic advantages of a system of private ownership, together with intense political reaction against the abuses of state control, frequently conflict with deeply held beliefs in the need for a continuing public interest in the permanent and irreplaceable heritage of immovable property. This conflict can arise most strongly in the case of land, whose supply cannot be expanded and whose existence is not a result of individual effort. Clarification of a continuing public claim on a portion of land value in the form of an annual tax can help reconcile these competing positions.
The Development of Property Taxation

The important example of Western European tax systems, which rely primarily on value added taxes and corporate and individual income taxes, has provided limited models for property taxation to the countries of Central and Eastern Europe. Nevertheless, the experience of the countries in this study has been varied. Estonia and Poland, for example, are vastly different in size and resources, but both have pursued bold, and in many respects successful, economic and political reforms.

Poland

Poland adopted an agricultural property tax in 1985 and a real estate tax in 1986. Both were carried into the postcommunist tax system, which retained the nonmarket base for these taxes. Poland's three property taxes (urban, agricultural, and forest) provide more than 13 percent of local revenues, more in rural than in urban areas. Local governments facing budget deficits are eager to increase property tax revenues, and urban areas seeking more efficient land uses have supported conversion of the tax base to market value. Although a change to ad valorem taxation is under serious consideration, it faces political resistance both from taxpayers concerned with shifting tax burdens and from government officials concerned with the assignment of responsibilities for recordkeeping and valuation. Poland's expanding private sector and steady economic growth may help ease these objections in the future.

Estonia

Estonia's early reform agenda included restitution of pre-1940 property ownership and establishment of private ownership rights, both enacted immediately after independence in 1991. The land tax was introduced in 1993 as an integral part of both land and fiscal reforms. The tax, on land only and levied on both public and private lands with few exemptions, was intended to stimulate the efficient use of land, particularly parcels restored to owners and heirs within and outside the country, and to encourage land improvements, privatization, and market development. Fiscal expectations were modest, and revenues initially were shared between national and local governments. Since 1996 all land tax proceeds in Estonia have been retained by local governments, contributing as little as 2 percent to urban revenues and as much as 22 percent in rural areas.

With commitment to a market economy, but with only the first steps taken in this direction, the government in 1993 nonetheless selected a market value tax base. This was motivated in part by the hope of developing a capacity to analyze and monitor future real estate markets. Recently the government has explored the possibility of adding buildings to the property tax base to expand tax revenues without increasing tax rates.

Czech Republic

The property tax has played a minor role in the Czech Republic's fiscal reforms. With more than 6,000 separate local governments, many with fewer than 500 residents, administrative capacity is limited, and there are no purely local taxes. Property tax revenues are assigned to local governments, but national law specifies the tax base and rates. Land and buildings are assessed separately and taxed on the basis of land area or building floor space, adjusted by factors reflecting location and use. Property taxes are only a small portion of municipal income, with transfers from national income tax receipts supplying most local revenue. Property tax reform has not been a central government priority.
Market value-based property taxation has been under discussion since 1993. Although these proposals remain politically unpopular, there is growing support for general property tax reform among local governments seeking greater fiscal stability and independence. The government is considering incorporating *ad valorem* elements into its area-based system by using information supplied by the emerging real estate industry to develop coefficients that approximate market pricing for location and types of uses. Its strong real estate market, stable economy, and administrative experience give the Czech Republic the foundation for a modern property tax system if it chooses to develop one.

**Slovak Republic**

The Slovak Republic's fiscal system reflects the tax program initiated by Czechoslovakia before the “Velvet Divorce” of 1993. Although self-government for municipalities was an explicit goal after the separation, central control and planning have been retained to a large degree. Distribution of a portion of income taxes collected by the central government remains the primary source of revenue for the nation's 2,853 municipalities. Separate taxes on land and on buildings are governed by national law, although the revenues and some administrative tasks are assigned to localities. Land and building taxes are set per square meter, with adjustments for location and use. These taxes yield less than 2 percent of total tax revenues, but are a growing source of revenue for local governments (12.4 percent of local budgets in 1998). Delays in the development of a competitive private real estate sector have impeded market valuation and *ad valorem* taxation.

**Russian Federation**

A lack of consensus on many fundamental issues presents special difficulties for fiscal reforms in the Russian Federation. The Russian tax system includes the common European set of value added and corporate and personal income taxes, but continuing budget deficits have brought about a proliferation of new taxes as well. The 1992 Law on The Basic Principles of Taxation, intended to assign responsibilities and allocate revenues among federal, regional, and local governments, was never fully implemented, because it was not expected to generate sufficient revenue at the subnational level.

A general tax code, first proposed in 1994, was enacted in July 1998, but agreement on the provisions for the various separate taxes has not yet been reached. The 1998 enactment retains taxes on land and property that were introduced to coincide with the massive privatization program initiated in 1991. It also authorizes a regional real estate tax based on market value to replace the taxes on land, on property (buildings) owned by individuals, and on property (assets, including equipment, inventory, and vehicles, as well as buildings) of enterprises. These three taxes account for approximately 10 percent of total tax revenue.

The proceeds of these taxes are shared according to federal budget laws and regional negotiation. Land taxes are shared among all three levels of government. The tax on property of individuals is assigned to local government, and the more substantial revenues from the enterprise property tax are shared between regional and local governments. In total, these taxes account for 17 percent of subnational budgets, with nearly 15 percent from the tax on enterprise assets. The new tax code envisions some limited regional authority over the base and rate of the real estate tax, but fiscal relationships between regional and local governments and the appropriate allocation of revenues and expenditures among all levels remain unresolved.

The proposed new real estate tax draws on the experience gained in a property tax experiment supported by the U.S. Agency for International Development (USAID) to introduce market value-based property taxes in several Russian cities. The cities of Novgorod Veliky and Tver have developed *ad valorem* property tax bases and have received federal authorization to proceed with
taxation. Novgorod Veliky introduced a first phase of the tax on legal entities that own both their land and improvements in January 2000, with plans to complete full implementation by 2003. If successful, this program can serve as a model for other regions.

**Armenia**

Armenia’s transition has been difficult, hampered by internal and regional conflicts and economic disruptions. After a slow improvement in 1994, a new constitution was adopted in 1995, followed by laws on territorial administration, local self-government, real property rights, and taxation. A tax on buildings was added to the existing tax on land, with the intention to merge the two into a market-based real property tax.

A revised property tax law was adopted in 1998 as part of comprehensive tax reform. To encourage business activity, the law decreased taxes on profits and corporate income and removed enterprise inventory from the property tax base. The revised property tax law also strengthened central control over the tax base and rates. The new Cadastre Department was established to consolidate the assessment and valuation functions of several Soviet-era inventory bureaus and registration offices. Armenian tax officials are now considering methods of expanding local revenues from property-based taxes, which now account for 95 percent of local tax receipts and one-quarter of local budgets.

**Transitional Issues in Property Taxation**

This period of fiscal transition has inevitably touched on many political, governmental, and social issues. Communist tax systems sought both to influence behavior and to facilitate planning, and they became more complex as economic performance worsened in the 1980s (Holzman 1992, p. 236). Later, Western European tax models were often superimposed on Soviet-era legal and administrative systems. The taxpaying public was equally unprepared for the new levies, resulting in rapid growth of the underground economy and low tax collection rates.

Property tax systems in transitional countries can be very different from those found in industrial, market-oriented countries (Youngman and Malme 1994). Land had no recognized market value under communism. Its intrinsic value was associated with its productive capacity for agricultural, timber, and mineral products, and its use was controlled by the state. Property ownership often does not extend to the land on which the buildings are situated, as privatization of apartments and commercial buildings has proceeded more rapidly than the establishment of land rights. As a result, land and property are often still treated separately in law and in practice.

In most transitional countries, property is taxed more heavily than land, and enterprises pay significantly higher taxes than individuals. Reduction of subsidies for housing, utilities, and other social support systems leaves the taxpaying capacity of many individuals low, and governments are loath to increase their tax burden.

Tax policy and administration have remained largely under central control during the past decade. As a result, only modest steps have been taken toward local fiscal independence, although property tax revenues have been allocated to local governments. Estonia and Poland permit municipalities to determine tax rates within fixed limits, and the Czech Republic and Russia permit some flexibility in assigning coefficients to area measures that establish the local tax base.

Local interest in reinstating pre-Soviet communities has resulted in a proliferation of small municipalities, especially in the Czech and Slovak republics. Although such localities may lack administrative experience and capacity, a centralized approach faces its own challenges. This can be seen most clearly in Russia, where the state tax service has undergone numerous reorganizations in an effort to improve tax collection.
These countries experienced property allocation without market influence during the Soviet era and, later, privatization through vouchers and other non-market transfers. It is not surprising that, with the exception of Estonia, all the countries studied here introduced taxes on an area non-value basis. Although the tax base varies by type of land, building use, and location, this differentiation does not reflect market data. The major tax base influence is location, with higher tax values in urban than in rural areas. Rural land is generally taxed on the basis of detailed measures of productivity created for communist plans and applied on an area basis according to soil type and geography.

Only Estonia has adapted the area-based system to reflect actual market influences. Estonia's land tax combines an area-based pricing system for urban land with market evidence related to location, quality, and usage. These criteria were developed initially from survey research with the assistance of expert appraisers from Finland. As real estate markets for both sales and rentals have grown, the pricing system has been able to reflect the new market-based information.

Area-based systems persist in transitional countries in part because they satisfy a widely held belief that taxation decisions are official acts that must be ratified by the proper authority, an approach at odds with a tax base drawn from market data. It may also reject reliance on professional appraisal judgment or mathematical models, as well as the individual appeals common in value-based systems. This traditional approach finds area-based taxes less problematic, because an official authority approves both the tax base and the tables of rates. Taxpayers, particularly enterprises, can calculate their own tax liabilities and make direct payments based on formulas provided by the state tax administration. As a result, sometimes, the easiest way to introduce a value-based tax is to introduce market elements into the area-based system.

Their historical treatment of land and buildings as separate entities provides these nations with a unique opportunity to evaluate these two elements as distinct tax bases. Although real property in industrial countries is often classified as a single entity, combining land and buildings, there are extremely important distinctions between them. 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 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.

Estonia's choice of a tax on land only was based in part on these economic considerations, as well as on the practical realities of administration. Such pragmatism is leading the Polish efforts to introduce ad valorem taxation on land while retaining for some period the current methods for taxation of buildings.

**Ad Valorem Property Taxation: Possibilities and Problems**

*Ad valorem* taxation can be a natural step in the development of a market-based economy as private property changes hands and new wealth is invested in real estate. With economic growth and development, the revenue capacity of a market value tax will increase with real estate prices, and such a tax can contribute to other important transition objectives, such as privatization, urban revitalization, and more efficient land use.

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4. There are legislative proposals to introduce market value pricing into per square meter rates in Armenia and the Czech Republic. Poland is considering a proposal to establish *ad valorem* area rates for land.

5. Note that this assumes that the land value assessment does not increase according to the use made of the parcel. An increase in land value assessment because of activity on the site would discourage more intensive use, just as a tax on the building itself would.
Each of the six countries in this study has taken the significant step of taxing land or real property, has designated most of the tax revenues to local governments, and is seeking to expand and improve local government fiscal resources. Property taxes are not a significant source of funds for financing local public services (table 1.1 shows the property tax to be an insignificant portion of total tax revenue and a minor part of local revenues, except in Armenia), but a broadly based *ad valorem* tax on real property offers greater potential for revenue growth than the area-based systems.

Moreover, the expansion of other taxes, such as income or sales taxes, to generate local revenue raises significant problems (see Bahl 1998 and Oates 1999 for a discussion of the advantages of the property tax over other possible revenue sources for local governments). Sales taxes would produce minimal revenues in residential and rural communities. Moreover, sales taxes, attached in small sums to purchases, do not provide the visibility that stimulates responsibility in public financial decisionmaking. Independent local income taxes are subject to cross-border rate competition and compete with other levels of government for a portion of the same tax base. Both sales and income taxes lack the stability of property taxes in times of economic volatility.

By comparison, the property tax offers special advantages as an independent local revenue source. Many local government services funded by the property tax confer benefits on real property and increase its value, a particularly important consideration where infrastructure needs are pressing.

This visibility of the tax is a major reason for the unpopularity of the property tax with politicians and taxpayers. Its virtues of visibility, transparency, and accountability are applauded in principle but present difficulties in application. These difficulties were vividly illustrated when the Armenian prime minister dismissed nearly 20 local officials for failure to enforce unpopular land taxes before an upcoming election (Radio Free Europe/Radio Liberty Armenian Service 1999).

Fiscal and political decentralization require that local officials and taxpayers make some independent decisions as to the level of public services and bear some part of the tax cost (Oates 1999, p. 3). Greater discretion over tax rates will permit local governments real fiscal choices. Moreover, a well-functioning intergovernmental finance system can contribute to national macroeconomic stability and the social services necessary for political acceptance of continued reform (Bird, Ebel, and Wallich 1995 describe why local finance matters in transitional economies' major reform objectives).

Non-*ad valorem* property tax bases are politically popular only as long as their rates are nominal. Taxes paid on a small property situated in a prime central location may be significantly less than the taxes due on a property of greater size in an outlying, less desirable area. As demand for prime space grows, the inequity of these differences in tax burdens will become less acceptable. A higher tax on more desirable locations will also encourage better utilization of land resources and can be a useful tool to improve urban productivity (Brzeski 1997).

**Implementation Challenges and Strategies**

The nonfiscal benefits of the property tax are important in justifying the costs required to develop an *ad valorem* administrative system. The difficulties of reorganizing administrative functions and the expense of integrating and collecting information can be balanced against the benefits obtained from a well-developed property tax information system. Estonian officials consider that the land tax has encouraged more productive use of land and stimulated market activity by making real estate price information readily available to investors through land and sales transaction registers and updated cadastral maps. The Russian pilot cities also clarified property rights and improved title registration procedures during development of their experimental property tax systems.
Designing and building the property tax database is a formidable challenge for transitional countries. Land and building records were maintained separately by different agencies in the Soviet period and are not linked. Neither set of records includes the full range of information needed for valuation and assessment. Tax records were identified by taxpayer, not by address or property. Many records, and especially maps, were considered secret documents. Official land and property prices recorded by notaries are not generally true indicators of market value.

In addition, the construction of a new fiscal cadastre containing the information needed for assessment of property taxes faces resistance from the various agencies that control parts of the necessary data. In Poland, years of discussion were required for the relevant agencies to agree that this process could proceed even without complete title registries and land surveys. In the Russian Federation, integration of information from various independent databases into a property tax information system was accomplished only by strong local political leadership and new information management software developed with assistance from USAID. The Czech Republic is in the process of linking land and tax information electronically through cooperation between the Ministry of Finance and the Cadastral Office.

Computer-assisted mass appraisal has sometimes been viewed as a threat to the nascent appraisal industry, and there have been attempts in several countries to limit both private and public valuation to specific groups of “licensed” appraisers and surveyors. To be accepted by these professionals, mass appraisal methods must be understood as opening new opportunities to the appraisal profession, as well as reducing the costs of assessment administration and ensuring greater equity and uniformity.

Assignment of the valuation function is a politically sensitive issue when competing agencies vie for control or local governments are overwhelmed with new responsibilities. Estonia assigned valuation responsibility for the land tax to the National Land Board and tax administration and collection to the National Tax Board. In other countries, tax reforms generally have been led by finance ministries or tax inspectorates. Where ministries and agencies compete for control, the creation of new departments or consolidation and reorganization of existing agencies may provide a solution.

Armenia, the Czech Republic, and Poland all consider central government leadership essential to property tax systems, but they anticipate the future transfer of greater responsibility to local governments. In the Russian Federation, the USAID-supported projects succeeded in organizing valuation and assessment administration at the local level, but the need to obtain federal authorization to levy the tax delayed its implementation.

Tax administration continues to be under central control in these countries, but some regional and local tax offices have developed a degree of independence (not always with desirable results). Nevertheless, this incipient decentralization creates the possibility that future collection responsibilities might be vested in local government agencies, subject to regional or national oversight. Effective tax collection and enforcement remain a challenge where a taxpaying culture and efficient tax administration are lacking, but tax compliance is a major priority and collection ratios are improving. Estonia’s land tax collections have increased annually and are now reported to exceed 98 percent. Public education, taxpayer services, and an accessible appeals system are important to this process.

The complex coordination required between property tax systems and larger economic, legal, and fiscal developments has caused most governments to take a cautious approach to ad valorem

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6. Methodologies for tax collection statistics do not always follow Western accounting methods. Estonia, for example, includes proceeds from tax arrears in annual statistics, with the result that figures overstate the actual ratio for annual collections. In some countries, collection rates are measured against budget projections, not against actual levies.
taxation. Nevertheless, Estonia and Latvia have implemented market value-based land taxation, and *ad valorem* property taxation is planned or being seriously considered in Armenia, the Czech Republic, Poland, and the Russian Federation, as well as in Hungary and Slovenia, which are not part of this study (Paugam 1999). Property taxation, particularly *ad valorem* taxation, has a potentially important role in providing a stable independent revenue to local governments, developing democratic and accountable public institutions, and stimulating market development and efficient land uses. Other countries with nonmarket-based land and building taxes may wish to make the transition to *ad valorem* property taxation. We hope that the experiences of these six countries will offer guidance to those efforts.

**References and Bibliography**


Property Tax Developments in Poland

Jane H. Malme with W. Jan Brzeski

General Background

As one of the most successful transitional economies, Poland offers important perspectives from which to view the development of property taxation in the context of the economic, fiscal, and political changes that have occurred since the breakup of the Soviet bloc. Poland is in its eighth year of continuous economic growth, with a thriving private sector and steadily decreasing inflation and unemployment (Koen 1998, p. 30). As Central Europe's largest country, bordering seven others, it is looked to as a model of economic success and stability by other postcommunist countries in the region.

Economic Reforms

Poland's drive for economic reform grew out of the intellectual and labor movements and demands for economic efficiencies that burst forth dramatically in the initial Solidarity Revolution in 1980–81. Although the revolution was quashed by martial law, a gradual evolution toward economic reform followed, and Poland was the first country to relinquish communist power voluntarily in 1989. Finance Minister Leszak Balcerowicz's bold and comprehensive package of economic reforms carried out in 1990–91 stimulated growth in the economy as early as 1992. An initial short recession was followed by continued growth in the range of 5 to 7 percent per year through the end of the decade. By the mid-1990s, Poland's economy had become increasingly broad based and had grown more than twice as fast as the average growth rate of the member countries of the Organisation for Economic Co-operation and Development (OECD).

Poland became a member of the OECD in 1996 and is negotiating for membership in the European Union (EU). Poland has the largest economy in post-Soviet Central Europe, but its gross domestic product (GDP), the star performer among transitional economies during the 1990s, is still much less than half that of other EU countries, measured on a per capita basis.1 Poland's large shadow economy, which probably accounts for an additional 15 to 20 percent, narrows the gap, but economic parity with EU countries is likely to take years to achieve.

Privatization

Poland's multitrack privatization strategy emphasized achieving economic growth, and the subsequent creation of new firms and privatization of retail and small service operations has been quite successful. The private sector now accounts for more than 65 percent of GDP. Progress

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1. According to The Economist (1999, p. 106), Poland's GDP would grow 21 percent in the decade between 1989 and 1999. Only two other transitional countries, Slovenia and Slovakia, had outputs higher in 1999 than in 1989, and were both considerably below Poland.
has been slower than expected using the classic privatization approach of selling state assets through public and private offerings on capital markets. This approach was preferred initially as a means of creating fledgling capital markets incrementally, with the potential for revenue generation for the government. More effective approaches have included the transformation of state-owned enterprises into companies formed by former employees and managers or the sale of assets belonging to insolvent, defunct state-owned enterprises. The most recent approach, initiated in 1995, was mass privatization through creation of national investment funds that manage portfolios of state-owned enterprises. The funds have been traded on the Warsaw Stock Exchange since 1997.

**Fiscal Reforms**

Fiscal reforms started with the introduction of corporate and individual income taxes, and were followed in the second phase of indirect taxes in the form of value added (VAT) and excise taxes. A third phase, to establish local wealth-based taxes, including an *ad valorem* property tax, was proposed in 1995, but has yet to be implemented. The lack of momentum for pursuing property tax reform is due in part to the revenue stability of the nonvalue-based real estate tax that was introduced in 1986.

The second phase shifted direct taxes on income of corporations and individuals toward indirect taxes, including a 22 percent VAT and various excise taxes. The indirect share of budget revenues rose from 43 percent in 1995 to 53 percent in 1998, while direct taxes dropped from 39 percent in 1995 to 37 percent in 1998 (Ministry of Finance 1993, 1994, 1995, 1996, 1997). New tax exemptions and reductions were introduced as incentives to entrepreneurs to enter the formal economy, and they seem to have been effective in reducing Poland’s large shadow economy. Effective corporate tax rates declined from 37 percent in 1993 to 33 percent in 1995. As a result, the share of revenue from corporate income taxes dropped from 14 percent in 1993 to 11 percent in 1996 and 1997, despite a sharp rise in enterprise profits and an unchanged high marginal tax rate of 40 percent. An optional form of tax reporting—a flat-rate income tax on service, manufacturing, retail, and catering activities—was introduced as an incentive to eliminate dishonest expense reporting, as well as to reduce tax administration and compliance costs.

Although the deficit in the overall state cash budget (including local budgets, social services, and other off-budget items) is modest (less than 2 percent of GDP) and the public debt ratio (slightly over 50 percent of GDP) has been declining, fiscal prospects remain challenging. Significant revenue losses are anticipated from the elimination of import surcharges and the reduction in import duties as a result of convergence with the EU. The government’s medium-term strategy commits it to cut corporate and individual taxes to sustain investment and output growth. This will require a corresponding expansion of coverage for the VAT, a reduction of tax exemptions, and the use of other taxes to increase revenues. An *ad valorem* property tax is one component of the government’s strategy to offer greater growth capacity in local government revenue and improved tax equity as real estate markets broaden.

The current real estate tax was introduced in the 1986 Law on Local Taxes and Fees. Even though in 1991 the new government revised the law substantially to assign all revenues from the real estate tax, as well as from agricultural and forest property taxes, to local governments, it did not shift to a market-based real property tax. An *ad valorem* property tax will be a central element in the third phase of fiscal reform that addresses taxes on wealth.

**Devolution of Government Functions**

A parliamentary democracy was restored in 1990, with two chambers, the Sjem with 460 deputies and the Senat with 100 deputies. The president, chosen in a nationwide election every four years,
has generally representative roles, but appoints candidates for prime minister and has veto power over legislation, which can be overridden by a two-thirds vote of parliament. The central government is composed of various central ministries, boards and agencies, and regional administrative units (voivodships).

Local self-government was reestablished in 1990 in 2,465 municipalities (gminas). Among them are 10 large metropolitan cities and nearly 50 cities. Local elections are held every four years, most recently in 1998. Each gmina has an elected president (large cities), mayor (other cities), or wójt (rural gmina), and a local legislative assembly (city/gmina council). Executive powers are vested in an executive board elected by the council and headed by the president, mayor, or wójt. Local governments initially assumed relatively modest responsibilities and financing authority. Steps have been taken toward further devolution of responsibilities to larger cities in accordance with the principle of subsidiarity promoted by the EU.

In 1995 a special financial agreement with the central government gave 46 cities additional responsibilities and expenditures, such as road maintenance, primary schools, social assistance facilities, local health care facilities, and local cultural institutions. This agreement sought to avoid earlier problems associated with devolution of responsibilities without commensurate financing, which had placed local governments under increasing financial stress.

Local governments raise nearly 30 percent of their own revenues. Property taxes account for 40 percent of own-source revenue, but the relative share raised by property taxes declined from more than 20 percent to less than 14 percent between 1993 and 1997. The decrease has been attributed to the lack of elasticity in these area-based taxes. The conversion to an ad valorem property tax has been advocated strongly by the larger cities as a way to strengthen local financial capacity, particularly as these cities experience increasing budget deficits (tables 2.1–2.3).3

Progress in government decentralization and democratic reform was furthered by the creation of two levels of regional self-government. On the regional level, there are now 16 self-rulled voivodships that are responsible for delivering various services, primarily in health, welfare, employment, and higher education. These are distinct from the regional administrative voivodships of the national government. There are also 380 subregional powiats. These regional governments and the 2,465 municipalities each have separate responsibilities that do not overlap. In the large cities, the subregional units are merged into one self-government with identical boundaries, and they are known as urban powiats. The elected officials at each level are autonomous, and there is no hierarchical relationship between them. It is expected that over time the regional units will assume more functions and further lessen the central government’s role in local affairs.

Municipalization of State Property

Another major element of the decentralization of political and economic power has been the transfer of state property to local government. The Act on Municipalization of State Property and Its Management, enacted by mid-1990, transferred to cities most of the state-owned real property related to urban services and housing, and vested the cities with civil code property rights. This action required municipalities to clarify possible ownership claims to each of these properties and to prepare formal acquisition of property rights through civil code provisions. Thus, each

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2. OECD (1998, table 143) reports that taxes on immovable property (category 4000) constitute 32.7 percent of the total tax revenues of local governments. Individual and corporate income taxes are the largest contributors at 59.5 percent. The 4000 category includes nonrecurrent taxes on property, but these are less than 2 percent of the total.

3. The average budget deficit was 4 percent in 1998, and 8 percent in larger cities. This deficit is a sizable increase from the average in 1997 (2.5 percent) and 1996 (1.8 percent). There was a modest surplus in 1995 (0.6 percent). Data are from OECD (1998) and 1998 deficit data are from Ministry of Finance (1998).
Table 2.1. Local Government Revenues, 1993 and 1997

<table>
<thead>
<tr>
<th>Source</th>
<th>Percentage of the national budget</th>
<th>Percentage of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>All local revenues</td>
<td>21.0</td>
<td>33.0</td>
</tr>
<tr>
<td>All local own-source revenues</td>
<td>9.8</td>
<td>12.4</td>
</tr>
<tr>
<td>Property-related taxes</td>
<td>4.0</td>
<td>4.4</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance data.

Table 2.2. Revenues from Real Property (Real Estate, Agricultural, Forest) Taxes, 1994–98 (US$ millions)

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Property tax totals</td>
<td>1,085</td>
<td>1,484</td>
<td>1,590</td>
<td>1,771</td>
<td>1,761</td>
</tr>
<tr>
<td>Real estate taxes</td>
<td>883</td>
<td>1,228</td>
<td>1,306</td>
<td>1,475</td>
<td>1,496</td>
</tr>
<tr>
<td>Agricultural taxes</td>
<td>185</td>
<td>225</td>
<td>248</td>
<td>259</td>
<td>231</td>
</tr>
<tr>
<td>Forest taxes</td>
<td>17</td>
<td>31</td>
<td>36</td>
<td>37</td>
<td>34</td>
</tr>
<tr>
<td>Total as a percentage of all local revenues</td>
<td>16.5</td>
<td>17.2</td>
<td>13.9</td>
<td>13.5</td>
<td>13.4</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance data.

Table 2.3. Average Percentage of Local Revenues from Shared National Taxes, 1993–97

<table>
<thead>
<tr>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>25.4</td>
<td>23.0</td>
<td>22.9</td>
<td>24.5</td>
<td>24.2</td>
</tr>
</tbody>
</table>

Note: The percentage is primarily a share of individual income taxes.
Source: Ministry of Finance data.

property had to be conveyed through notarial act and registered in a new title book. This created an enormous strain on the existing notary and title systems, which led to the establishment of private notaries and inclusion of the title registry in the court system. Although this change eliminated the bottlenecks with respect to notarial acts, it did not solve the overload on title registries, particularly in large cities that have not been able to keep up with the changes of property ownership.

State enterprises, newly created municipal entities, and cooperatives had used real estate on the basis of management rights. To vest ownership rights in the state, cooperatives, and municipalities themselves, the government amended the Land Management and Expropriation Act in December 1990 to make property management rights transferable. This was accomplished by creating perpetual leaseholds pertaining to land and leasehold or ownership rights to buildings on lands under perpetual leasehold. This legislation instantly attached recognizable, enforceable, and transferable rights to units of property, and thus created a marketable commodity. In addition, the act established real estate principles for real property owned by the state and municipalities, rules for expropriation of real property by the state and local governments, and regulations for disposition of state and municipal real property.
State and municipal authorities were authorized to dispose of real property through a competitive bidding process that stimulated markets and minimized fraudulent disposition of public property. The state and municipalities were also allowed to transfer companies, together with their real estate assets, to employees through leasing arrangements.

**Private Property Rights**

Poland never abolished private property rights during the communist period, although the public interest was officially sanctioned as superior to private interests. While ownership of public sector properties is now being clarified through the municipalization process, titles to much private property remain unclear. The redistribution of property rights has been one of the most complex tasks in the transformation and is far from complete. One unresolved issue is wholesale compensation for and restitution of the property confiscated during the communist period. Poland remains one of the few countries in Central Europe with no general legislative resolution of these problems, which has impeded further investment and privatization. A special law was enacted to regulate restitution of church property, but private restitution claims to date have been successful only through judicial action. The incentive to complete these reforms is less strong because of the substantial private ownership still in existence.

Property rights vested in real estate are governed by the Civil Code, which defines real property, various possible tenancies, estates and interests, and ways to transfer the rights and obligations of real estate ownership. The transfer of property rights (deed of conveyance) takes place through a notarial act, which is a contract between the parties executed in the presence of a notary public. Public registration of property rights occurs in a land title registry (perpetual books), which issues a certificate of ownership to third parties. The costs associated with transfer and registration are significant, about 10 percent of the transaction price.

The property rights defined in the Civil Code are legally enforceable through the Civil Procedures Code. Many matters regarding private real estate refer to administrative decisions of government agencies, which are regulated by the Administrative Procedures Code, permitting legal persons (individuals and firms) to appeal administrative decisions. In addition, a civil rights ombudsman has authority to bring class action suits against legislative and regulatory provisions that are believed to violate human and civil rights. These may also pertain to private property rights vested in land.

Nevertheless, many owners of real property in Poland are not prepared to exercise their rights effectively, and some rights are yet to be tested in practice. Numerous conflicts arise from gaps and inconsistencies in the laws, and real estate legal practice is not fully developed. Conflict resolution has been left largely to the courts, although the establishment of arbitration boards has emerged as a way to expedite resolution of disputes at lower cost.

Acquisition of real estate by foreigners has been a particularly sensitive issue in Poland. To encourage foreign investment without losing control over the process, the government updated the 1920 Act of Acquisition of Real Estate by Foreigners. It requires a permit from the Ministry of Interior for acquisition of ownership rights or perpetual ground leasehold. A foreigner is deemed to be a legal person (individual or firm) that is located abroad. If the legal entity is located in Poland but is subject to direct or indirect control (at least 50 percent of direct/indirect ownership of investment capital) by people who are not Polish citizens or by legal entities that are located abroad, it is deemed a foreigner. The permit application requires individuals (physical persons) to state their ties to Poland and their objectives in acquiring the real estate. An appraisal of the property is required, and a fee of 1 percent of the price is charged on approval and execution of the acquisition permit. An exception is made for purchases of apartments by foreigners, for whom the process is similar to that for Polish citizens (The Warsaw Voice 1998, p. 26).
In 1998, according to the *Polish News Bulletin*, the Interior Ministry issued 2,189 permits to foreigners wishing to buy real estate (they acquired about 4,355 hectares). This was more than twice the number in 1993, and the number has risen steadily each year.

The unfolding of these processes is creating a new ownership structure with transferable property rights that are well defined and protected. Still, much of the valuable property remains beyond the reach of market forces because of unclear property rights and a high degree of uncertainty regarding restitution claims. Although considerable progress has been made in creating market mechanisms, some important unresolved issues hamper more dynamic development of real estate markets. Reducing the costs to individuals for registering title or transferring property, establishing a policy and process for restitution, and developing a modern real estate cadastre with up-to-date information have all been recommended to improve real estate market development. The need for real estate cadastre construction has been at the center of debates on the development of a fiscal cadastre for an *ad valorem* property tax system.

**The Development of Land and Building Taxation**

The economic reforms that followed the Solidarity Revolution included the introduction in 1985 of an agricultural property tax, which is essentially a wealth tax, followed by a real estate tax in 1986 within the context of the new Law on Local Taxes and Fees. These taxes were introduced with purely fiscal objectives: to expand the tax base into nonincome areas and to capture wealth being diverted to this untaxed area at a time of declining government revenues and worsening macroeconomic conditions. The transition from communism to a market economy and privatization of property had not yet begun.

The only major changes in real estate and agricultural taxes after the end of communist rule concerned the restitution in 1990 of local self-governments in Poland. The 1991 amendments to the Law on Local Taxes and Fees made taxes related to real estate the sole own-source revenues of the new local governments. The Forest Property Tax was added in 1992. These taxes are not market based. Recent amendments have made various changes to the laws, but have not changed their basic tax structures.

The three taxes currently levied on real property produced approximately 13.4 percent of local revenues in 1998, of which the greatest portion (85 percent) is raised from urban property taxes (real estate tax). The agricultural property tax (13 percent) and the forest property tax (2 percent) raise the remaining portions. The total revenues raised by these taxes are approximately US$1,781 million (table 2.4). Each tax is governed by its own legal provisions that specify taxable and tax exempt property. Amendments in 1997 attempted to close loopholes and broaden the scope of the tax.

General categories of exemptions are specified in national legislation and are applied uniformly throughout the country. In addition to various categorical exemptions for each tax, tax relief is provided to the elderly, veterans, and others in special circumstances. Special economic zones, which have proliferated across the country to encourage investment, provide property tax and other tax exemptions and preferences to businesses. These zones have been criticized for their number (between 1996 and 1998 17 such zones were established) and their potential to jeopardize the tax base, as well as for their deviation from EU guidelines, but they have not lost their popularity (*The Warsaw Voice* 1998, pp. 108–13). Additional exemptions, which are granted by local authorities, vary widely from one jurisdiction to another.

**The Real Estate Tax**

The tax base for the real estate tax is land and buildings and commercial structures other than those subject to agriculture and forestry taxation. It is an area-based tax levied on square meters
Table 2.4. Local Government Revenues, 1998
(US$ millions)

<table>
<thead>
<tr>
<th>Source</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total local government revenues</td>
<td>13,178</td>
</tr>
<tr>
<td>Total own local government revenues</td>
<td>4,411</td>
</tr>
<tr>
<td>Real estate taxes collected</td>
<td>1,496</td>
</tr>
<tr>
<td>Revenue lost due to</td>
<td></td>
</tr>
<tr>
<td>Raising less than maximum tax rates</td>
<td>179</td>
</tr>
<tr>
<td>Relief, postponements, forgiveness</td>
<td>96</td>
</tr>
<tr>
<td>Agricultural taxes collected</td>
<td>185</td>
</tr>
<tr>
<td>Revenue lost due to</td>
<td></td>
</tr>
<tr>
<td>Raising less than maximum tax rates</td>
<td>54</td>
</tr>
<tr>
<td>Relief, postponement, forgiveness</td>
<td>18</td>
</tr>
<tr>
<td>Forest taxes collected</td>
<td>17</td>
</tr>
<tr>
<td>Revenue lost due to</td>
<td></td>
</tr>
<tr>
<td>Raising less than maximum rates</td>
<td>0.3</td>
</tr>
<tr>
<td>Relief, postponement, forgiveness</td>
<td>0.2</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance data.

of usable living area for buildings and the land parcel area. The depreciation amount reported for income taxation is used for nonresidential structures not classified as buildings.

Exempt categories include real estate owned by foreign governments and international organizations under treaties, public rights-of-way, and structures used for public transport and public utilities. Real estate owned by local self-governments is exempt, but central government property is not automatically exempt. In addition, exemptions are provided for religious, educational, charitable, health, social service, and research institutions; associations with activities related to youth, education, noncommercial physical fitness and sports; and farmsteads.

Tax rates are expressed as a sum of money per square meter for land or building (table 2.5). For structures—such as pipelines and power generation, transportation, and specialized industrial systems—that are taxed on depreciation, the rate is 2 percent of their book value. Local self-governments determine the tax rates on land and buildings through the annual budgetary process, but upper and lower limits are established by the central government in its annual budget law. The upper limits are traditionally adjusted by an inflation factor; the lower limit is 50 percent of the upper limit. The upper limits on tax rates vary between residential and nonresidential uses, both for land and buildings, with the nonresidential rates considerably higher than the residential rates.

Table 2.5. 1998/99 Tax Rates by Taxable Property Category
(US$)

<table>
<thead>
<tr>
<th>Property category</th>
<th>Tax rate/square meter/year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential buildings</td>
<td>0.11</td>
</tr>
<tr>
<td>Buildings used for economic purposes</td>
<td>3.85</td>
</tr>
<tr>
<td>Land in residential/noneconomic use</td>
<td>0.02</td>
</tr>
<tr>
<td>Land in economic use</td>
<td>0.13</td>
</tr>
<tr>
<td>Structures</td>
<td>2% of depreciation base for income tax</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance data.
There were approximately 5,400,000 real estate taxpayers in Poland in 1998, when the average annual payment per taxpayer was approximately US$114. This average does not reflect the significant differences in rate levels. The maximum allowable rate for property used for economic activities is 35 times the rate for residential uses. Land is also taxed at a considerably lower rate than buildings.

The 1997 amendments clarified and expanded the nonresidential or economic use categories, on which a higher tax rate is levied. Exemptions were also broadened, most importantly for generating facilities of electric, gas, and water utilities that were experiencing financial difficulties in cities, and for buildings used in forestry and agriculture to lessen the tax burden on farmers, who had strong advocates in the coalition government. Buildings and lands listed in the heritage registry were exempted on the condition that they be maintained in accordance with heritage conservation laws. Any parts of these buildings used for business activities are taxable. The exemption is intended to attract private resources into maintenance of heritage property, but at the same time to have the tax burden carried by business properties.

**The Agricultural Property Tax**

This tax is levied on land belonging to farmsteads exceeding one hectare. The tax base consists of usable land area expressed in terms of conversion hectares that takes into consideration the land area, type, soil, and usage classes (registered in the technical cadastre), and allocation to a tax zone. Four tax zones have been established, including rural localities, cities, and urban districts, depending on economic and production-climatic conditions. Allocation to a given tax zone is made by the Ministry of Finance. There are two types of land (arable land and meadows and pastures) and 10 usage classes. There are eight classes of soils for arable land and six classes for meadows and pastures. All these categories are used to calculate the number of conversion hectares on agricultural land parcels, which constitutes the tax base to which a tax rate is applied.

Exempt from this tax is land area under lakes, flowing water, reservoirs, flood dikes, boundary strips, or land damaged by drainage, and specified land classes not expected to generate agricultural income. Land surrounding the homesteads of elderly members of farm cooperatives is also exempt. Various tax abatements are granted for farm improvements and for personal circumstances, such as military service.

Tax rates per year are expressed as a sum of money equivalent to 2.5 quintals of rye (a measure of quantity) for each conversion hectare. The money equivalent is calculated each year based on average price per quintal of rye paid on wholesale markets for the first three quarters of the preceding year. The Central Bureau of Statistics announces the average prices in the government's official publication, Poland's Monitor, on the 20th day after the end of the third quarter. Local governments have had the authority to decrease that rate since 1992. There are more than 2 million agricultural taxpayers, with an average payment of US$100 per year.

**The Forest Property Tax**

Land of at least 0.1 hectare that is used for production of forest vegetation, that constitutes a nature reserve, that is part of a national park, or that is on the list of heritage sites is taxed as forest land. Property used for forestry functions (buildings, structures, drainage installations, roads, land under power lines, and storage and parking areas) as well as for park-related tourist facilities is included within this tax classification.

The tax base consists of forest land area expressed in terms of conversion hectares in the case of forests covered by a registered forest management plan. Actual hectares are used for land not under formal management. The conversion hectare is calculated according to major types of tree species growing in the forest areas and their quality classes as included in the forest management plan on January 1 of the taxable year.
Tax rates differ for forested lands with and without forest management plans. For managed lands, the tax rates applied to conversion hectares are expressed as a sum of money equivalent to 0.2 cubic meters of coniferous wood used in saw mills, calculated on the basis of an average selling price for the first three quarters of the preceding tax year. These average prices are published in Poland's Monitor. On lands without a management plan, lands that are a part of nature reserves, and national parks, the tax rate is applied to the actual number of hectares and is expressed as a sum of money equivalent to 0.3 quintals of rye per hectare per half year. This is the same price used for the agricultural property tax. There are approximately 1,216,000 forest taxpayers, who pay an average of US$16 per year.

Intergovernmental Organization

The laws that govern property taxation are enacted by the national parliament, which also enacts an annual budgetary law that stipulates the upper limit for property tax rates. Local governments may determine certain additional exemptions and abatements, as well as the actual tax rates.

The national government operates two registries that collect data for taxation: one for technical cadastral identification (Land and Building Evidence), supervised by national surveying authorities, and another for title registry identification (Perpetual Books), supervised by the court system. Local self-governments collect and administer the three real property taxes by connecting their own fiscal cadastres with these two registers. They also set tax rates during their budgetary process and receive all the tax proceeds. Other taxes are administered by the national tax service, although the local governments receive shares of the proceeds from individual and corporate income taxes.

Local governments collect legal and property information for taxing the property of individuals (physical persons) using technical and title registers and information on building construction from planning and architecture departments. Land maps, land area, parcel identification, and building descriptions are available from technical cadastres and city building departments; owner/taxpayer identities are taken from title registries. Land use regulations and building restrictions can be obtained from local government planning departments. Local governments have access to these databases, but must arrange to receive the data on diskettes or in some other form. The law requires that registries make information available, but local governments must determine how to acquire it. Legal persons, such as enterprises, firms, and associations, must report required information to the authorities.

Tax Collection

Taxpayers are defined by law as "physical or legal persons, or organizational entities without legal status," who are leaseholders, lessees, users, or occupiers of taxable land, as specified by law. Physical persons are sent an assessment notice and tax bill together and pay one amount for all property taxes due. The law specifies that the real estate tax is an annual tax to be paid in four installments. Payments can be made directly at the local government office or in a bank or post office. Legal persons calculate and report their own taxes and contribute an overwhelming part of revenues (usually 80 to 90 percent) from the real estate tax. Legal persons and organizational units without legal status pay each tax separately on a monthly basis.

Unpaid taxes are by law an undisclosed lien on the property, even if the property is not registered. This uncertainty creates an obstacle to the development of mortgage financing. While there is a legal possibility to force a judicial sale, local governments are reluctant to start such proceedings. In addition, local governments rely on the National Tax Service to handle tax arrears, and it is less motivated to pursue these matters over other, larger central government tax liabilities. Only the largest cities have recently been given authority to collect property tax arrears.
Taxpayer Appeal Rights

General appeals procedures for tax assessments and tax bills are regulated by the Administrative Procedures Code. Appeals are lodged first with a local government president, mayor, or wójt, and thereafter with a regional appeals board for local governments. Their decisions can be appealed to the highest Administrative Appeals Court. The initiation of a protest does not postpone the payment of taxes, but the appeals body may rule that the payment be postponed. Essentially, no tax data are available to taxpayers other than the assessment notice and tax bill unless the case is under appeal.

Progress toward Ad Valorem Property Taxation

Although the area-based tax system had been functioning relatively well in the early 1990s from a fiscal perspective, it was not capturing the growth in the tax base resulting from the emerging market economy. Advisers and government leaders were in general agreement that an overhaul of the real estate tax and introduction of a market value system were in order. In 1993 and 1994, an ad valorem property tax simulation project funded by the U.S. Agency for International Development (USAID) was undertaken in Cracow in cooperation with the Cracow Real Estate Institute, and confirmed that the market was sufficiently developed for an ad valorem system.

Initial Proposals

Following a resolution passed by the Polish parliament in March 1994 that instructed the government to prepare a draft ad valorem property tax law, the Council of Ministers adopted a long-term economic development strategy in June 1994. It ordered the Ministry of Finance to institute a comprehensive fiscal real property cadastre that could be used for mass appraisal of property for ad valorem taxation, with a 1999 implementation date. The fiscal cadastre was envisioned as the first and most logical step toward a national land information system that would contain a complete inventory of all physical, economic, and legal information.

In early 1995, an interministerial working group that consisted of the ministers of justice (chairman), construction, and agriculture was charged with establishing the basic premises of the reform and resolving institutional and jurisdictional issues, including disagreements among ministries over who would control various elements of property data registers and valuation. The working group also had to consider reorganization plans that included the creation of a new Ministry of the Economy. At the same time, the Ministry of Finance set up an internal task force to develop the reform concepts and draft legislative proposals.

The working group adopted a statement of principles for the new property tax, affirming the need for an ad valorem tax as a continuation of the restructuring of the system that began in 1990, to establish a stable and effective fiscal system for local governments. The statement also stated that

- The new property tax will include all types of real property and will replace the area-based taxes on real estate, agricultural property, and forest property.
- A real property cadastre, focused initially on fiscal functions, will be developed for use in valuation and tax assessment.
- The tax base for ad valorem taxation will consist of values determined according to national cadastral valuation, and officially designated "cadastral values" for all taxable properties throughout the country.
- The proposed reform would offer the additional benefits of encouraging clarification of real property ownership, orderly development of local real estate markets, investment in housing, and development of mortgage credit institutions.
The working group recommended that a central agency called the National Office of Cadastre, Geodesy and Cartography be created to develop and manage property information systems and registers, as well as perform national cadastral valuations.

The special task force of the Ministry of Finance drafted new acts to establish the basic legal foundation for the *ad valorem* property tax system. The proposals incorporated recommendations from the working group as well as features drawn from international experience. The full set of proposed laws was presented to parliament for enactment in 1995 (see Kolodko 1996, p. 4, for a report on the government's recommendations). After extensive discussions and lobbying by advocates for local government, the Ministry of Finance gave local governments a larger role in administering the proposed new system.

These 1996 revisions provided for local management of the cadastre and full administration of local taxes, including property taxes, gift and inheritance taxes, and stamp duties. The local government entities would be municipal unions composed of several municipalities or designated cities of sufficient size to achieve economies of scale. The draft Law on Obligatory Municipal Unions, Designated Cities, and Municipal Offices of Local Taxes and Cadastre permitted only the largest cities to administer their own systems. Although administration of the local taxes would be left wholly to local governments, subject only to general laws, cadastral operations were to be supervised and coordinated through the new National Office of Cadastre, Geodesy, and Cartography. The draft laws proposed an effective date of 2001 for implementation of *ad valorem* taxation, but this could be earlier if requested by the local council of a municipality deemed capable of fulfilling certain legal and technical prerequisites.

The momentum for *ad valorem* taxation reform stalled in the legislative process, however, as professional, bureaucratic, and political forces mobilized around control of land surveying, title registration, and tax administrative functions. Despite general agreement as to reform principles (as set forth in the working group's statement), these organized groups prevented final agreement on the ambitious legislative package, leaving property tax reform without a strong advocate in a new coalition government that was more cautious about market reforms.

The 1997 elections included the pledge of new Prime Minister Buzek to hand over more power and property to citizens and local organizations, and to provide new momentum to continue economic reforms. The need for revenue growth, the desire by local officials for greater fiscal autonomy, and the increasing recognition of the nonrevenue benefits of the property tax again focused attention on this particular aspect of tax reform.

**Creation of the Department of Local Government Taxes and Cadastre**

To push reform forward, in 1998 Deputy Prime Minister Balcerowicz established a new Department of Local Government Taxes and Cadastre within the Ministry of Finance to organize the strategy and prepare a new package of legislation for consideration by parliament.

The government requested support from USAID to send Polish officials to the United States to study property tax systems, and they subsequently started to work on new reform concepts. The initial proposals contemplated placing cadastral and valuation functions in the new powiat level of government, which would service the local governments within its jurisdiction. Early in 1999 a series of seminars was presented to members of parliament and local officials to acquaint them with the new ideas. After further deliberations, a revised concept of property tax reform was circulated in April 1999.

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4. A battle within the government was waged over local government reform in 1998. The restructuring of regional and local government was a priority of the new government coalition, which sought to create regions of sufficient size to which central functions could be devolved efficiently (Economist Intelligence Unit 1998).
Major differences between the 1995, 1998, and 1999 proposals revolved around administration of the fiscal cadastre and valuation functions. The 1995 proposal for a new National Office of Cadastre, Geodesy, and Cartography and the 1998 consideration of subregional administration were replaced by local government control of fiscal cadastres. The local offices would service local governments or their larger clusters with cadastre management and valuation services. This new approach recognized the increasing decentralization of government functions while trying to avoid the interministerial struggles for funding and control that stalled the earlier proposals. The new approach also unified the separate treatment of property taxation, cadastre management, and fiscal valuation.

The proposal specified that a fiscal cadastre containing a taxpayer register and a taxable object register with units for description and valuation of the properties would be used to assess the real property tax as well as other levies, if specified by law. Fiscal valuations would include unit values established separately for farmland, forest, and other open lands, and developed or developable land. The unit values for farmland (four categories each of tillable land and meadows and pastures) and for forest and other nonagricultural rural land were included in the draft law, and could be adjusted annually by agreement between the public finance and rural ministries. For urban land, local tax authorities would classify land into four categories (residential, industrial, other developed area, and other) and prepare land value zones with area prices per square meter for each category. The local council would adopt by resolution the land value zones and unit values, and publish the official list.

**Developing New Strategies**

The 1999 proposals were stalled as the government’s agenda of major public sector reforms was criticized for being too ambitious to attempt all at once. Strategies turned to integrating property taxation into the broader local finance and tax reforms, and requiring it to be both self-financing and revenue neutral. Poland obtained USAID support to study the costs and fiscal impacts of property tax implementation in five selected cities.

The revised proposal under discussion would replace the three existing taxes on urban real estate, agricultural lands, and forest lands with a value-related formula for land, but, in recognition of development time and cost factors, would retain the current method of taxing buildings. The strategy is to introduce the new concepts in several stages, with the first stage using an area-based formula for land, modified by location coefficients reflecting market relationships. Later, buildings will be taxed on initial nonresidential book values, with replacement costs depreciated by market-derived depreciation schedules. The constraints facing each stage are that the reforms must be self-financing in the sense of full recovery of costs. In addition, the first stage must also be revenue neutral as applied to existing taxpayers in the aggregate. This will be feasible only if previously undiscovered properties are added to the tax base and some exemptions are eliminated.

There is growing consensus among policymakers that the economic reforms introduced over the past decade have reached such a stage of maturity that a market value-based tax on property is both feasible and desirable. There is an active and growing real estate market, including privatization of landholdings by local governments and secondary sales of residential and commercial properties.⁵ *Ad valorem* taxation is recommended to expand and broaden the property tax

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⁵ *The Warsaw Voice* (1998, p. 121), reporting on land prices in Warsaw, noted that the Warsaw real estate market was "approaching normalcy" based on an analysis comparing transaction prices for land from 1996 to 1997.
base for local governments, as well as to provide a more equitable distribution of taxes and greater fiscal transparency and accountability. Nevertheless, real opposition to the reform exists, primarily among the untaxed and undertaxed who acquired considerable property wealth through transfers made during the privatization process. Many local elected officials are also afraid of the political consequences of increasing local taxes, preferring funding from central government transfers and sale of municipal assets.

Recognizing that an eventual transition to an ad valorem tax is inevitable, the leadership of the Polish Cities Association is working with the Ministry of Finance on the new proposals. Polish officials are also focusing on the nonfiscal benefits of a value-based property tax, including its potential as a stimulus of real estate markets and mortgage credit institutions and as a tool for urban revitalization and more efficient land use. Market values for real estate are still not widely understood by the general populace, who fear higher taxes will result. The political battle for introduction of a market value-based tax has not yet been won.

Current Issues and Future Developments

One lesson learned is that, irrespective of substantive issues, institution building in transitional countries can be a protracted process that has to address and resolve the problems of management structures and controlling interests acquired prior to the transition. The longer the transformation process, the more difficult it becomes to overcome organized interests and to achieve reforms.

The radical first phase of income tax reform was accomplished relatively easily. The second phase, with the introduction of VAT and excise taxes, was much more difficult. The third phase, which includes ad valorem property taxation, has not been put into place. Nevertheless, deliberations indicate that considerable progress has been made in addressing some of the institutional obstacles that stalled the 1995 proposals. There is also a growing awareness of the need to educate the public about the benefits associated with an ad valorem real estate tax.

As Poland continues to sustain its economic growth and invest wisely, it will be able to finance better services and raise its standard of living. Land is a major resource, and real estate investment and development play an important role in the reallocation of assets to sustain and nurture growth. The misallocation of land resources under communism, especially in urban areas, is still very evident. Low-density industrial areas are frequently found in prime central locations, commercial and service sectors are scattered, and residential density increases with distance from the center.

Efficient reallocation of land assets and users will require financial incentives in the form of market-based rents and carrying costs; improved methods for the transfer, registration, and protection of property rights; easier access to credit; and the reflection of the real value of real estate in taxation and infrastructure fees. There are gaps in the institutional and legal framework necessary for efficient land markets, particularly in land use planning and development, building codes, and financing mechanisms. Urban productivity growth is needed to drive continued macroeconomic growth. As market transactions in real estate increase, financial institutions grow stronger, and public policy formation continues to mature, Poland is well positioned to develop an urban strategy that is economically efficient and equitable for various social and income groups.

Poland is well on its way to a strong market economy, a vital private sector, democratic institutions, and social stability. The property tax has played a role in decentralization and in financing local governments. The difficulties in making the change to an ad valorem tax base offer a vivid illustration of the political, economic, and social complexities of the transformation under way, even in forward-looking and successful postcommunist societies.
Appendix: Other Taxes Applicable to Real Property

Additional Taxes on Real Property

Poland has no other recurrent taxes applied to real estate. Nonrecurrent taxes on real property include transfer taxes, a type of betterment tax, and a recently enacted tax on increases in land value resulting from a change in land use plans.

Transfer Taxes

There are three component transfer taxes or fees, which are based on declared property value: stamp duty, notarial fee, and title registration fee.

A property's declared sales price is set forth in the deed document that is drafted and executed at the notary's office, which has a duty to caution the parties against false statements (that is, underreporting). The notary collects the stamp duty and notarial fee. The stamp duty is generally 5 percent of the reported price, but it is 2 percent for purchase of an interest in a cooperative (proprietary leasehold right). The government is considering extending the 2 percent rate to all property transfers. The notarial fee is also a percentage of the reported price (average 3 percent), but the rate decreases with increasing price level categories.

Notarial deeds are sent to the local treasury (tax) chambers, which have the right to question the reported price and substitute another price as the base for levying the stamp duty. Treasury chambers maintain value maps and try to monitor the market for these purposes, although there is widespread dissatisfaction with the accuracy and reliability of the values. Brokers usually advise their clients of the acceptable price range. If the local chamber substitutes its own price for the reported price, the buyer may order (and pay for) a separate valuation to contest the chamber's decision. Appeals may be made all the way to the highest Administrative Appeals Court.

The Land Title Registry collects a fee of 1.6 percent of the reported price on recording the new ownership title into a Perpetual Book. There are long delays in this process, which may take years in large metropolitan areas.

Adjacency Fee

A local government has the option of using this instrument, which functions like a betterment tax, for partial cost recovery of infrastructure investments. When a local government provides additional public services or facilities (streetlights, pavements, sidewalks, trunk lines, and so on) that increase the value of adjacent real property, it may impose a special assessment within three years after making the improvements. The cost for individual properties may not be greater than 50 percent of the increase in value attributable to the improvements. The property owner may pay in annual installments for a period of not more than 10 years, for which the government can secure a tax lien and charge interest on the outstanding balances. Under some circumstances, the property owner can deduct from payments certain services in kind or materials provided during construction of the improvements.

Tax on Increases in Land Value Resulting from Land Use Planning

A 1995 physical planning law provides for compensation to property owners for decreases in the value of their real property as a result of land use plan changes made by local governments. It also provides for a tax or fee to be paid by property owners when the value of their property increases as a result of such changes. The tax is payable on sale of such a property within five years after the land use change. The rate of the tax, which may be up to 30 percent of the value
increase attributable to the land use change, must be stipulated in the plan. This stipulation prevents local governments from changing the rate during the five-year period the tax can be levied. The taxable value may be appealed.

**Income Tax on Real Estate Profits**

Poland has no specific capital gains taxes, but capital value increases are taxable under income tax regulations. A tax obligation occurs when property (or partial interest in property) is sold or exchanged within five years of its purchase or development and the transaction is not within the regular business of the taxpayer. The tax is 10 percent of the proceeds. There is an exemption from this tax if the proceeds are reinvested in the development or renovation of residential properties or the purchase of residentially zoned land.

**Inheritance and Gift Taxes**

The amount of inheritance and gift taxes varies according to numerous factors, including the tax group to which the taxpayer belongs, the relationship to the person making the bequest or gift, the value of real property being inherited or received, and the tax exempt threshold amounts. The closer the blood relationship, the lower the tax. The higher the value of the subject property, the higher the tax.

The tax exempt threshold varies depending on the parties’ relationship and other factors. Residential buildings are treated with preference. When a residence is smaller than 110 square meters and is occupied by the person(s) inheriting or receiving it, it is exempt from taxation. On other properties, depending on circumstances, the inheritance and gift tax ranges between 3 and 12 percent.

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The Land Tax in Estonia

Jane H. Malme with Tambet Tiits

General Background

Estonia regained its independence in August 1991 after more than 50 years of annexation to the Soviet Union and set its course resolutely toward the West. With only 452,000 square kilometers, nearly half of them forest covered, and a population of 1.5 million, Estonia has made extraordinary strides in implementing market-oriented reforms.

Located on the eastern coast of the Baltic Sea, a few miles from Helsinki across the Gulf of Finland, Estonia lies at the crossroads of the traditional trade routes between Europe and Russia, and between northern and Central Europe. Today, its major trade partners are Finland and Sweden. The capital city of Tallinn, with nearly a third of Estonia's population, welcomes and attracts international investment and advice and, increasingly, foreign tourists. As the first post-Soviet country to introduce a market value-based tax on land as an integral part of its early reforms, Estonia offers valuable lessons for other countries considering new property tax systems.

Economic Reforms

After establishing its independence, Estonia moved quickly to undertake economic and monetary reforms. The kroon, pegged to the German mark, was introduced as the national currency in 1992, and the money supply was stabilized to control inflation. A cornerstone of economic stabilization has been the government's insistence on a balanced national budget and a prohibition against borrowing from the central bank to fund government expenditures. The Bank of Estonia has strengthened its financial system to meet international standards. The reform-minded, market-oriented government has instituted measures to privatize state-owned industries and encouraged foreign investment and assistance. As a result, considerable foreign direct investment, especially from Sweden and other northern European countries, has flowed into Estonia, particularly into the capital city of Tallinn.¹

Despite eight changes in the national government since independence in 1991, a broad consensus for reform and consistency in economic policies has been sustained. As a result, Estonia has attained economic growth of between 3 and 5 percent per year since 1994. Despite a downturn in 1997, projections for the future are positive, because Estonia continues to manage its economy well. By 1997 more than 60 percent of economic activity was in the private sector, with services almost completely privatized. Inflation has been dramatically reduced from more than 1,000 percent immediately after independence to 6.5 percent in 1998, with further reductions predicted.

¹ Sweden accounted for 32 percent of foreign investment; Finland, 27 percent; the United States, 5 percent; Denmark, 5 percent; Norway, 5 percent (Estonian National Bank data). Major shares of Estonian exports go to Sweden (21 percent) and Finland (17 percent).
Most analysts view Estonia's economic transition as remarkably successful, given the country's small size and prior economic dependence on the Soviet Union. It was the first Baltic country considered for membership in the European Union.

**Land Reforms and Restitution**

During its period of independence between 1918 and 1940, Estonia had undertaken land reforms that created individual property rights in both rural and urban land. By 1940 the legal cadastre listed 210,000 cadastral units, 170,000 rural and 40,000 urban. In 1940 land was expropriated to national ownership and governed by the Soviet Civil Code, which regulated priority of rights, tenure, and allowable uses of land.

Land reform has been a major priority of independent Estonia. During the period of Soviet perestroika (restructuring), the Farm Act of 1989 had permitted the creation of private farms that could be passed on to heirs, but without the rights to sell or mortgage the land. In 1991, parliament passed the Ownership Reform Law and the Land Reform Law, which established the legal framework and procedures to privatize state-owned property and restitute private ownership rights expropriated during Soviet rule. These laws authorized formerly collectivized land to be restituted to former owners or their descendants, transferred to state or municipal ownership for lease or eventual privatization, or divided among present and past members of the collective on the basis of seniority. The 1992 Agricultural Reform Act liquidated the collective and state farms.

According to the 1991 laws and procedures for restituting land, former owners or their heirs, regardless of their present place of residence, were entitled to regain property or to receive compensation or substitute property for what was "illegally expropriated" between 1940 and 1991. More than 212,000 claims were received by the application deadline in March 1993. The title books and cadastre system created prior to 1940 were used to verify ownership, but conflicting claims by former owners, between former owners and those with established user rights, and between land and building rights have complicated the process and delayed its completion. Revisions to the laws were enacted in 1993 to clarify priority of rights for conflicting claims.

Compensation claims that have been particularly difficult to resolve involve land that could not be returned or was not desired. The 1992 Land Price Law provided that the land value for compensation was to be 40 times the 1940 value. Former owners could also claim compensation for destruction of buildings at 10 times the 1940 value if at least half of the building remained. These amounts have been difficult to estimate, and the projected costs have far exceeded earlier estimates.

Compensation is paid in the form of vouchers. Although denominated in Estonian kroons, it was later found that the normative value greatly exceeded the value in the market. As a result, the government decreed in 1994 that compensation would be based on the values established in 1993 for assessment of the land tax.

By 1999, most restitution claims had been processed, thus removing a major obstacle to land privatization. More than 97,000 restituted parcels have been recorded in the land cadastre, constituting nearly half of the parcel records and a total of 48 percent of the country's territory.²

**Municipalization**

How best to administer and accelerate the privatization of nationally owned property has been a subject of extensive debate. In 1991, as part of the land reform laws, parliament decided to turn over to municipalities all property not retained or reserved in national ownership. Privatization

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² As of June 1999, there were 227,455 parcels recorded consisting of 2,160,750.2 hectares of land, of which 837,101.9 hectares had been restituted.
of nonrestituted land in public ownership is subject to a public bidding process. Sixty-five percent of the proceeds derived from municipal land auctions must be returned to the national budget. Many local governments did not find the revenue incentive worth the cost and effort required to carry out the bidding process, and they were slow to undertake privatization. Land rent paid by building owners provided a more reliable and less complicated source for local budget revenues.

Impatient with the slow speed of land privatization by local governments, parliament rescinded the general transfer of excess national land to municipalities in 1993 and restricted municipal ownership to land in municipal possession prior to 1940, land under municipal buildings, and public land used as streets and parks. These revisions were intended to simplify and expedite land privatization by centralizing administration. The central approval process, however, has experienced administrative difficulties and delays. To accelerate privatization, 1997 amendments to the Land Reform Act sought to simplify auction procedures for unused national land, to allow preferential sales to current users of land used by agricultural enterprises, and to provide other incentives for long-term leases or purchases (IMF 1998).

Private Property Rights

New laws were required to designate private rights to land ownership and new registration procedures. New procedures were incorporated in the Land Register Act, enacted in 1993 and amended in 1994 and 1996. Under the jurisdiction of the Ministry of Justice, land registries are located in county and city courts designated by the ministry. The registration process is still generally manual, and only about half of the land titles had been recorded by 1999. The government set 2003 as a goal for completion.

Once land has been privatized or restituted, transfers of ownership are relatively uncomplicated. There are some restrictions on ownership of land by noncitizens, with major exceptions for restituted land and for apartments. Foreigners may acquire ownership and lease rights to land with the permission of the governor of the county, or in the case of some smaller islands from the central government. In practice, permission is generally granted, but the minister of internal affairs can be requested to resolve disagreements between county and local officials.

As Estonian law recognizes ownership of buildings as a property right separate from land, both foreign and domestic buyers have found building ownership with long-term land leases an acceptable alternative. Municipalities also favor this arrangement, because they do not have to share the proceeds of a land sale with the national government and because they can test the reliability of the investor before privatizing the land. Lease terms from 36 to 99 years for municipalities and up to 50 years for state-owned land are permitted. Longer leases are possible with the governor’s permission. It is also common for a building owner or buyer to enter into a precontract for ownership of the land to take effect when the privatization or restitution process is complete. A down payment of part of the purchase price secures the agreement until the final transfer of rights to the buyer occurs. Such arrangements have helped speed up the privatization and titling process.

Nearly all housing is now in private ownership, which has occurred in two ways. The Residential Privatization Act (1993) permitted apartments to be privatized as moveables, and the Apartment Ownership Act established and defined legal rights to ownership shares in residential buildings and shares of the land on which the building is situated. These shares must be registered as real property, and are subject to the land tax on the land portion. Under this law, apartment dwellers may also vote to privatize the land as a cooperative, registered in the name of the dwelling association.

Nearly a third of Estonia’s land area has been retained in national ownership, including land under government buildings; land that serves various national purposes, such as national defense and nature preserves; and land with important national resources, such as forest lands and mining
areas. The Land Board estimates that land available for privatization, excluding restituted land, constitutes only 1.8 million out of 4.2 million hectares.

**Governmental and Fiscal Structure**

The Estonian Constitution (Eesti Vabariik) was adopted by popular vote in June 1992, establishing a parliamentary form of government with an elected president, a parliament (the Riigikogu), and a government headed by a prime minister. The governmental and fiscal relationships between the state and sublevels of government were codified in 1993 to provide for one level of local self-government for cities, towns, and communes.

Most of the 256 local self-governments are quite small, and they have struggled with the rapid changes in laws and responsibilities that have been devolved from the central government without regard to local capacity or expertise to carry out the directives. Regional administrative units of the central government retain important functions, but are without self-government authority.

The 1993 Law on Taxation established the national and local tax structures and set forth the rights and duties of taxpayers and the tax administration. Although there were no local taxes at the time, the law provided for future local taxation to be authorized by national law and imposed by municipal decree. The national tax system has been praised for its simplicity, including a flat 26 percent tax on business and personal income, a broad value added tax of 18 percent, and a land tax (The Economist 1999, March 20). Other national levies are social security, gambling and excise taxes, and customs and state duties (see the appendix to this chapter).

The income tax and the land tax were designated to be shared taxes, with the proceeds divided nearly equally between the national and local governments. No autonomous sources of revenue were designated for local governments until the Law on Local Taxes was adopted in 1994. These local taxes, some of which might be more accurately called fees or charges, provide only 1 percent of local income. The shared revenues from the income tax comprise the largest portion of the local revenue base: 47 percent for all local governments and 59 percent for the city of Tallinn. The second largest revenue portion is transfers and loans from the central government (table 3.1).

**The Development of Ad Valorem Land Taxation**

The tax on land was introduced in 1993 as an integral part of land and fiscal reforms. A national tax with shared revenues, it was meant to stimulate more productive uses of restituted and privatized land—develop it or sell it (The Economist 1998, March 21)—and provide revenue that could be directed toward local governments to further fiscal decentralization and privatization. The tax rate was set at 0.5 percent for 1993 and 1 percent for 1994. Revenue was projected to be about EEK 100 million. In 1995 all proceeds from the land tax were designated for local governments, but in 1998 land tax revenues accounted for only 6.5 percent of local revenues (table 3.2). Proceeds from the land tax are greater in rural areas than in urban areas.

Parliament chose to establish a tax on land only, basing its decision on economic, political, and practical considerations. A land tax would encourage efficient economic use without the deterrent of a tax on buildings and would impose a lesser burden on residents whose property holdings were transferred from the Soviet period and bore little relationship to their ability to pay. In addition, from an administrative perspective, it was deemed nearly impossible to assemble the information needed to value both land and structures within a reasonable time, as land and buildings had been treated and recorded separately under the Soviet system.

The most far-reaching and remarkable decision was to base the tax on land value and to undertake market valuation when real estate markets were just beginning to develop and legal ownership was still unsettled. In part, the development of the tax base was expected to help track
Table 3.1. Local Government Budgets, 1996–98
(EEK millions)

<table>
<thead>
<tr>
<th>Sources of revenue</th>
<th>1996</th>
<th>1997</th>
<th>1998</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate income tax</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Individual income tax</td>
<td>2,404.1</td>
<td>2,924.7</td>
<td>3,477.5</td>
</tr>
<tr>
<td>Forestry tax</td>
<td>0.5</td>
<td>0.9</td>
<td>0.6</td>
</tr>
<tr>
<td>Natural resources tax</td>
<td>33.6</td>
<td>63.8</td>
<td>66.9</td>
</tr>
<tr>
<td>Land tax</td>
<td>211.0</td>
<td>270.3</td>
<td>297.2</td>
</tr>
<tr>
<td>Property income</td>
<td>148.5</td>
<td>290.6</td>
<td>320.6</td>
</tr>
<tr>
<td>Stamp duty</td>
<td>1.1</td>
<td>0.9</td>
<td>0.8</td>
</tr>
<tr>
<td>Gambling tax</td>
<td>2.0</td>
<td>3.8</td>
<td>4.0</td>
</tr>
<tr>
<td>Other incomes</td>
<td>267.6</td>
<td>340.0</td>
<td>378.7</td>
</tr>
<tr>
<td></td>
<td>3,068.4</td>
<td>3,895.0</td>
<td>4,546.3</td>
</tr>
<tr>
<td>Unused from previous year</td>
<td>151.8</td>
<td>262.7</td>
<td>166.8</td>
</tr>
<tr>
<td>Loans</td>
<td>791.2</td>
<td>481.1</td>
<td>557.2</td>
</tr>
<tr>
<td>Subsidies from government</td>
<td>910.6</td>
<td>890.2</td>
<td>1,086.1</td>
</tr>
<tr>
<td>Other</td>
<td>0</td>
<td>450.6</td>
<td>622.2</td>
</tr>
<tr>
<td></td>
<td>4,992.0</td>
<td>5,979.6</td>
<td>6,978.6</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance data.

price information as markets developed.

Public opinion on land reform, land value, and taxation was surveyed in May 1992, in August 1993 shortly after the Land Tax Law was implemented, and in November 1993 when taxes became payable for the first time. Responses revealed general support for the restitution of land rights and privatization. Although lacking background in how real estate markets operate, respondents also recognized location and the quality of the area as important factors in determining the value of private houses. The earlier surveys found a substantial number of respondents who viewed taxes on land as unfair, but by November 1993, approximately two-thirds accepted the tax. Only 2 percent had a strong negative response, saying they would not pay the tax because they believed private ownership of property was sacrosanct. Extensive public education combined with the use of factors understood by the general public for determining taxable value was credited for this significant change of opinion regarding land taxation.

Legal Framework

The legal framework was established in the Law on Land Tax, effective July 1, 1993, and in the Law on Land Price that was adopted in 1992, replaced by the Land Valuation Law 1994, and revised again in 1996. The tax base is the capital value of land, without buildings, timber, plants, or

Table 3.2. Land Taxes in Estonia, 1993–98
(per cent)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>All taxes</td>
<td>0.35</td>
<td>1.03</td>
<td>0.99</td>
<td>1.12</td>
<td>1.14</td>
<td>1.11</td>
</tr>
<tr>
<td>Taxes for local governments</td>
<td>0.09</td>
<td>7.02</td>
<td>5.31</td>
<td>7.89</td>
<td>8.30</td>
<td>7.76</td>
</tr>
<tr>
<td>Local revenues</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>6.88</td>
<td>6.94</td>
<td>6.54</td>
</tr>
<tr>
<td>Gross domestic product</td>
<td>0.13</td>
<td>0.39</td>
<td>0.36</td>
<td>0.40</td>
<td>0.41</td>
<td>0.41</td>
</tr>
</tbody>
</table>

a. The land tax was introduced on July 1, 1993.

The Development of Property Taxation in Economies in Transition

The tax has been market value-based from its inception, even though the lack of market data has necessitated the use of market simulation models.

Exemptions are limited, including only land belonging to foreign embassies and religious congregations, cemeteries, certain natural and historic sites under government protection, and lands where economic activities are prohibited. Government-owned land is taxable, although lands for public ways, streets, squares, parks, and other public purposes are exempt, as determined by municipal councils. The decision to tax government land was based on the belief that the cost would encourage privatization. In 1994 a five-year exemption was provided for farms, established according to the 1989 Farm Act. When the exemption expired, tax rates for agricultural land were limited to between 0.3 and 1 percent until December 31, 2000.

Special rules apply to taxes paid by pensioners who apply for partial exemption. To qualify, the applicant must have had the right to the land before the initial date of taxation (July 1, 1993) and may not receive rental income from the taxable parcel. The municipality determines the amount of the exemption, which may be up to EEK 200 per year, applicable to 1,000 or fewer square meters of urban land or up to one hectare of rural land. The 1994 exemption was due to expire in 2000. The revenue forgone in 1998 because of this exemption was estimated to be EEK 4.9 million, or 0.6 percent of land tax revenues.

The tax rate is decided annually by local councils within the limits specified by national legislation. The limits, initially between 0.8 and 1.2 percent in 1995 and 1996, were broadened to between 0.5 and 2 percent of full value in 1997. A lower tax rate between 0.3 and 0.7 percent was applied to agricultural property through 1997, and the maximum was raised to 1 percent in 1998. Most municipalities have selected tax rates near the upper limits. The average tax rate increased from 1.3 percent in 1997 to 1.5 percent in 1998. Municipalities are required to inform the National Tax Board annually on February 1 of the rate selected for the current year. Owners are legally responsible for paying the tax. Because land reform is still in progress, and some restituted and privatized land has yet to complete the land titling and recording process, the occupant of land in private use can be held responsible for payment. The land tax is deductible from the corporate income tax.

Intergovernmental Issues

When the land tax was enacted in 1993, the tax proceeds were to be shared equally between the national government and 256 municipalities. The local governments have retained all land tax revenues since 1996, and have gained limited autonomy in determining rates and exemptions. To stimulate privatization of municipally owned land, parliament decreed that after January 1, 2000, only tax revenues from privately owned land will be retained by local government; taxes on public leases will become national revenue. Land occupants will be required to pay a land use tax of equal amount.

Municipal councils determine the rate of land tax, within the limits set by national law, and may use the revenues for any authorized public purpose. The land tax is still a minor source of municipal income and is more important in small towns than in the cities. Although revenues from the tax have increased significantly since it was first levied, with EEK 297 million (nearly US$19 million) collected in 1998, the addition of buildings to the tax base to increase the yield is being considered.

Local governments' expenditures continue to exceed revenues. Concern about excessive borrowing resulted in adoption of legislation in 1997 that restricted annual loans to local governments to 15 percent and overall lending to 75 percent of the national budget. The legislation was adopted in part to meet International Monetary Fund guidelines for reducing the national budget deficit, but was also prompted by alarm that the city of Tallinn was having to borrow funds to repay prior loans.

Administration
Land tax valuation and collection are central government functions. Valuation is performed by the National Land Board, an agency of the Ministry of Environment, and tax administration is the responsibility of the National Tax Board in the Ministry of Finance. These agencies are funded by the national budget.

Parliament recognized that strong administrative direction and coordination would be required to accomplish land restitution, privatization, and market development. In 1993, the National Land Board was reorganized and transferred from the Ministry of Agriculture to the Ministry of Environment, with responsibilities for developing a national land cadastre and an ad valorem land taxation system. The national cadastre is being developed as a central inventory of information, in accordance with the 1994 Law on Land Cadastre. The cadastral information is used in valuing land for taxation, as well as to establish prices for privatization, for compensation when restitution is not possible, for leasing public land, and for land redistribution. Land tax values are also the base for calculating transfer fees.

The National Land Board's functions include the development of methodology, valuation standards and procedures, and the supervision and training of valuers. The board administers regional cadastral offices that develop the value zones for their localities. Municipalities are required to collect information on property transactions recorded in accordance with the Real Property Law and submit it to the National Land Board. When the valuation process is complete and the cadastral values are approved, local officials calculate the taxable value for each land parcel. The National Tax Board administers tax billing and collection records through its county offices. Municipalities are responsible for providing the necessary information to the Tax Board to update its Land Tax Register.

Land Valuation

When the first valuation of land was undertaken in 1993, the obstacles were enormous. The market economy was undeveloped, the basic tools of valuation—appraisal expertise, ad valorem methodology, appropriate and accurate land and price information—were in short supply, the legal framework was incomplete, and there was a shortage of staff and financial resources.

The National Land Board established the central goals for the valuation project and drew on expertise in mass valuation techniques from other countries. The Organisation for Economic Cooperation and Development and the Finnish and Danish governments provided support. The Land Board agreed that a market value-based mass appraisal system must be developed that was understandable, feasible to implement in a short period of time, and reasonable in cost. The system would be based on supply and demand indicators that could be improved and refined as real estate markets developed. It was hoped that the land tax project would be instrumental in speeding up the development of new land and sales registries and updating cadastral maps and land records. On the whole, these steps have occurred.

Cadastral land maps were prepared from existing sources by the National Land Board to provide the information necessary for parcel descriptions. Although a mathematical model was designed initially, it was largely abandoned based on practical understanding gained in the field. Basic price zones for urban and settled areas were developed and valuation teams were assigned to each valuation region. Land Board employees received some training, but learned primarily by working in teams with the foreign advisers. A Finnish real estate firm (Huoneistomarkkinointi Oy) served as overall project adviser.

The valuation system developed for urban land combined an area-based pricing system using market criteria for location, quality, and usage to create relative price zones among and within each urban area. Relative market desirability was established through opinion and judgment by expert valuers and local officials, augmented by whatever reliable price information was available.
In the two largest cities, Tallinn and Tartu, rental information could be capitalized into values. The same method was used for rural land, although separate criteria related to soil capability and productivity as well as location. The final valuation report with price schedules for each area required approval by the municipal council. This basic methodology has been used for land taxation since 1993.

The 1994 Law on Land Valuation replaced the 1992 Law on Land Price and set forth the legal basis and procedure for land valuation, whether for private or public purposes. The law states that the objective of valuation is to determine the market value of land, using the generally recognized principles and methods of real property valuation. These standards govern land valuation for tax assessment, for private clients (appraisal), and for restitution claims.

For purposes of land taxation, the law specifies that a cadastral value as of January 1 of the valuation year is to be established periodically, although no revaluation cycle is specifically required. In practice, the 1993 valuations were adjusted in 1996, and new values are expected to be assessed in 2001. The 1994 law codified the 1993 system by specifying that the cadastral value is to be determined by dividing land into valuation zones of similar levels, and authorizes the use of the generally accepted valuation methods. Different criteria are to be used for pricing urban and rural (agricultural and forest) lands.

As markets developed and became more rational, prices were monitored by the National Land Board. In 1996 the board carried out a revaluation with considerably expanded and more reliable price information. As intended, the initial valuation system was adaptable to the use of current market data. Two government decrees in 1996 regulated procedures for this update. The comparative sales method was used for estimating values in urban areas, except in city centers where income and residual methods were commonly applied. Even in rural areas, indirect market information was sufficient to aggregate for use in comparable areas.

The new Civil Code had established procedures for accurate recording of land transfers and prices, and this information, reported by notaries to the local government, is entered into the National Transaction Register. The register was organized and began recording information on real estate transactions in 1997. By 1999 it contained information on 4,722 transactions on units of real property (land and improvements). The register also contains rental information from the city of Tallinn, which developed its own computerized sales register. Two other cities, Parnu and Tartu, had systematic records of property sales, which were used in the 1996 valuation.

An analysis of sales information has indicated that prices of transactions recorded in the Title Office pursuant to the new Civil Code were accurate, as were those where one party to the transfer was a private firm or a foreigner. Transactions regulated by the old Civil Code were less reliable, but the reduction of the transfer fee improved accuracy.

Zoning and land use regulations are undeveloped and multiple uses coexist on some parcels, making it impossible to determine a highest and best use value. Value is assigned according to the prevailing type of use. A law regulating zoning and development issues was enacted in 1995, but it has not been implemented widely.

Valuers
Land Board valuers were generally qualified surveyors with special training and on-the-job experience from working with foreign advisers in 1993. These qualifications were recognized in the 1994 Law on Land Valuation, which specifies that a valuer must either be a public official responsible for land valuation or have a license issued in conformity with procedures determined by the National Land Board. Qualified valuers are entitled to receive information from owners and occupiers of land and from local and state government entities, and must maintain the confidentiality of professional and business information acquired for purposes of valuation. Education and training from Estonian and international appraisal professionals has been available in Tallinn throughout this period, and there is a growing number of qualified private valuers.
In 1996 and 1999 the National Land Board retained a private real estate consulting firm (AS Kinnisvaraekspert) to serve as an adviser and consultant in the valuation process. Members of the firm had played key roles in the 1993 design and implementation of land tax assessments, and provided continuity as well as private real estate market experience. The firm also collects and analyzes rental rates, construction costs, and other economic information.

Approval of Valuations and Taxpayer Appeal Rights

The National Land Board reviews the valuations developed by county cadastral offices and approves them for public viewing. Municipal governments are required to post the proposed assessments in their offices for 20 days and provide public notice through the local media prior to adopting them for taxation. The valuation report, maps and valuations, and an explanation of the process and analysis must be made available to the public during this period. A schedule of times when taxpayers may meet with county valuers must also be posted. During this period, taxpayers may appeal on two grounds: that the assessment was inconsistent with the law, regulation, or methodology for land tax valuation, or that the error in the assessment is greater than 20 percent.

After final approval of the valuations by the county cadastral office, taxpayers may file an appeal related to the value of their individual properties, the assessment, or the tax bill by making a deposit of EEK 500. The deposit will be returned if the municipal officials find the appeal justified, but it will be retained to cover its procedural costs if the appeal is rejected. There is no special tax tribunal in Estonia. Less than 3 percent of taxpayers appealed the valuation in 1996.

Access to Information

Estonia has recognized that open democratic practices are critical to reform. Thus taxpayers have access to information related to taxation of their property from local government and county tax offices. Land ownership, parcel description, assessed value, and related data in the cadastre are public information, available at municipal offices as well as county cadastre offices and the archives at the National Land Board. Ownership records are recorded by the Title Office under the jurisdiction of the Ministry of Justice, which restricts access to information about private transactions, including sales prices. However, the Law on Land Cadastre requires that the National Land Board’s Transaction Register provide public access to sales price information.

Tax Collection and Enforcement

Taxes are paid in three equal installments (May 15, August 15, November 15). Taxpayers make their tax payments to commercial banks. It is estimated that 95 percent of the taxable properties are recorded in the official tax list. The collection ratio has been growing steadily, from 84 percent in 1995 to 98 percent in 1998. Tax billing is fully computerized and is administered by National Tax Board staff in each county office. Unpaid taxes become a lien on the property. The National Tax Board has the right to seek a court order for sale of the property for nonpayment of taxes. The taxpayer’s rights are protected through the court proceedings. Payments as a result of judicial order have come about as a result of business bankruptcy proceedings, not tax administration enforcement.

3. The Estonian figures include the amounts received from tax arrears in total revenues, and thus overstate the collection ratio compared with generally accepted Organisation for Economic Co-operation and Development accounting measures, which exclude payments of arrears.
Administrative Costs

National government administrative costs for the land tax in 1996 were EEK 10.3 million, or 4.8 percent of the land tax revenues. The valuation cost was EEK 3.7 million, of which urban land accounted for EEK 0.9 million; agricultural land, EEK 1.8 million; and forest land, EEK 1 million. Tax collection costs were EEK 6.6 million. Local governments incurred some additional costs, so that the total cost was estimated to be approximately 5 percent of the tax revenues.

Current Issues and Future Developments

Expanding the Tax Base to Include Buildings and Improvements

The major issue regarding the land tax is whether to include buildings in the tax base. The Ministry of Finance studied the administrative, economic, and social costs in preparing its recommendations to parliament. The ministry's report listed the following advantages and disadvantages of a tax on buildings and made suggestions on its implementation, should parliament decide to expand the tax base.

Advantages:

- Increased tax base and tax revenues (estimated as three to five times the current revenues)
- Greater equity due to a closer correlation between the property value and ability to pay
- Potential for revenue growth without raising the tax rate
- Broader tax base to spread revenue costs more widely and minimize the burden on residents.

Disadvantages:

- Tax base growth highly concentrated in Tallinn, where property values are also the highest
- Potential to discourage new construction and building renovation
- Disproportionately greater administrative costs.

If parliament chose to expand the tax base to include buildings, the ministry then offered several recommendations:

- Retain the tax as a national tax based on market value and assign revenues to local governments.
- Apply the same definition of tax liability to owners and users.
- Continue limited exemptions.
- Provide a planning period of at least three years and adequate funding for implementation.

Suggestions were also made to mitigate the administrative costs, including establishing a threshold to exempt property of low value and keeping land value as the only base for forest land.

Furthermore, the report recommended that the tax be applied to a unified taxable unit of property, although this would require administrative reorganization, because the land cadastre and the building registry are not administratively or physically integrated. The current building registry would require substantial revision and updating to be used as a database for a market value mass appraisal system. This feasibility study has thus far not found popular support in parliament.

Improving Real Property Information Systems

The organization of real estate transaction data has been a major undertaking and a considerable accomplishment. Because of delays in transferring data from notaries through local governments to the National Land Board, legislation has been proposed to have notaries report the information directly to the Land Board.

By early 1999, approximately 2,160,750 hectares had been recorded in the cadastre. Of these, 5,209 hectares are municipal land and 1,013,717 hectares are national land, mainly forests, swamps,
and national parks (National Land Board 1999). Considerable impatience has been expressed regarding the slow pace with which new information on real estate transactions and prices is being recorded and made available. Given the substantial number of units to be recorded and the complexities involved in the legal, decisionmaking, and administrative processes of restitution and privatization, progress is expected to be slower than desired.

Nevertheless, analysis of the technical and financial factors that might accelerate completion of land reform is under way. One important factor relates to the accuracy of land boundaries necessary for registering title. The Land Cadastre Law was amended to make it possible to restore or privatize land parcels with general boundary information, thus allowing the landowner to choose a less expensive, faster, but less accurate method where borders are not disputed.

Appendix: Other Taxes and Revenues Applicable to Real Property

The land tax is the only recurrent tax on real property. Real property transfers are subject to a transfer fee of 0.2 percent for values higher than EEK 10 million. For properties of lower value, there is a sliding scale.4 Profits made on transfers of property rights are subject to the 26 percent income tax, although profit on residential property that has been owner-occupied for two years is exempt from this tax. There are no other capital gains, inheritance, gift, or wealth taxes applicable to real property, but notary and registration fees are collected for transfers of property as a result of inheritance, gift, or contract. See table 3.3 for tax revenue for 1993–98.

Table 3.3. Taxes in Estonia, 1993–98

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total tax revenues</td>
<td>7,908</td>
<td>11,535</td>
<td>15,079</td>
<td>18,920</td>
<td>23,708</td>
<td>26,660</td>
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<tr>
<td>Central government taxes</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Total central tax revenues</td>
<td>6,042</td>
<td>10,026</td>
<td>13,103</td>
<td>16,247</td>
<td>20,455</td>
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<td>Individual income tax</td>
<td>0</td>
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<td>1,722</td>
<td>1,950</td>
<td>2,316</td>
<td>2,762</td>
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<td>Corporate income tax</td>
<td>1,032</td>
<td>1,037</td>
<td>1,050</td>
<td>891</td>
<td>1,228</td>
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<td>Social security contribuition</td>
<td>2,380</td>
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<td>Value added tax</td>
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<td>Excise taxes</td>
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<td>Import duties</td>
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<td>61</td>
<td>0</td>
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<tr>
<td>Other taxes</td>
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<td>258</td>
<td>578</td>
<td>766</td>
<td>93</td>
<td>101</td>
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<tr>
<td>Local government taxes</td>
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</tr>
<tr>
<td>Total local tax revenues</td>
<td>1,866</td>
<td>1,509</td>
<td>1,976</td>
<td>2,673</td>
<td>3,253</td>
<td>3,827</td>
</tr>
<tr>
<td>Individual income tax</td>
<td>1,832</td>
<td>1,394</td>
<td>1,865</td>
<td>2,404</td>
<td>2,924</td>
<td>3,471</td>
</tr>
<tr>
<td>Land tax</td>
<td>17a</td>
<td>106</td>
<td>105</td>
<td>211</td>
<td>270</td>
<td>297</td>
</tr>
<tr>
<td>Other taxes</td>
<td>12</td>
<td>9</td>
<td>6</td>
<td>58</td>
<td>59</td>
<td>59</td>
</tr>
</tbody>
</table>

Note: In 1998, EEK 15 were approximately equivalent to US$1.

a. Half year.


4. The percentage of the price for properties between EEK 100,000 and EEK 1 million is 0.2 to 0.3 percent; between EEK 50,000 and EEK 100,000 it is 0.3 to 0.4 percent, and up to EEK 500 it is a maximum of 6 percent.
References and Bibliography


Historical Background

The Czech Republic has been perceived as a leader among the Central and Eastern European nations making the transition from central planning to a market orientation. Czech economic and fiscal accomplishments, the progress of local self-government (samospráva), and the role of the property tax in local government finance illustrate important aspects of the transition.

Until the end of World War I, the Czech lands of Bohemia and Moravia were part of the Austro-Hungarian Empire. They had been permitted limited participation in self-government and demonstrated notable industrial development (Wolchik 1991, p. 8; see chapter 1 for a succinct review of recent Czech history). When the Empire was broken up in 1918, Slovakia was joined with Bohemia and Moravia to form the federal state of Czechoslovakia. An early experiment in federalism offered the opportunity to experience democracy and begin a tradition of local self-government.

The Economy in the Communist Era

Czechoslovakia’s development was disrupted by the Nazi invasion and World War II. The subsequent 40-year communist period held Slovakia’s strong nationalist sentiment and the principle of samospráva in abeyance. The Czech lands retained the integrity of their relatively advanced, precommunist industrial development, while the traditional, structurally disadvantageous industrial projects of the Soviet developmental style were imposed on a Slovakia that had been predominantly rural (Frydman, Rapaczynski, and Turkewitz 1998, p. 49).

The central planning philosophy of the communist era was extended to the provision of local government services, almost all of which were funded by central government grants as a result of indirect taxes and transfers imposed on retail and industrial activities. In addition, the quality and type of local services were controlled by the central government. There was a general feeling that the process of allocating funds to local governments was influenced by political or party connections rather than by legitimate needs for public services. This approach to grants distribution generated a great deal of mistrust of the central government at the local level.

The Transformation Era

The collapse of the centrally planned social system in Czechoslovakia followed by two decades the “Prague Spring” of 1968, when the attempt to achieve political and economic liberalization led to the Warsaw Pact invasion of Prague (Frydman, Rapaczynski, and Turkewitz 1998, pp. 52–58). Beginning with the “Velvet Revolution” in December 1989, the Czechs and Slovaks began their journey down the path of economic and political transformation. Their joint endeavors did not last long, but between 1990 and 1993 they installed a number of common institutions,
including a more Western-style tax system. The nationalist aspirations of the Slovaks led to an agreement to dismantle the federation in the “Velvet Divorce” of 1993.¹

With the end of Soviet control of the economy, reformers faced numerous complex problems. Housing for the most part had been publicly owned and subsidized. Rural land had been combined into large agricultural collectives. Most retail trade was conducted in state-controlled stores. Industrial activity was a function of central ownership and planning. In short, there was no market to establish scarcity prices or to indicate the value of homes, farms, and businesses.

In general, the Czech Republic has been successful in casting off the central planning system and has been heralded as the most effective economic system to embark on the path of transformation. It achieved relatively low inflation and unemployment and succeeded in avoiding significant budget deficits (OECD 1996, p. 100). Strong economic performance followed the 1989 revolution because of an early liberalization of prices, a far-ranging privatization effort, an opening of the market to international trade, a reorientation of foreign trade to the European Community area, and generally effective macroeconomic policies. The Czech Republic was the first postcommunist member of the Organisation for Economic Co-operation and Development and is among the first transition states qualifying for accession to the European Union (CIA 1998).

The process of industrial restructuring has not been completed despite successes in the privatization program. Opposition political parties have sought to take power by promising to alleviate the transformation through more gradual transition policies to help shield unproductive firms from market costs. The Ministry of Finance and the banking system have not learned how to function in a market environment that attaches importance to creditworthiness for loans. In the new environment, a go-slow transformation policy administered by the Ministry of Finance simply permits the credit policies of the large, state-owned banks to keep less than profitable firms in business (see Frydman, Rapaczynski, and Turkewitz 1998, pp. 72–79 for a discussion of the banking system in the former Czechoslovakia and in the Czech Republic).

While this analysis is oversimplified, it is understandable that some bank loans were made for risky projects early in the transition process and that some nonperforming loans were associated with the collapse of the Soviet bloc’s Council for Mutual Economic Assistance (OECD 1996, p. 52). Early in the transition era, massive, reciprocal inter-enterprise credits were made by firms that should have been closed down.

The Czech reputation for transformation success suffered in late 1997 when the premiership of Vaclav Klaus, a respected leader of the Czech recovery, ended in a campaign finance scandal. Through that period, the Finance Ministry and the Czech government tended to ignore economic pressures to move ahead with the privatization of the large banks. Since that time, progress has been steady, if not rapid. The banking sector, important because it will remain the primary source of investment funds in Eastern Europe for some time to come, is now approaching full privatization (Frydman, Rapaczynski, and Turkewitz 1998, p. 72). The state of the banking sector has important implications for the development of the real estate market and the use of the property tax. Because investment funds are scarce yet vital for the investment processes that will promote development, there is simply little money available for a home mortgage market. At the same time, the development of a real estate market has been slow, and perhaps this has been the result of reluctance on the part of the Czech population to take on the obligation of long-term mortgages, thereby constraining the development of demand in this market.

¹ The Czech Republic has a population of 10.3 million, nearly twice the size of Slovakia’s population, and a land area of about 79,000 square kilometers, nearly a third larger. Its area is a little smaller than Austria and almost identical in size to Scotland, with a population density somewhat higher than that of most countries in Central Europe, although only about a third of that of Germany.
Privatization

Because so many of Czechoslovakia’s state-owned enterprises were not viable in market terms, privatization was perceived as a priority when the transformation began. Private ownership was to be the means of restoring productive efficiency, providing market rewards to motivate managers and workers, and offering incentives for entrepreneurs to leave dying markets and penetrate viable ones (Brada 1996, p. 68).

Privatization is exceedingly important in any discussion of the potential for property taxation in transitional countries. Transferring state-owned industry or housing from the public to the private sector increases the base of taxable properties. If privatization is successful, a more productive market performance by property owners produces not only more private wealth, but also greater tax revenues and a more beneficent public sector to enhance the lives of the citizens.

The first phase of the Czech Republic’s privatization process was probably the most successful. It involved the sale of (or in a few cases leasing rights) to state properties, especially small service establishments, such as shops and restaurants. Between 1990 and 1992, 26,000 such establishments were auctioned, producing revenues of 3.4 percent of gross domestic product and 4.7 percent of government expenditures for 1991 (OECD 1993, p. 70).

The privatization of industry in Czechoslovakia began in October 1991 with two waves of voucher privatization. About 700 state enterprises having an estimated value of about CZK 175 billion were earmarked for the first wave. Formal projects or proposed privatization plans were required for those state-owned enterprises prepared to transform themselves into corporations. Outsiders could submit privatization plans for enterprises. About 1,500 competing projects were presented, representing an average of nearly four competing plans for each firm being privatized. The Czech National Property Fund designated CZK 206.4 billion (943 joint stock companies) for voucher privatization, and Slovakia’s National Property Fund designated CZK 90 billion (484 joint stock companies) for the project. These projects elicited the participation of 5.9 million Czech citizens and 2.6 million Slovak citizens (Mikloš 1997, pp. 103-19).

This process successfully privatized from 65 to 90 percent of all Czech state-owned assets, a significantly higher proportion than for neighboring countries. Because the voucher scheme permitted 77 percent of eligible citizens to participate in the first wave, and even more in the second wave, the process was quite popular. A major problem was that investors turned over 72 percent of their voucher points to investment privatization funds in the first wave and 64 percent in the second. The largest 14 of these investment groups managed 55.5 percent of all available first-round vouchers. Most of the investment privatization funds were established by banks, and they emerged from the process with extensive, interlocked industrial and banking holdings, which makes the Czech ownership structure similar to those of Germany and Japan (Brada 1996, p. 73).

Fiscal Affairs and Tax Reform

While the transformation process has brought the Czechs some successful changes, their fiscal and governmental systems remain essentially a two-tier democratic republic consisting of the national center and the municipalities. There are 6,234 independent municipalities in the Czech Republic, a number that has increased notably since 1989. Liberated from the socialist era of

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2. According to Brada (1996, p. 72): “On the basis of these plans, some firms were privatized by nonvoucher methods, including tenders and direct sales to new owners, including foreign investors. Ultimately, 1,491 state-owned enterprises, 988 of them from the Czech Republic, were included in the first wave of voucher privatization, which ran from October 1991 to December 1992, and a second wave, from August 1992 to November 1994, privatized a further 861 firms in the now-independent Czech Republic.”
central planning, small communities strongly desired and were permitted to assert their individual independence. Table 4.1 reveals that most towns are small, with fewer than 500 residents.

The challenge of assuring the competent administration of these small units, given their obvious resource and personnel limitations, suggests either the administrative union of small groups of villages, the establishment of an intermediate level of administration to assist the villages in interacting with the center, or both. As a step toward resolving this problem, the subnational portion of the system will adopt about 14 regional administrative units to assume some central government and municipal functions.

A fundamental question in fiscal matters is the degree of centralization of the taxation system. The Czech system has been highly centralized through recent decades, although there has been a tendency since the revolution to consider and pursue measures that would promote more genuine independence for the municipalities. As is common in the transitional countries, the central government still plays a dominant role in intergovernmental relations and in the determination of policies normally made by the local government in industrial countries. Likewise in tax affairs, the mechanics of implementation remain almost exclusively the domain of the Ministry of Finance and the Ministry of the Interior.

The fiscal system is changing, nevertheless, through the rediscovery of its history of capitalism and democracy between the wars, beginning in 1918. At the end of World War II, normalization was just being approached when the communist takeover put market economics on hold. Since the liberation of 1989, there has been a strong consensus in Czech society that a market-oriented economic order should be reestablished. Although there may be disagreements about how such a system can best be achieved and the pace of the transition, the development of democracy and local self-government is a high priority for Czechs in general.

The tax system of Czechoslovakia, like that of other centrally planned economies, was unsuited to make a successful transition, so a comprehensive tax reform was instituted in 1993. The new system, typical of other former communist countries, largely imitated Western European fiscal systems. It attempted to respond to Western tax conceptions, but inevitably reflected some of the old system’s legacies (see Holzman 1992, pp. 233–55). The early tax reforms did attempt to introduce elements of Western-style decentralization, but the result has been “a

### Table 4.1. Czech Municipalities

<table>
<thead>
<tr>
<th>City population</th>
<th>Number of cities</th>
<th>Percentage of cities</th>
</tr>
</thead>
<tbody>
<tr>
<td>199</td>
<td>1,740</td>
<td>27.9</td>
</tr>
<tr>
<td>200–499</td>
<td>2,005</td>
<td>32.1</td>
</tr>
<tr>
<td>500–999</td>
<td>1,225</td>
<td>19.7</td>
</tr>
<tr>
<td>1,000–1,999</td>
<td>648</td>
<td>10.4</td>
</tr>
<tr>
<td>2,000–4,999</td>
<td>349</td>
<td>5.6</td>
</tr>
<tr>
<td>5,000–9,999</td>
<td>134</td>
<td>2.1</td>
</tr>
<tr>
<td>10,000–19,999</td>
<td>66</td>
<td>1.1</td>
</tr>
<tr>
<td>20,000–49,999</td>
<td>44</td>
<td>0.7</td>
</tr>
<tr>
<td>50,000–99,999</td>
<td>16</td>
<td>0.3</td>
</tr>
<tr>
<td>More than 100,000</td>
<td>7</td>
<td>0.1</td>
</tr>
</tbody>
</table>

*Source: Municipality and Finance (1997).*

3. In assuring the competent administration of these small units, a private corporation, Triada, has developed to provide consulting services for smaller municipalities. It currently services more than 1,000 of them, providing software for accounting and personnel and other purposes.
highly complex, uneven and distortionary system” (Holzman 1992, p. 234). A separate question altogether is whether the Czech and other transitional tax systems were geared toward generating sufficient revenues.

When the Czech system was introduced in 1993, there was a balanced reliance on direct and indirect taxes. After the socialist period, in which taxes were by and large hidden, it took some administrative courage to introduce direct taxation to a reluctant populace. The most prominent indirect tax in the Czech Republic is the value added tax. The value added tax has two rates, 5 percent for basic necessities and 22 percent for other commodities and services. The top rate is the second highest among the transitional countries (Martinez-Vazquez and McNab 1997, p. 60). Other indirect taxes include an excise tax (applied to gasoline, tobacco, and alcoholic beverages) and customs duties.

Czech direct taxes include personal and corporate income taxes. The personal income tax, introduced in January 1993, has been gradually reduced, with 1999 rates ranging from 15 percent on an annual tax base up to CZK 102,000 to 40 percent on an annual base greater than CZK 1,104,000. Each taxpayer is allowed a personal deduction of CZK 34,920, CZK 19,884 for a spouse, and CZK 21,600 for each dependent child living with the taxpayer. The general corporate income tax rate is 35 percent. Since 1996 tax changes, 20 percent of the corporate income tax yield is returned to the locality where it is collected.

These taxes represent additional revenues to replace 36 percent of the wage tax yield, which is to be transferred from local budgets to the central budget. The interjurisdictional sharing of tax revenues is an established practice, as elsewhere in the region, although it is based often on the misdirected assumption that all tax revenues should be restored to the area in which they were collected. Other important forms of direct taxation in the Czech Republic are a road tax and the property tax.

The Property Tax

In many countries, notably the English-speaking ones, the property tax is the most important source of revenue for local governments (Bird and Slack 1991, pp. 83–97). It has the potential to be an important tax for municipalities in the transitional countries, although it has proven difficult to implement. The Czech Republic has adopted a property tax, but it provides very little revenue.

Decentralization and the Property Tax

Implementation of the property tax requires an assignment of policy and administrative functions. Policy issues include the types of property to include in the base, the level of assessment, the revenue importance, and the tax rate. Administration is concerned with the property valuation, recordkeeping, and collecting the property tax.

Countries must also make explicit decisions on which level of government will be responsible for each of these general areas. A typology is offered in table 4.2 to illustrate the tradeoffs. In the United States, the property tax process has been decentralized for both policy and administrative issues. In some countries, such as the United Kingdom, only part of the process has been centralized.

4. Bird, Ebel, and Wallich (1995, p. 37) write of a “tendency for local governments to feel they have a primary claim on tax revenues generated within their jurisdiction,” pointing out that such “source-based taxation (also known as derivation-based) is unusual at the subnational level in market economies because of the inequities and inefficiencies that are likely to result from allowing subnational governments to keep large shares of the taxes levied on firms producing for a national or world market.”
Table 4.2. Typology of Property Tax Policy and Administration

<table>
<thead>
<tr>
<th>Policy</th>
<th>Central government</th>
<th>Subnational government</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central government</td>
<td>Czech Republic</td>
<td>Netherlands</td>
</tr>
<tr>
<td></td>
<td>France</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Sweden</td>
<td></td>
</tr>
<tr>
<td>Subnational government</td>
<td>Germany</td>
<td>United States</td>
</tr>
<tr>
<td></td>
<td>United Kingdom</td>
<td>Japan</td>
</tr>
</tbody>
</table>

Source: Dillinger (1988).

whereas in the Czech Republic and some other countries both functions have been centralized at the national level.

All four models have advantages and disadvantages. The major disadvantage of the decentralized approach is that local governments may not have the technical ability to administer the property tax. The disadvantage of centralization is that the central government does not receive any revenue directly from the property tax, so policy and administrative issues may not receive priority attention.

General Problems with the Property Tax

Aside from the challenge of identifying the appropriate degree of devolution, administration of the property tax can be quite difficult and costly and often encounters widespread resistance (see Bird 1993, pp. 215–16). One problem for this type of tax is its visibility. It is not deducted in small installments, but usually must be paid directly to the municipality in a lump sum. When inflationary pressures require upward adjustment of the tax to enable continued provision of costly services, taxpayers become even more aware of these increments, as well as the services. Should services financed locally by the property tax (such as roads, garbage collection, and often education) be of poor quality, the taxpayers wonder why they are paying good money for poor services and come to resent the tax. Finally, for both technical and political reasons, assessed values will diverge from market values within classes of property. Taxpayers can compare their property taxes with their neighbors, giving rise to politically and financially costly assessment appeals, as well as strong sentiment for tax relief. In any case, public disenchantment with property tax increases can be expected, especially in inflationary times, whether the increase results from higher rates applied to an unchanged set of assessed values, from unchanged rates applied to higher assessed values, or a combination of the two.

Strengths of the Property Tax

Despite the tendency to oppose the property tax, there is much to recommend it. A tax on real property might well “make good sense as part of the tax system as a whole . . . the property tax scores quite well in terms of both its efficiency and its equity aspects” (Bird 1993, pp. 215–16). If fiscal decentralization is to be successful, municipalities must receive a reliable source of revenues supplied independently of the state and have a measure of independence in policy determination on local fiscal issues. Anything less leaves municipalities excessively dependent on the state, underfunded, and incapable of rendering services to the level of demand.

Even if the low level of the property tax were increased to provide genuine assistance in the delivery of municipal services, the taxes and user fees commonly perceived in the transitional
countries to be appropriate for local governments are insufficient to perform all the necessary tasks. Hence, some revenue transfers from the central government will continue to be necessary, unless the mix of taxes used by local governments is enhanced strongly, presumably by shifting some kinds of taxation from central to local jurisdiction. Another reason for transfers would be the need to deal with externalities.

Furthermore, genuine local self-government is not consistent with central control over policy setting in municipal fiscal affairs. In the Czech Republic, Kamenickova (1996, p. 16) has described the tax system as one in which “there are no local taxes.” The decisive policy prerogatives of all taxes are determined by the center, either the national administration or parliament. Municipalities have little opportunity to affect tax revenues by their own choices. They are, of course, able to sell properties that have accrued to them through transition processes or to make loans in the event of revenue shortfalls. Property is a nonrecurring revenue source, however, that will not provide a sustainable cash flow indefinitely, and loans must be used with prudence.

**Intergovernmental Organization**

Property tax policy in the Czech Republic is the responsibility of the parliament, but tax administration and long-run strategic policy issues are highly centralized in the Ministry of Finance. The day-to-day details of administration are performed by the Ministry's District Financial Offices, located throughout the country. As a result, alternatives to change the property tax system generally originate with the Ministry of Finance.

One advantage of this centralized approach is that suggestions for improvement rest with one agency. International consultants, for example, have to deal with only one governmental entity, which is likely to have professional staff familiar with the reforms being recommended, and the solicitation and coordination of alternatives are less likely to be caught up in local politics. One disadvantage is that proposed changes in the property tax may not have the support of local political leaders, because they were not involved in the process. The second disadvantage is that a centralized process may ignore the economic and social differences among the more than 6,000 local governments. Finally, centralized policymaking may not account for the administrative competencies of the local governments. In this case, policymakers apparently felt that successful property tax implementation required a strong role for the central government.

**Tax Base and Rate**

The tax yield on real estate is determined by the tax base and rate. Both land and buildings are included in the property tax base, but the valuation of each is made separately. The tax base reflects primarily the area of land plots and the floor space of buildings. The process by which a property's actual value is determined is established by national law. Tax rates are also centrally determined, and there are separate rates for land and for buildings.

**Valuation**

Although the property tax valuation of land and buildings is based on the area in square meters, some modifications can be made by local tax administrators as a function of the size of the city and the type of the land or buildings in question. Thus local authorities do have some input in the

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5. Kamenickova (1996, p. 16) writes: “As a result of this, a discord occurs in local budgets between the authority and competence of the municipality on the expense side which is rather high, and the competence on the income side which is very limited.”
determination of actual tax revenues, but the leverage is not significant enough to augment local revenues effectively.

Valuation of properties is completed by the taxpayer, who is also responsible for the actual calculation of taxes due. Self-reporting of data is uncommon in most countries, and self-determination of taxable value is even less common. It is revealing that the amount of this tax, even when combined with the inconvenience of filling out the forms and determining the actual tax due, has not led to excessive noncompliance or complaints from taxpayers.

The property tax form is included in a manual that directs taxpayers in valuing each parcel of property and type of building. For example, the formula for determining the taxable value of a building is as follows: the tax base equals the area of the building in square meters multiplied by a coefficient related to the size of the city where the building is located.\(^6\) Thus the taxable value is primarily a function of the land or building area in square meters rather than the market price. This nonmarket-based value system reflects the lack of a normally functioning real estate market and of professional property tax administrators. The system also reflects the traditional use of the property tax that was imposed on private residences and farms during 40 years of communism.

We have been unable to determine how the values of coefficients were established, but the use of the coefficients for local purposes is more apparent. Municipalities can adjust their coefficient down three levels or up one level, and the city of Prague can apply a coefficient of 5 to certain well-located properties. For buildings with multiple levels, a factor of 0.75 of the ground floor base is added for each level and the total square meters are multiplied by the appropriate coefficient.

To determine the amount due to the Ministry of Finance, the taxpayer multiplies the base by a specified rate. For buildings, the rate is stated in Czech crowns and ranges from CZK 1 to CZK 10 per square meter of floor space. For each class of property (land), the owner is instructed to multiply the base in square meters by both a rate and a coefficient. These determine the amount of the tax, reflecting the attributes of the land (that is, location, size of the parcel, and use). This system applies to yards and buildings; vacant plots; residential parcels; sites for garages; summer cottages; and industrial, commercial, and service institution property. Exceptions are made for agricultural land, forests, and fish ponds. The tax on agricultural land is based on estimates of the average productivity of the land in the cadastral region, as determined by the Ministry of Agriculture and reported to the Cadastral Office. The official values are issued by the Ministry of Finance as a price decree.

After calculating the tax due, the taxpayer files the return and makes payment directly to the district financial office of the Ministry of Finance, which then returns property tax revenues to the taxpayer's city. Data from the tax form are entered by the district office in the ministry's computerized recordkeeping system, which is itself a significant accomplishment.

The property tax burden is relatively light. The burden is heaviest on improvements to land relative to the tax on land, reflecting the political power of the farming sector in the economy and perhaps a misunderstanding of the potential benefits of taxing land at rates at least equal to those imposed on improvements.

**Exemptions**

The Czech property tax system grants exemptions separately for land and buildings, as is standard in other countries. Land exemptions include state-owned parcels and plots for military use,

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\(^6\) Less than 300 residents, 0.3; 300 to 600, 0.6; 600 to 1,000, 1; 1,000 to 6,000, 1.4; 6,000 to 10,000, 1.6; 10,000 to 25,000, 2; 25,000 to 50,000, 2.5; 50,000+, 3.5; and Prague, 4.5.
Taxes on Real Property in the Czech Republic

schools, and natural preserves. An interesting exemption is forest land used for the transmission of natural gas and electricity, which in most countries represents a substantial portion of the taxable value of gas and electric utilities.

Exemptions on buildings include those allowed for state- and city-owned structures; churches and schools; and for publicly-owned housing, which makes up about 50 percent of all housing. The property tax is used to encourage private residential construction by exempting new homes from the property tax for 15 years.\(^7\) To encourage the transition to market ownership, low-income older individuals in residences restored to private ownership through restitution are also granted a 15-year moratorium from the property tax. All exemptions must be applied for annually. Owners of land and buildings who believe they are exempt from the tax must complete the normal forms and request the exemption from the Ministry of Finance. However, local authorities clearly have some autonomy in granting specific exemptions. For example, in some parts of larger cities the exemptions granted by the local authority represent a major portion of the potential tax revenues, causing concern that social welfare considerations may endanger tax revenue adequacy (Holzman 1992, p. 242, indicates that the Czech Republic also grants exemptions on the value added tax for consumer goods “with detrimental consequences for tax revenue”).

Sources of Information

Although the Czech Republic has a self-reported and self-assessed property tax system, compliance appears to be quite good. Fiscal authorities obtain information on compliance through two methods. Annual estimates of potential property tax receipts are conducted using cadastral data, which, as described below, are certainly not above suspicion. The estimated potential receipts are compared to actual, aggregate receipts. The Ministry of Finance also compares corporate tax returns with the filed property tax returns. Because the property tax payments of small businesses are deductible from the corporate income tax, an electronic comparison of the two files by the Ministry of Finance allows nonfilers to be identified. Little enthusiasm is apparent for auditing, and from our observations, none is systematically made.

One problem with the level and quality of information is the cadastral system, which was adopted in the 1870s and operated with few interruptions until World War II and the communist era, when it was basically ignored. The decline of the system was notably severe in the rural areas, where farms were formed into state-owned collectives and legal boundaries became unimportant. In 1964 the cadastral system was revised and property rights began to be recorded, but the reporting requirement was voluntary and was generally ignored. An attempt was made in 1976 to computerize the cadastral office, but by 1990 there was only one central computer and one database. After the Velvet Revolution, the cadastral system was reconstituted in 1993. Currently 77 computerized district cadastral offices with 6,000 employees are improving the quality of land records.

The goals of the Cadastral Office are to record descriptive information, to develop digitized maps, and to maintain archival data on all parcels. None of these is a minor task, and the process is complicated by decades of neglect. The office must first identify the ownership of millions of parcels of land. The cadastral system had records of 13 million parcels in 1993, but there are estimates that 8 million to 10 million parcels have never been recorded.

The Cadastral Office and the Ministry of Finance report an excellent working relationship, but a system that is missing data on millions of parcels undermines the credibility of the property tax system. Even if data were accurate and complete, the cadastral system is not linked

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7. A construction tax is levied at the time of inspection. The rates vary according to the types of construction, for example, residence, vacation home, commercial, or industrial.
electronically to the Ministry of Finance and does not include information on buildings or improvements, a serious omission that needs correction. On a more positive note, efforts are under way to correct the problem of unrecorded parcels by developing an on-line system linking the Cadastral Office and the Ministry of Finance.

**Appeal Procedures**

There are formal mechanisms for submitting appeals at the district offices of the Ministry of Finance, but there is little activity. Because taxpayers determine their own status and tax liability and the tax rates are low, there is little more to protest than the legal declaration of property classification.

**Revenues**

The property tax holds the key to raising sufficient revenues to provide services for subnational governments. While the property tax had a tradition in the former Czechoslovakia, it was apparently largely symbolic and was assessed only on single-family homes and agricultural land. Since the revolution, the property tax has not yet become a substantial part of the fiscal scene, but time has demonstrated the need for an autonomous source of local revenues. As the central government's need for revenues increases and the limits of other tax revenues are approached, it appears anxious to retain a larger proportion of these yields, while encouraging the subnational units to generate a healthier share of their own income.

Although the share of real estate tax in the revenues of the subnational governments is not insignificant, it is certainly modest when compared to individual income taxes. The property tax has been quite level in recent years, although some growth in tax receipts has been experienced through other taxes (tables 4.3 and 4.4). Nevertheless, finance authorities have begun to perceive that the property tax represents a less than fully tapped source of funds for local services.

A new tax law proposed by the Ministry of Finance to pursue these potentially larger revenue yields could increase the significance of the property tax by as much as a factor of three. The political crisis that ended the tenure of Vaclav Klaus as prime minister intervened in the legislative process. Discussions continue about the introduction of a market-based property tax, but consideration of concrete proposals has been repeatedly postponed.

**Current Issues**

Other issues under discussion have implications for the property tax. First, there is a proposal to reclassify the fees charged for local government services as taxes and to expand their range,

**Table 4.3. Revenues of Districts and Municipalities, 1993–98**

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total revenues</td>
<td>101,326</td>
<td>110,985</td>
<td>129,115</td>
<td>161,681</td>
<td>147,070</td>
<td>161,801</td>
</tr>
<tr>
<td>Tax revenues</td>
<td>35,970</td>
<td>53,243</td>
<td>70,679</td>
<td>72,670</td>
<td>76,093</td>
<td>83,320</td>
</tr>
<tr>
<td>Other taxes</td>
<td>32,949</td>
<td>49,435</td>
<td>66,880</td>
<td>68,652</td>
<td>72,150</td>
<td>79,212</td>
</tr>
<tr>
<td>Real estate taxes</td>
<td>3,021</td>
<td>3,808</td>
<td>3,799</td>
<td>4,018</td>
<td>3,943</td>
<td>4,108</td>
</tr>
<tr>
<td>Nontax revenue</td>
<td>19,143</td>
<td>21,453</td>
<td>18,401</td>
<td>21,333</td>
<td>23,546</td>
<td>24,708</td>
</tr>
<tr>
<td>Transfers state budget</td>
<td>17,000</td>
<td>15,483</td>
<td>16,306</td>
<td>16,840</td>
<td>18,020</td>
<td>17,913</td>
</tr>
</tbody>
</table>

*Source: Czech Statistical Office (1997).*
Table 4.4. Real Estate Taxes as a Percentage of Other Revenues, 1993–98

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Of total revenues</td>
<td>2.9</td>
<td>3.4</td>
<td>2.9</td>
<td>2.5</td>
<td>2.7</td>
<td>2.5</td>
</tr>
<tr>
<td>Of total tax revenues</td>
<td>8.4</td>
<td>7.1</td>
<td>5.4</td>
<td>5.5</td>
<td>5.2</td>
<td>4.9</td>
</tr>
<tr>
<td>Of other tax revenues</td>
<td>9.2</td>
<td>7.7</td>
<td>5.6</td>
<td>5.8</td>
<td>5.5</td>
<td>5.2</td>
</tr>
<tr>
<td>Of nontax revenues</td>
<td>15.8</td>
<td>17.7</td>
<td>21.0</td>
<td>18.8</td>
<td>16.7</td>
<td>16.6</td>
</tr>
<tr>
<td>Of state budget transfers</td>
<td>7.8</td>
<td>24.5</td>
<td>23.2</td>
<td>23.8</td>
<td>21.9</td>
<td>22.9</td>
</tr>
</tbody>
</table>


thereby providing some increase in current revenues as well as a modest source of new revenues. Second, an effort is being made to limit local debt, which has grown quite rapidly in the past few years in a number of municipalities. Third, the distribution of taxes from the central government will be modified to reduce the disparities in the distribution of shares of taxes transferred to local governments. Finally, as noted earlier, the Cadastral Office is working aggressively to update the system and link it electronically with the Ministry of Finance.

The overriding consideration in fiscal developments is the flow of resources to the municipalities. The central government has been willing to share responsibilities for the provision of services without an equal willingness to share the revenues those services would require. While the national government is concerned with local resource requirements and is prepared to discuss and pass legislation to improve the situation, the municipalities have been unable to count on funds for other than current operations.

On a continuum from simple nonmarket-based systems to systems whose taxable values are derived from actual market data, the current system is much closer to the nonmarket variant, because the emerging privatization process has not yet yielded a real estate market to generate scarcity prices. These markets are evolving slowly, but many issues remain to be resolved. In housing, rents are largely regulated, especially on nonprivatized dwellings, and the banking sector is not organized to enable the financing of private housing.

Although the Czech property tax is modest, it represents several notable accomplishments. Its design and implementation, developed in an orderly manner, have been geared to create a system that can be administered in the context of the resources available to public officials. The goal of improving property tax administration is seen as a key step in the development of public finance. The government, by moving slowly in its efforts to change the property tax system to a value-based tax, has taken a long-term view of the process and has established a foundation that should contribute to a successful transformation.

References and Bibliography


Historical Background

Slovak culture and traditions have developed in the shadows of the country’s neighbors: the Czech lands and Austria to the west, Hungary to the south, Poland to the north, and Ukraine to the east. Freed from Hungarian occupation at the end of World War I, Slovakia shared federal status with the Czechs as part of Czechoslovakia from 1918 to 1993. A Slovak state was established under Nazi tutelage in March 1939 (Wolchik 1991, p. 13). When World War II ended, democracy made a faltering new beginning, and the federation continued into the period when the communists seized power. Czechoslovakia was part of the Soviet bloc as a member of the Warsaw Pact and the Council for Mutual Economic Assistance.

Since late 1989, both the Czech and Slovak republics have been developing democratic and market systems. In 1993 the Czech and Slovak republics separated, in what was known as the “Velvet Divorce.” Restoring local autonomy and using the property tax as part of the overall system of financing municipal services are vital elements of developing democracy and a market economy in Slovakia.

An effective property tax must be based ultimately on the market value of property, but such a system is still not possible in Slovakia, for both economic and political reasons. To understand the potential role for the property tax, together with the historical roadblocks to the development of a normally functioning real estate market, it is necessary to review the limitations on the development of the new market system in general. These include the legacies of the socialist era and the constraints inherent in the state of Slovak development, the process of privatization of property, and the political and economic circumstances constraining the development of local self-government.

Socialist and Developmental Legacies

During the communist era, democracy was left on hold for 40 years as central planning attempted to mold economic development. Slovakia was thoroughly integrated into the Soviet bloc’s Council for Mutual Economic Assistance market (Frydman, Rapaczynski, and Turkewitz 1998, pp. 48-49), and the structural damage done to Slovak industry was significant. The mix of industrial products, heavily biased toward armaments, and the trade connections established by Soviet-type planners complicated the transition to a market economy.

After the Velvet Revolution in 1989, Slovakia launched some successful market-oriented reform efforts, but in 1992, without any formal consultation with the Slovak people, political leaders unilaterally decided to break from the federation. In the Velvet Divorce in 1993, Slovak leaders were
rejecting not only a partnership with the Czechs, but also the Czech preference for rapid transition to a market orientation. Before and after the opening of the reform era, the Slovaks were substantially less comfortable with departure from the order and security of Soviet ways than the Czechs.

Nevertheless, the Slovak self-government and fiscal systems today still closely resemble those developed jointly with the Czechs in the twilight of the Czechoslovakian era. However, the Slovaks have clearly defined the geography of regions (oblasty), laying the groundwork for a system that could alter the existing two-tier governmental landscape consisting of the central government and the municipalities.

Reemergence of Local Governments

Following the Velvet Revolution, the desire to establish local governments was strong in Slovakia. Under socialist rule, from 1950 until 1989, the autonomy of local governments had largely been lost as decisions about the quality and types of public services were directed by the central government based in Prague. Regional governments did exist, but their role was merely to administer and facilitate central government policies.

The autonomy of local government was further compromised by intergovernmental finance. Virtually all revenues for local government operations were funneled through the central government, and local governments had little leeway in the provision of public services. There was a sense that funding decisions were based on political and party influence and had a limited relationship to needs or demands, especially capital expenditures. Many of the functions normally provided at the local level were provided by the central government, for example, police, public utilities, fire protection, education, housing, and medical care.

Under central planning local governments became almost moribund, a situation that ran counter to the Slovak tradition. The new freedom that arrived in 1989 allowed the reemergence of local governments, and there are currently 2,781 municipalities in Slovakia. A few cities have populations over 50,000, and the capital city of Bratislava has a population of 452,000. Most of the cities have fewer than 500 inhabitants, and many have fewer than 100. A comparison of nine Central and Eastern European countries reveals that Slovakia and the Czech Republic have significantly more cities per 10,000 citizens than any of their neighbors (table 5.1). The country that comes closest is Hungary, which shares many traditions with its neighbors.

The number and the limited size of Slovakia's cities and towns raise the question of whether there is an excessive number of small governments given the personnel and resource limitations for the administration of such small municipalities. Several supportive organizations have emerged to facilitate the development of a core of professional local public managers. About 125 cities have created the position of city manager, similar to that in American cities, except that Slovak elected officials also play an important role in the day-to-day operations of the city. The Slovak Republic also has an organization of city finance directors, which operates much like the Government Finance Officers Association in the United States. Local governments have also formed the

2. Valko (1997, pp. 76 and 77) notes that the new Slovak constitution “establishes the possibility to stop . . . the process of privatization and/or restrict business activities and to reverse various measures that already had been taken in this respect.” Again, “efforts were made to slow down economic reform and to reinstate state control over the economy or its disposition.”

3. The two groups conduct regular meetings for training and professional development. They are active in the development of policy relative to their financial relationship to the central government and the proper level of government for the provision of services. The emergence and the focus of these two groups appear to be a direct result of the U.S. Agency for International Development mission in Bratislava, which adopted the policy of building administrative infrastructure in local governments in Slovakia and has conducted regular workshops on personnel and financial issues germane to the management of local governments in countries in transition.
Table 5.1. Number of Subnational Government Units in Selected Transitional Economies

<table>
<thead>
<tr>
<th>Country</th>
<th>Type of government</th>
<th>Number of municipalities</th>
<th>Country population</th>
<th>Municipalities per 10,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>Municipality</td>
<td>356</td>
<td>3,400,000</td>
<td>1.05</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>Municipality</td>
<td>255</td>
<td>8,900,000</td>
<td>0.29</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>Municipality</td>
<td>6,234</td>
<td>10,300,000</td>
<td>6.05</td>
</tr>
<tr>
<td>Hungary</td>
<td>Municipality</td>
<td>3,148</td>
<td>10,300,000</td>
<td>3.06</td>
</tr>
<tr>
<td>Poland</td>
<td>Municipality</td>
<td>2,459</td>
<td>38,400,000</td>
<td>0.64</td>
</tr>
<tr>
<td>Romania</td>
<td>Municipality</td>
<td>2,948</td>
<td>22,700,000</td>
<td>1.30</td>
</tr>
<tr>
<td>Russia</td>
<td>Municipality</td>
<td>2,000</td>
<td>149,000,000</td>
<td>0.13</td>
</tr>
<tr>
<td>Slovakia</td>
<td>Municipality</td>
<td>2,781</td>
<td>5,300,000</td>
<td>5.25</td>
</tr>
<tr>
<td>Ukraine</td>
<td>Municipality</td>
<td>619</td>
<td>52,100,000</td>
<td>0.12</td>
</tr>
</tbody>
</table>

Source: Calculated from Bird, Ebel, and Wallich (1995); Czech and Slovak data from in-country sources.

Organization of Cities and Towns of Slovakia, which represents about 90 percent of all the municipalities in dealings with the central government.  

State of the Slovak Economy

Slovak economic development has been surprisingly strong, especially considering the political environment and the demanding requirements of the transformation process. As a result, citizens should expect a gradual growth not only in private sector welfare, but also in the volume and quality of public goods and services at the national and local levels.

Slovakia adopted, at first under Czech tutelage, the standard strategies of price liberalization, restrictive monetary and fiscal policies, and the liberalization of foreign trade. Following the liberation from central planning, signs of economic progress began with growth in construction, increased domestic demand, and greater export productivity. As development progressed, government, household, and gross fixed capital investment spending also increased. Within five years, 95 percent of prices were unregulated, the most notable exception being rent control in housing. The expected explosive inflationary effects of these actions were successfully countered by the National Bank of Slovakia’s restrictive monetary policy. Slovaks argue that their fiscal management performance was not surpassed by any other transitional state.

These initial economic successes were due in large measure to a mini-boom in exports. Prosperity and expansion in western markets provided demand, and the shift was made from old Council for Mutual Economic Assistance markets to the European Union markets that are so important. The Slovak Republic’s ratio of exports to gross domestic product (GDP) was roughly 65 percent in 1995 (OECD 1996, p. 115), and the mix of exports was showing a tendency to reflect

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4. The organization has been active in drafting and reviewing legislation on public administration and public policy issues for subnational governments. An important issue it and the central government have been struggling with is the assignment of responsibilities for public services between these two bodies of government. The organization has also organized a foundation to train city employees in all areas of local government responsibilities in Slovakia.

5. Slovakia’s people are not happy with the sacrifices implied by the pursuit of transformation objectives. In 1993 a U.S. Information Agency opinion poll showed 47 percent of Slovaks preferring the current system to the previous communist one; 42 percent said it was worse. No less than 72 percent agreed that democracy did not fulfill their expectations, only 23 percent said it did. The economic situation in 1993 seemed better than under socialism for 22 percent, but it was deemed worse by 71 percent. Finally, 39 percent preferred private rather than state control of business, 53 percent favored state control (Marcincin 1996, p. 11).
a more favorable industrial structure for the long term. By mid-1997, 27.7 percent of Slovak exports were purchased by the Czech Republic, 23.3 percent by Germany, 6.5 percent by Austria, 5.6 percent by Poland, and 5.5 percent by Italy; members of the European Union received 44.9 percent of Slovakia's total exports (Slovak Economic Sheet 1997). Growth in exports to these countries exceeded total import growth. Nevertheless, this trade progress could still be insufficient for Slovakia's needs.

Privatization

Potential Benefits

Privatization today does not seem as promising for transitional economies as it did at the outset. However, it has signaled the emergence of property ownership and guaranteed the “irreversibility of the political changes carried out after the year 1989” (Mikloš and Zitňanský 1997, p. 88), and it has provided newly restructured firms with some insulation from state intervention.

Early in the transformation process, the hope was that privatization would transfer low-productivity properties from the state's financial and managerial burdens to the lists of higher productivity taxable properties. Privatization was to grow the private sector and return economic competitiveness to Slovakia. The theory remains fine, but practice in the former Czechoslovakia and elsewhere suggests that endogenous growth through the development of small start-up firms is far more promising.

Privatization can promote fiscal decentralization by contributing to the revenues of Slovak municipalities as larger private sector holdings increase the base of the property tax. Unfortunately, the current privatization achievement is probably not an important factor in the generation of local government revenues, because the property tax is rather inconsequential in terms of its yield.

History

Slovak privatization initially paralleled that of the Czechs, and can be viewed positively. A first round of small-scale privatization in 1992 auctioned off smaller production plants, retail stores, restaurants, and so on, and a second round permitted foreign buyers to bid for previously unsold properties. A first wave of large-scale privatization from 1991-93 focused on the denationalization of small-scale firms from retail and the trade services branches, as well as some dwellings. A total of 678 Slovakian state enterprises were sold for revenues of Sk 169 billion (Mikloš and Zitňanský 1997, p. 88). The denationalization of more large-scale industry, construction, agriculture, transportation, health care, financial institutions, and so on was the intent of a second wave of voucher privatization, initiated in September 1993.

The voucher method permitted, for a nominal sum, the participation of all interested citizens. Each could purchase coupon booklet for investment privatization funds for a direct claim on that national wealth that was to be privatized or let their points be used by private agents. In September 1993 state bonds replaced the voucher system, slowing and changing privatization dramatically. The bond compensation program provided each registered citizen with a bond for Sk 10,000 maturing in five years. The bonds could be traded for shares sold by the privatization agency or used toward the purchase of individual apartments (Mikloš 1997a, p. 108).

From 1994 through 1996, privatized properties went from just under 29 percent to about 50 percent of formerly state-owned property. In numerous cases, direct sales of national property

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6. In 1994 and 1995, 17 percent of state-owned property was privatized by the “standard method” of direct sales, bringing the overall share of privatized industrial properties to 45 percent of the total (Mikloš 1995, p. 11). In 1996 approximately 400 direct sales were made at a price of Sk 18 billion (Frensch 1997, p. 21), or roughly another 5 percent of total industrial properties privatized with the total task about 50 percent completed.
were in the form of management buyouts, with the sales being made “exclusively to individuals
and companies close to or recommended by government coalition party structures” (Frensch
1997, p. 91). It has been estimated that the Sk 18 billion revenues on 1996 sales had a book value
of around Sk 50 billion (Frensch 1997, p. 21). At such prices the sale of large volumes of property
should have been simple.7

The extent of privatization is also indicated by the share of GDP produced by the private
sector (table 5.2). By the end of 1996, that share in industry was 68.2 percent (an increase in that
year of 3.6 percent); construction, 83.2 percent (1.4 percent increase); retail sales, 94.6 percent
(2.9 percent increase); transport, 82 percent (19.9 percent increase); and agriculture, 86.1 percent
(4.3 percent increase) (Marcintin 1996, p. 130).

Substantive complaints about the government’s privatization policies have included the fol-
lowing issues:

- The process is nontransparent. The media, the public, and the political opposition are not
  permitted to scrutinize the government’s privatization actions.
- State-owned property sales have almost always excluded foreign buyers.8 A relatively large
  number of enterprises designated as being of “strategic importance” is withheld from
  privatization altogether.9
- The coalition government’s privatization process has not restructured industries. Monopoly
  positions held under the previous regime have been retained (Marcincin 1996, p. 24), which
  will likely preserve soft budgetary constraints even in privatized firms.10 Some of the ac-
  tions undertaken by the National Property Fund have been illegal. In some instances, trans-
  actions were closed before the property in question was in the possession of the privatization
  agency. Thus, according to Kolariková (1995, p. 13), the agency “was dealing with some-
  body else’s property.”

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7. The National Property Fund sells assets at prices significantly below book values; it does not issue
any information about competing projects or the relevant sales criteria. The first installments have usually
been only about 20 percent of the negotiated sales price. Generally, as much as 50 percent of the payments
of the purchase price have been forgiven if the purchaser declared himself or herself ready to use that
monetary equivalent for investment purposes. “In the case of Slovnaft, when 39% of shares was sold, 84%
the sale price was later forgiven” (Marcincin 1996, pp. 12–13). Furthermore, “Very controversial was an
amendment to the Income Tax Law, approved in late March 1996, which freed new owners of privatized
companies from paying taxes on income resulting from an NPF decision to lower the purchase price of the
property. Although a forgiven payment is considered an income, the law exempts new owners from paying
tax on such income if the remaining money is used for investment purposes.”

8. Slovakia has an apparent preference for domestic sales and intimidates foreign buyers. “The IMF,
concluding a study in October, 1996, . . . commented on the SR’s incompletely transparent privatization
methodology as follows: such privatization must have more apparent effects on the trust of the public or
have more negative consequences. Fogginess of the process repels potential foreign investors from entering
into the process in the same measure as in other transforming states in central Europe” (Mikloš 1997,
p. 136).

9. Twenty-seven companies are specified in energy, the gas industry, the postal service, telecommunications,
armaments, pharmaceuticals, machinery, agriculture, forestry, and water resources. Forty addi-
tional companies will be subject to privatization, but the state has assured the preservation of its right to
influence them. “The state maintains a ‘so-called golden share’ (a share with special rights) in those joint-
stock companies, where the majority stake has already been privatized” (Mikloš 1997, p. 111). According to
Mikloš, a former privatization minister, this golden share contradicts a constitutional principle of equality
among various forms of ownership. Furthermore, it was to be implemented retroactively in firms previ-
ously privatized.

10. Mikloš (1997a, p. 25) sees the ongoing ownership of the National Property Fund of significant shares
of large Slovak firms as a rather ominous situation, making it likely that two parallel “private” sectors exist in
Slovakia today: “One, characterized by large monopolies, supports government, cooperates with it and af-
ficts legislation and state economic policy, by which it ensures its particular position, while the second private
sector is characterized by small enterprises, without protection from state officers and monopolies.”
Table 5.2. Growth of Private Sector Output Shares, 1993–95
(percent)

<table>
<thead>
<tr>
<th>Sector</th>
<th>1993</th>
<th>1994</th>
<th>1995</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Public</td>
<td>Private</td>
<td>Public</td>
</tr>
<tr>
<td>Industry</td>
<td>60</td>
<td>40</td>
<td>44</td>
</tr>
<tr>
<td>Road freight transport</td>
<td>49</td>
<td>51</td>
<td>43</td>
</tr>
<tr>
<td>Retail sales</td>
<td>12</td>
<td>88</td>
<td>10</td>
</tr>
<tr>
<td>GDP, sector share</td>
<td>61</td>
<td>39</td>
<td>42</td>
</tr>
</tbody>
</table>


- The privatization agency will almost certainly not have the funds to honor the privatization bonds (whose market prices have come to reflect that expectation) when they come to maturity (Vaskovič 1995, p. 4), although the Organisation for Economic Co-operation and Development (OECD 1996, p. 66) has more positive expectations.
- Numerous property sales have been made opportunistically, to enrich private parties of interest to the governing coalition or to reward parties loyal to the coalition.\(^\text{11}\)

Privatization and Aggregate Economic Performance

Slovak economic performance would have been even better had politics and privatization contributed in a more positive way. Because privatization has favored insiders and political supporters, it has deflected potential foreign investors, who face selling prices far closer to market values. Where such investments are undertaken, there is presumably a lag time between contracting and experiencing the full productivity-enhancing effects. Therefore, to the extent that other countries are more successful in attracting such investments, the difference in growth rates, observed only with the time lag mentioned, will be more apparent in the future.

The state has retained indirect but significant influence on industry through state-owned banks, essentially permitting industry to continue the soft budget constraints of the previous era through bank credit and collections policies. Financially supporting industry through liberal credit policies keeps marginal firms functioning and prevents a politically undesirable swelling of unemployment rolls. Therefore, the state has not been anxious to privatize the banks, despite pressures to do so.\(^\text{12}\)

The persistence of privatization problems, the slowing of the process, and the related slow progress toward effective industrial restructuring have several effects: retaining inflated state-owned, inefficient, and noncompetitive private industrial sectors; keeping state expenditures higher than they need to be; constraining productive performance; keeping tax revenues below the levels needed to meet local public service demands; and failing to promote local self-autonomy.

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\(^{11}\) Marcinčin and others have documented this assertion at length. He explains why an opinion poll published in 1995 found that "only 14% believed that the current coalition changed its privatization program for reasons other than strengthening its political power" (Marcinčin 1996, p. 17).

\(^{12}\) It was widely reported during the political crisis of late 1997 that an important element of Czech reform inadequacy was the inappropriate retention of state influence on the private sector. Through the state-owned banks, firms could be encouraged, through state moral suasion and lending policy not to downsize their workforce. In the seven years since the Velvet Revolution, the legacy of labor hoarding from the previous planning regime has still not been overcome. The same can be said for the Slovak economy.
Privatization, Markets, and Real Estate Values

This privatization situation affects, among other things, industrial development, the fiscal development of local governments, the property tax, and the development of the real estate market. We are particularly interested in the requirements for the establishment of a real estate market, which include the following elements (see Zapletalová 1997 for a somewhat different perspective):

- A banking system that has the capacity to fund real estate mortgages
- The private ownership of property
- An active real estate market in all the principal types of properties
- The elimination of price controls in the housing market so that market forces establish values
- The elimination of subsidies (such as for housing and utilities) that affect the real estate market.

Because these characteristics have not yet been created or achieved in Slovakia, current real estate prices cannot be said to reflect market forces or provide the basis for uniform taxation. The government is attempting to address some of these issues by raising housing rents by an additional 70 percent, liberalizing certain previously controlled prices on electricity and gas for residential and commercial customers, and increasing other fees and charges (EIU 1999). These measures were adopted to counteract disappointing revenue yields, but their implementation will improve the conditions for market-based decisionmaking and market information.

Taxation in the Transition Period

Immediately after the Velvet Revolution, Czechoslovakia began to prepare for the adoption of a tax system that borrowed heavily from Western Europe. It was based on the kinds of taxes prevalent there without reference to whether such a system was truly optimal even for the countries using it, whether it could work well in the very different transitional economies, or whether the tax revenues would be sufficient for these countries.

The four most important governmental revenue sources in Slovakia are, therefore, the value added tax, personal income tax, corporate income tax, and an income tax on unincorporated businesses. Although these taxes are collected by the central government, all revenues except the value added tax are shared with local governments. These transfers are the primary revenue source of the local governments.

In the short period since the Velvet Divorce, Slovak legislation and policy pronouncements have emphasized a desire to achieve decentralization and to develop self-government for the municipalities. In practice, however, the Slovaks evince a stronger tendency to retain the old central planning ways than do the Czechs.

Taxes on Land and Buildings

The property tax in the Slovak system of local self-government remains a product of Czechoslovakian policy and legislative development. Although the tax systems of the twin republics have not diverged greatly, we expect that over time they will. In both republics property tax policy is established by the central government, but the day-to-day administration of the property tax is largely the domain of the municipalities, most of which are very small. Some of the small units in the Slovak Republic lack the personnel and other resources that would permit effective administration.

The taxation of land is based on the area of each individual parcel, and the taxation of buildings
is based on the number of square meters of a structure's floor space, including the land area under the buildings. The tax rates for land and buildings have been established separately. Adjustments in the property tax formula account for the location of land and buildings and for the utilization of the taxed unit. These piecemeal efforts to approximate a property's actual value for tax purposes represent a limited substitute for market valuation. Slovak officials have begun to give some consideration to the adoption of a value-based system of taxation, but a number of obstacles must be overcome before adoption of an *ad valorem* system.

Data on per capita land and building taxes show a significant pattern of revenue generation in the Slovak municipalities (figure 5.1). As the size of the municipality increases, per capita revenues from the tax on land decline, but the opposite situation is evident for tax on buildings. The implication is that the land tax, which is applied to a resource that cannot be removed from the region to avoid the tax, is underutilized in the cities, badly reducing needed revenues to levels below their potential.

**Exemptions**

Property tax law grants explicit exemptions for state-owned, cultural, religious, and other such properties. An individual owner of commercial real estate is taxed at a rate of about one-third of the rate applied to commercial organizations. All property owners applying for exemption must complete a form annually for each eligible parcel. In the larger cities, these exemptions represent a substantial portion of the potential property tax base. The transitional countries generally tend to pursue exemption policies that severely limit the revenue-generating capacity of the tax system (Holzman 1992, p. 242).

Presumably to promote private housing construction, explicit 15-year exemptions are granted

**Figure 5.1. Per Capita Land Tax and Building Tax, by Size of Municipality, 1996**

![Graph showing per capita land tax and building tax by size of municipality]

*Source: Ministry of Finance data.*
for newly constructed and recently renovated homes and to owners of restituted buildings. Because the current property tax base and rates do not produce a large yield, the incentive effect of this policy on the current tax level is not significant.

Residential property tax exemptions are granted to citizens who are at least 70 years old and to taxpayers able to convince the local government council that their property tax burden is excessive relative to their income. This form of tax relief appears to have little impact on the revenue yields from land and building taxes, except for the 12 percent exemption on land tax in the capital city of Bratislava (table 5.3). It is likely that a larger measure of tax relief is enjoyed through simple tax evasion.

**Intergovernmental Organization**

Public administration includes both state administration and self-government. Subnational government officials can be engaged in both kinds of administration, because state administration includes service tasks delegated by the center to local units. Because many of the self-government and state administration services are performed by the same officers with the same equipment and materials, it would be impossible to isolate the costs of such services into local and central government components.

For the property tax in particular, policy and administration are split between the central and local governments. The central government controls property tax policy and law, establishes the base for land and for buildings, and sets the tax rates for each specific type of land and building. Local governments are responsible for the collection of property tax data and taxes. They must rely on the centrally operated cadastre for information pertaining to the ownership of properties.

**Sources of Information**

Information, including the square meter area of the land and buildings situated on it, is collected on forms designed by the central government and filled out by the taxpayer. The forms are accompanied by a readily understandable instruction book that contains both explanations and examples. The taxpayer submits the form to the municipality. About 40 percent of municipalities have no computers, so the data must be recorded by hand.

Specific information pertaining to land areas is available from the cadastre, but that institution provides limited help in identifying land ownership and no help in assessing the tax on buildings. The current quality of the cadastre is quite poor, especially in rural areas and smaller towns. Moreover, the information about taxable land and buildings received from taxpayers cannot be matched or verified against the cadastre. Despite this problem, the Ministry of Finance does not publicize any concerns that property tax compliance is a serious problem. However, any restructuring of the fiscal system to increase property tax yields substantially would doubtless have a negative impact on compliance.

**Table 5.3. Percentage of Land and Building Taxes Granted as Tax Relief by Size of City**

<table>
<thead>
<tr>
<th>Population range</th>
<th>Land</th>
<th>Building</th>
</tr>
</thead>
<tbody>
<tr>
<td>0–1,000</td>
<td>3.3</td>
<td>2.0</td>
</tr>
<tr>
<td>1,001–6,000</td>
<td>1.8</td>
<td>2.3</td>
</tr>
<tr>
<td>6,001–10,000</td>
<td>1.7</td>
<td>1.6</td>
</tr>
<tr>
<td>10,001–25,000</td>
<td>1.4</td>
<td>1.0</td>
</tr>
<tr>
<td>25,000+</td>
<td>3.3</td>
<td>1.9</td>
</tr>
<tr>
<td>Bratislava</td>
<td>12.1</td>
<td>2.3</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance 1997 data.
Taxable Base and Rates

Property taxation is not based on market-generated property prices, and land is treated separately from buildings. Land's taxable base depends on its area and use. There are 11 classifications of land, for 8 of which the assessed tax value adjusts for land quality, as estimated by the Ministry of Agriculture. For agricultural land the data collected on quality and potential productivity are remarkably detailed, and parcels in close proximity can have substantially different estimated productivity.

There are six classes of buildings, ranging from residential housing to industrial buildings. The basic tax rate ranges from Sk 1 to Sk 10 per square meter, and increases by Sk 0.75 for each floor. The rates can be adjusted annually. The tax on buildings allows for two additional adjustments that allow city administrators a modest degree of flexibility in taxing differential qualities of location within their jurisdiction. First, data on the size and type of a building can be multiplied by a coefficient, which is determined by the population of the community where the building is located. The coefficient for the largest cities is greater than that for the smallest towns by a factor of 4.5. Second, the local administrator may apply a final coefficient to the formula reflecting the quality of the location of a taxable property within the city. The administrator can, therefore, increase the tax bill by an amount as large as 150 percent or reduce a tax bill by an amount up to 50 percent.

With an area-based tax, one would expect to find a close relationship between the area of the land or the building and the tax revenues produced. Figures 5.2 and 5.3 reveal that this is not the case in Slovakia. Certain classes of land are taxed far more heavily than others, for example, building plots in cities produce more revenue per square meter than arable land or forests. The same is true for the taxes on improvements.

Industrial and commercial buildings produce much greater revenues per square meter of area than do agricultural or apartment buildings. It appears that the heaviest tax burden is on commercial and industrial activities, or on capital. Casual observation suggests that smaller towns and cities are inclined to tax built plots more heavily than arable land; forests, perhaps seen as less productive of revenues than farmland, are subject to even less tax than farmland.

Figure 5.2 reviews the ratio of land tax levied to given areas of land by city size. In towns of up to 1,000 inhabitants, for example, the ratio of land tax levied on built plots is about eight times as high as that of arable land, and higher yet than of forests. The ratio declines inconsistently for large cities, being approximately two for Bratislava.

The ratio for arable land is more consistent and substantially lower, at around 1.25 for towns and smaller cities, though the ratio is only 0.14 in Bratislava. Figure 5.3 illustrates why the smaller towns, for which the property tax is a unique source of independent revenue, tend to put the burden of tax revenues on buildings rather than on land.

Commercial and industrial buildings have consistently higher taxes than buildings for other uses. 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. Note, too, that the relatively greater importance of the property tax to municipalities is structured so that the ratio of tax to square meter of building space increases monotonically and significantly as the tax jurisdiction or municipality becomes smaller.

Tax Collection

The tax is collected from the property owner. In cases where ownership is uncertain, users of the property are responsible for the tax. Data obtained from the Ministry of Finance suggest the
Figure 5.2. Ratio of Land Tax Levied to Area of Land by Size of City

Source: Ministry of Finance data.

Figure 5.3. Ratio of Building Tax Levied by Square Meter of Building Class by City

Source: Ministry of Finance data.
existence of a serious lag in the collection of the property tax, especially in the small communities where arrears may exceed 40 percent from land and approach 20 percent for the more heavily taxed buildings (table 5.4). The problem of uncollected property tax declines as the size of the city increases, although one would assume it to be unacceptably large from the standpoint of the revenue-hungry municipalities. In Bratislava, the reported number seems too low.

**Appeal Procedures**

Appealing a property or building tax assessment in Slovakia is attempted first through the local administrator. If denied, the taxpayer may appeal to the District Council and then to the Ministry of Finance, but only if new information has become available since the original appeal or if it is determined that information used in the original appeal was incorrect. All appeals and decisions must be in writing, and all matters are confidential. Appeal procedures have been established in detail by legislation. The most active area of appeal is against taxes on agricultural land, and many owners are now turning to private firms to prepare appeals on the value of the productivity coefficients estimated by the Ministry of Agriculture.

**Other Taxes on Property**

There are three additional property-related taxes: the estate tax, the transfer tax, and the gift tax. The value of the base for all three has been specified by a price decree of the Ministry of Finance. When property is transferred, administrators can choose the higher of either the reported sales price or the assessed price as the basis of the tax. Assessment is done by a small corps of fee appraisers, who report their values to the cadastre.

The first Sk 500,000 of appraised value is exempt from estate and gift taxes when land is inherited by people under age 18. Inheritance tax rates increase progressively for individuals more distantly related to the decedent who made the bequest. Immediate family members face a rate of up to 5 percent, extended family members are assessed up to 10 percent, and non-relatives may be assessed up to 40 percent. In 1996, these three taxes generated revenue of Sk 896 million (1997 interview with Ministry of Finance official).

**Revenues**

The property tax yield is low relative to total tax receipts of all levels of government, total tax receipts of local governments, GDP, and other possible measures. Local governments will not gain autonomy and financial self-sufficiency through the current property tax (table 5.5).

### Table 5.4. Percentage of Land and Building Property Taxes in Arrears by Size of City

<table>
<thead>
<tr>
<th>Population range</th>
<th>Land</th>
<th>Building</th>
</tr>
</thead>
<tbody>
<tr>
<td>0–1,000</td>
<td>56</td>
<td>20</td>
</tr>
<tr>
<td>1,001–6,000</td>
<td>38</td>
<td>15</td>
</tr>
<tr>
<td>6,001–10,000</td>
<td>44</td>
<td>20</td>
</tr>
<tr>
<td>10,001–25,000</td>
<td>37</td>
<td>13</td>
</tr>
<tr>
<td>25,000+</td>
<td>26</td>
<td>12</td>
</tr>
<tr>
<td>Bratislava</td>
<td>3</td>
<td>3</td>
</tr>
</tbody>
</table>

*Source: Ministry of Finance 1997 data.*
The current real estate tax does not provide a level of funding that could satisfy the service needs of subnational governments, so municipalities have had to rely on revenue sharing, subsidies from the national government and fees raised locally (table 5.6).

Many local governments have had to resort to selling assets to finance current operations, and some have resorted to deficit finance. The assets in question are mostly housing and businesses transferred to the municipalities from the state that have not been privatized. These properties represent an important asset for the newly enfranchised cities and towns, but they can also represent a burden, because their deteriorated physical state suggests the need for heavy investments that the municipalities can scarcely afford.

The central government could view this situation as a healthy one that motivates the municipalities to promote privatization. Unfortunately, numerous difficulties retard the privatization process. The central government might also consider this asset stock as a reason not to provide revenues for the municipalities to the extent desired. For the next few years, the option of selling assets provides a potential revenue source that partially relieves the central government from the burden of providing for the financial needs of subnational governments.

Current methods of finance do not provide the municipalities with sufficient resources to assure successful fiscal performance. The state, facing financial crises of its own, has tended to reduce the resource flow to the local level. It also appears anxious to transfer to local governments service provision responsibilities that had been managed centrally, such as the school system. The central government is considering the advantages of turning primary and secondary

Table 5.5. National Budget, 1993–96
(Sk billions)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP in current prices</td>
<td>369.9</td>
<td>441.3</td>
<td>518.0</td>
<td>581.3</td>
</tr>
<tr>
<td>GDP in 1993 prices</td>
<td>369.9</td>
<td>388.1</td>
<td>416.7</td>
<td>443.3</td>
</tr>
<tr>
<td>Total revenues of public budgets</td>
<td>169.8</td>
<td>158.1</td>
<td>184.2</td>
<td>190.5</td>
</tr>
<tr>
<td>National budget</td>
<td>150.3</td>
<td>139.2</td>
<td>163.1</td>
<td>166.3</td>
</tr>
<tr>
<td>Local budgets</td>
<td>19.5</td>
<td>19.0</td>
<td>21.0</td>
<td>24.2</td>
</tr>
<tr>
<td>Total tax revenues</td>
<td>91.2</td>
<td>115.2</td>
<td>139.7</td>
<td>150.3</td>
</tr>
<tr>
<td>Tax revenues of national budget</td>
<td>82.2</td>
<td>105.6</td>
<td>131.1</td>
<td>140.1</td>
</tr>
<tr>
<td>Tax revenues of local budgets</td>
<td>9.0</td>
<td>9.6</td>
<td>8.6</td>
<td>10.2</td>
</tr>
<tr>
<td>Total revenues of local budgets</td>
<td>20.1</td>
<td>20.1</td>
<td>22.2</td>
<td>25.4</td>
</tr>
<tr>
<td>Real estate tax</td>
<td>1.6</td>
<td>2.0</td>
<td>2.1</td>
<td>2.9</td>
</tr>
</tbody>
</table>


Table 5.6. Real Estate Tax, 1993–96
(percentage of)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP in 1993 prices</td>
<td>0.43</td>
<td>0.52</td>
<td>0.50</td>
<td>0.65</td>
</tr>
<tr>
<td>Revenues of public budgets</td>
<td>0.94</td>
<td>1.27</td>
<td>1.14</td>
<td>1.52</td>
</tr>
<tr>
<td>Total tax revenues</td>
<td>1.75</td>
<td>1.74</td>
<td>1.50</td>
<td>1.93</td>
</tr>
<tr>
<td>Total revenues of local budgets</td>
<td>7.96</td>
<td>9.95</td>
<td>9.46</td>
<td>11.42</td>
</tr>
<tr>
<td>Tax revenues of local budgets</td>
<td>17.78</td>
<td>20.83</td>
<td>24.42</td>
<td>28.43</td>
</tr>
</tbody>
</table>

Note: Differences in sums and ratios result from rounding the data. Source: Medzinárodné prehl'ady (1997).
education over to local governments, which makes much sense from the standpoint of local autonomy, but only if the necessary funding is also transferred.

The local governments look at their current budgets and have the impression that the tax system, through transfers, subsidies, and local fees, provides nearly enough to meet all their operating responsibilities. If primary and secondary education were to be added to the list, however, it will soon become apparent that local budgets are incapable of providing adequate funding.

General Policy Issues

The fiscal and administrative autonomy of local governments are hallmarks of democracy. Unfortunately, these remain inadequately developed in the Slovak Republic because of the insufficient property tax yield. Moreover, the municipal fiscal system suffers an annual crisis initiated by the central government's budget announcement, which follows an extended period of uncertainty and inability to complete subnational planning processes. A fully functioning property tax would reduce the fiscal dependence of the municipalities on the state and create the greater autonomy advocated by many of Slovakia's political leaders.

Local self-government not only suffers from this lack of fiscal autonomy, but was particularly at risk under the coalition formed by President Mečiar, which pursued a process of recentralization by redesigning privatization procedures to secure personal and political gain. The election of a new regime and the public's later refusal to elect Mečiar as president has given renewed hope to Slovakia's political development.

Equity and efficiency could be enhanced in the property tax system by moving to market valuation of properties. Currently, an attempt to do this is being contemplated by the Ministry of Finance, but these aspirations will continue to be hampered by the lack of market data. Residential rental rates remain under state control, and more than 50 percent of residential properties are owned by the government, although ownership has been transferred from the central government to the municipal level.

In the absence of market data, it would be both possible and advisable to refine the existing valuation process by better accounting for the location and quality of assessed properties. This approach would be unlikely to achieve complete uniformity of assessments, but would be a step in the right direction, also providing substantial additional revenue to the local governments. Increasing rates, coupled with new valuation procedures, would clearly enhance tax yields.

The administration of the property tax is also of great importance. At issue is whether or not the municipalities should continue to collect it. Roughly half of the 2,853 cities and towns have access to computers and only about one-third have full-time administrators. Although considerable efforts are being made to train municipal officers and plans are being considered to increase the number of municipalities authorized to hire full-time workers, local resources are insufficient to administer local fiscal activities effectively. Privatization, especially of specific (for example, technical) tasks also may be a possibility.

Currently, the cadastral system is also a roadblock to the administration of the property tax. During the previous era, the cadastral system was rendered nearly inoperable by the communist regime's disregard for private land ownership and the corresponding conviction that the records were of limited value to the state. Efforts are under way to improve the cadastral system, and there are plans to digitize the entire national database.

The functioning of the cadastral system also presents an apparent moral dilemma. Because it cannot be monitored by the municipalities, to which it is responsible for the identification of taxable properties, the cadastral system has little incentive to rigorously assist the client municipalities that need to make sure taxable properties are identified and on the tax rolls.
In conclusion, Slovakia has struggled with political uncertainty and has experienced privatization captured by opportunistic elements. Given the extant legacies and constraints, it has done about as well with fiscal decentralization as could have been expected. The property tax has not yet played a significant role, but as Slovakia moves from its hasty adaptation of a perceived standard Western taxation system to a more specifically designed system attuned to contemporary fiscal needs, the tax system may well continue to develop in such a manner as to provide independent revenues for local autonomy.

References and Bibliography


Property Tax Developments in the Russian Federation

Jane H. Malme with Natalia Kalinina

General Background

The Economic and Political Transition

The "revolutionary transformation" (Gorbachev 1987, p. 33) that in a very short time dismantled the Soviet empire and shattered communist control was set in motion when Mikhail Gorbachev rose to power in 1985 in the midst of worsening economic crises and public discontent. By 1987 Gorbachev had introduced the concepts of glasnost (opening Soviet society to internal criticism and external comparison) and perestroika (the need for restructuring that society). Together, these concepts set the course for destruction of the old order and the creation of a new Russian nation. That transformation is still under way, as a new order seeks to replace 70 years of communist authoritarianism and central planning with democratic institutions and a market economy able to survive global competition in the modern age. Restructuring the economy and relinquishing bureaucratic and political control are complex and daunting tasks in this nation, which even without its former republics is the largest land mass on Earth (17.075 million square miles with a population of 148.7 million people).

When Gorbachev introduced "the most important and radical program for economic reform our country has had since Lenin introduced his New Economic Policy in 1921" (Gorbachev 1987, p. 33), he did not envision the destruction of the entire system. He recognized, however, that the central government system of setting production outputs and fixing prices for more than 200,000 individual commodities was wasteful, inefficient, and not sustainable in a postindustrial world, and that corruption and the lack of individual incentives were stifling productivity.

By 1990, as communist power was being rejected throughout Eastern Europe and the new political freedom to criticize the power structure was being actively demonstrated (Smith 1991, p. xxi),1 Russians chose, in free elections, reform-minded mayors for the cities of Moscow and St. Petersburg, and elected Boris Yeltsin as president of the new Russian Soviet Federal Socialist Republic.

With apparent popular support, the economic reformers in the Gorbachev government proposed a 500-day plan that would begin the transition from a command economy to a market economy. It included price reforms; stabilization measures; budget, tax, and monetary policies; and land privatization. The plan was predicated in part on the economic independence of the Soviet republics, which had declared their sovereignty, but was met with a firestorm of opposition from the Soviet power structure. The disagreements were not so much about economic reforms as about loss of control (Posner 1992, pp. 104–10).

The clash between reformers and the old guard escalated and culminated in the failed coup on August 19, 1991, on the eve of Gorbachev’s return to Moscow to sign a new treaty with eight

1. More than 200,000 people demonstrated outside the Kremlin in February 1990 to demand that the Communist Party accede to their wishes to abandon its sole right to power and permit a multiparty political system with free elections.
The Development of Property Taxation in Economies in Transition

republics. This document would limit the power of the central USSR government, guarantee free
development of property, and grant each republic independent authority over its economy, in-
cluding control of its natural resources and tax policies. Most threatening to the old guard was
that the treaty allowed any republic to choose independence. The draft Treaty of the Union of
Sovereign States was to be signed in Moscow on August 20, 1991, and leaders of the Baltic republics
of Estonia, Latvia, and Lithuania had made clear they would choose full independence. The
treaty was the last straw in a six-year struggle between reformers and the old order.

In the aftermath of the coup, the Soviet Union was disbanded, Communist Party supremacy
was abolished, and Russia was established as a new independent state led by President Yeltsin
and his group of economic reformers, who immediately put forth a far-reaching reform program.
This chapter reviews developments during the Yeltsin administration, but recognizes that the
legacy of the Yeltsin years and the future direction of reforms are now being shaped for the new
century by President Putin and a new government.

Privatization and Private Property Rights

Rapid privatization was a primary objective of the Yeltsin government, which initiated a large-
scale program in 1991 to privatize both state industrial enterprises and housing. Many enter-
prises were privatized, although not restructured, and they remained under the control of their
Soviet-era managers. Housing residents were given the option of acquiring ownership of their
apartments, practically free of charge. In neither case, therefore, did market factors enter into the
transfers to ensure future viability. Nevertheless, significant segments of the Russian economy
were transferred out of central government control and into private hands.

Land ownership remained primarily under government control, although there were some
urban land lease auctions for commercial investors in the larger cities. Industrial enterprises and
rural collectives were able to register ownership rights to the land in their privatization plans and
pay the standard price within a year of application. Owners of detached houses were permitted
to register the land on which their 
dachas
and homes were located.

A lack of consensus over the fundamental issue of land ownership has been a major barrier to
land reform. The Russian government and the State Duma (lower house of the Federal Assem-
bly) have not agreed on a land code. The Civil Code, adopted in 1994, defines private and public
ownership rights, but these rights will not become effective until a land code is enacted. Commu-
nist and agrarian factions in the Duma have prevailed in passing land codes that ban the sale of
farmland. President Yeltsin vetoed these versions, while seeking compromise through amend-
ments that would restrict the purchase and sale of farmland for other than agricultural use. The
president also signed a decree permitting subnational governments to decide on land disposi-
tion. Several regional (oblast) dumas have passed legislation to legalize the purchase and sale of
land, including farmland, but the lack of national legislation remains an obstacle to market devel-
opment and investment.

To encourage real estate market development, a 1995 presidential decree authorized legal
entities and individuals that had permission to build on a parcel to register ownership of the
land. Many chose not to pay the purchase price, so long as rents and land taxes remained mini-
mal, and many municipal officials, enjoying the influx of rent payments to local budgets, have
not encouraged land purchases.

Registration of property ownership has been burdensome for new owners and costly for gov-
ernments. Numerous documents have to be completed and filed with various government agen-
cies. As a result, much property remains unregistered, including valuable new construction. In
efforts to streamline the registration process and to encourage privatization and clarification of
property rights, some regional and local governments set up registration chambers, where repres-
sentatives from the agencies involved in registration were present to accept and process documents.
In February 1998 the new federal Law on State Registration of Real Property Rights and Transactions established registration chambers under the jurisdiction of the Ministry of Justice. This law required regional governments to follow the title registration process established by the law, and by March 1999 more than two-thirds (66) had done so. A uniform, federationwide system for identifying property rights should provide greater certainty and a less burdensome process for purchasers and investors if fully implemented.

Decentralization

The struggle between the old order and the new culminated in the dissolution of the Congress of People’s Deputies elected under communist control. Elections for the new Federal Assembly coincided with a nationwide referendum on the adoption of a constitution for the Russian Federation in December 1993. The new constitution established a federal state with a three-level government structure. The federal level has a strong president, with authority to issue decrees on a wide range of matters, and to appoint a prime minister and cabinet. The legislative branch is the bicameral Federal Assembly, with a Federation Council and State Duma. The Duma initiates laws and may override presidential vetoes.

The second level of government consists of 89 “subjects” of the federation, which include autonomous republics, oblasts, okrugs, and krais (native lands) with uniform rights in law, if not always in practice. The metropolitan cities of Moscow and St. Petersburg have the status of oblasts. The elected leaders of these regional subjects comprise the Federation Council (until 2002). Each regional government is divided into the third level, which includes raions or districts that have some autonomy, but are subject to oblast laws and regulations. These governments existed during the communist period as administrative units of the central government.

The rights and roles of subnational governments within the federation are evolving, with difficult issues unresolved, such as boundaries, the degree of regional autonomy, and the protectionist policies adopted by some of the oblasts. As early as the 1980s, regional administrators had withheld revenues intended for the federal budget, when the central government passed down increased expenditure responsibilities during perestroika, and this practice resurfaced under the fiscal pressures of the 1990s.

The new constitution vests ultimate authority in the federal government, but envisions some level of independence among regional and local entities. In 1995, the Law on the General Principles of Local Government Organization provided limited powers of self-government to the local level of government, such as adoption of local charters, budgets, and taxes in accordance with federal law. The authority to establish local taxes is limited by the federation’s power to determine the basic tax structure. Elections of oblast governors and city mayors as well as local legislative bodies (dumas) were initiated at this time.

By the mid-1990s, nearly equal shares of general government revenues were received by the federal government and regional (including local) governments (OECD 1997, table an. 3, p. 188). There remains a lack of clarity concerning the responsibilities of federal and regional governments, and the appropriate sharing of revenues to perform their respective functions (Bahl and Wallich 1995).

Fiscal Structure

In the late 1980s the Soviet tax structure reflected the fiscal arrangements of central planning and control, and required radical restructuring for a new decentralized and privatized economy. Like other Central and Eastern European transitional countries, the Russian Federation adopted the common European set of the value added tax (VAT) and corporate and personal income taxes (Holzman 1992 describes pre- and postreform fiscal systems). Regional governments have
The Development of Property Taxation in Economies in Transition

negotiated shares of these revenue sources (table 6.1). The 20 percent VAT produces the largest yield for the federal budget (44 percent in 1998). The regional share of VAT collections decreased from 30 percent in the first quarter of 1999 to 15 percent in the final three quarters, to be made up by regional adoption of sales taxes that were authorized in the new Tax Code.

Continuing budget deficits have made fiscal reform a major subject of debate within the administration, between the administration and the Duma, and between central and regional governments (OECD 1997, table A9, p. 253). The number of taxes increased during the 1990s (200 have been identified), exemptions proliferated, and tax collection was dismal (OECD 1997, pp. 58–60). Efforts to improve budget balances have been stalled by political conflicts over the direction and beneficiaries of reforms. Necessary steps of reducing subsidies and improving tax collections are not easily accepted in a society tolerant of tax evasion and long accustomed to government support unrelated to its cost, especially when the sense of equity has been undermined by “large scale misappropriation” of public revenues and assets (Camdessus 1999, p. 6).

The Law on the Basic Principles of Taxation (1992) was intended to establish the framework for taxation throughout the Russian Federation, to specify the taxes to be levied by each level of government, and to allocate tax revenues among the governments. This law was intended to replace the system that relied on the central government negotiating shares of taxes with the regions. It was never fully implemented, because expenditure assignments did not match revenue needs, and inflation and other uncertainties made the change unfeasible.

A major initiative undertaken in 1994 was to develop the Federal Tax Code to consolidate the more than 600 separate laws, decrees, and regulations governing taxation; reduce the number of taxes; and create one uniform and internally consistent tax law. Passage of the Tax Code through the legislative process has been slow and difficult, but worsening financial conditions and pressure from international financial organizations have continued to push tax reform efforts. In 1996 a presidential decree stated that new measures were necessary to strengthen fiscal discipline by reducing the number of taxes, consolidating state extrabudgetary funds with the federal budget, decreasing the tax burden on industry, establishing tax-sharing minimums, and limiting exemptions. The Tax Code, part I was enacted in 1998, and was effective in January 1999. Changes and amendments were submitted to the State Duma throughout 1999, and certain provisions will not be implemented until part II is passed. Its provisions for the specific taxes are still under consideration by the State Duma. President Putin has pronounced that tax reform is a major priority.

Part I of the code establishes the basic system of taxation in the federation, and requires that tax and fee legislation and regulations adopted by regional and local governments be consistent with the principles and limits of the code. The code specifies the types of taxes and fees and the levels of government permitted to impose them. Table 6.2 shows the federal, regional, and local taxes that will become effective on adoption of part II of the code.

### Table 6.1. Total Tax Revenue of Corresponding Budgets, 1995–98
(rubles millions)

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<tr>
<th></th>
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<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Federal budget</td>
<td>170,463.3</td>
<td>218,721.6</td>
<td>243,547.7</td>
<td>235,983.9</td>
</tr>
<tr>
<td>Regional and local budgets</td>
<td>189,009.3</td>
<td>254,271.7</td>
<td>328,988.6</td>
<td>308,121.3</td>
</tr>
<tr>
<td>Total</td>
<td>359,472.6</td>
<td>472,993.3</td>
<td>572,536.3</td>
<td>544,105.2</td>
</tr>
</tbody>
</table>

*Source: Federal Treasury data.*

2. The 1997 federal budget had a deficit of Rub 173.5 trillion, with the largest expenditure item (Rub 151.2 trillion) for debt service.
Table 6.2. Taxes to Become Effective on Adoption of Part II of the Tax Code

<table>
<thead>
<tr>
<th>Federal taxes</th>
<th>Regional taxes</th>
<th>Local taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>• VAT</td>
<td>• Property tax on legal entities</td>
<td>• Land tax</td>
</tr>
<tr>
<td>• Profit tax on legal entities</td>
<td>• Real estate tax</td>
<td>• Individual property tax</td>
</tr>
<tr>
<td>• Personal income tax</td>
<td>• Road tax</td>
<td>• Advertising tax</td>
</tr>
<tr>
<td>• Capital gains tax</td>
<td>• Transport tax</td>
<td>• Inheritance and gift taxes</td>
</tr>
<tr>
<td>• Excise taxes: raw materials</td>
<td>• Sales tax</td>
<td>• Local license fees</td>
</tr>
<tr>
<td>• Customs duties, fees</td>
<td>• Tax on gambling businesses</td>
<td></td>
</tr>
<tr>
<td>• Miscellaneous taxes: subsoil use, minerals</td>
<td>• Regional license fees</td>
<td></td>
</tr>
<tr>
<td>extraction, hydrocarbons income, biological</td>
<td></td>
<td></td>
</tr>
<tr>
<td>resources use, forest, water, ecological</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


The code retains the three existing taxes on property: the property tax on legal entities (previously the property tax on enterprises), the individual property tax, and the land tax. It also provides that these taxes will not be levied if regional governments choose to impose the real estate tax.

The Tax Code retains the tradition of treating legal entities and individual taxpayers differently for all taxes. Although the real estate tax will be payable by both, the rights and obligations, as well as the administrative procedures, will vary in accordance with part I provisions of the code and Tax Ministry procedures.

The centralized administrative structure of the tax system is preserved. For most of the 1990s the State Tax Service (STS) was responsible for tax collection and administration of all taxes except customs taxes and extrabudgetary revenues. Originally within the Ministry of Finance, which was responsible for tax policy and federal budget preparation, the STS had been given autonomy as a federal agency with ministerial ranking. The STS has offices at the federal, regional, and local levels throughout the federation. Eighty-eight regional STS directors supervise the local offices and report to the central office, which has no direct assessment responsibility. Taxes are collected at the lowest levels and passed upward.

In December 1998 a presidential decree restructured the federal executive branch, establishing the new Ministry of Taxes and Assessments that vested the former STS with new powers to increase tax collections. Reforming the tax system to make it simpler, fairer, and more transparent; to root out corruption and the culture of nonpayment; and to improve its administrative effectiveness have been key requirements of the International Monetary Fund in approving future financial support for Russia (Camdessus 1999).

The Development of Land and Building Taxation

Taxes on property were included in the new tax structure introduced in Russia in the early stages of transition to coincide with extensive privatization efforts. The taxes maintained the traditional separation of property (including buildings and other tangible assets) from land, which was treated as a form of natural resource. Land had no value under communism except in its productive capacity. In 1991 separate taxes were established on the property of enterprises (legal entities) (also referred to as an “assets tax on enterprises” or as a tax on the “property of legal persons”) and of individuals (also referred to as a tax on the “property of physical persons”). During the same period, the Law on Payment for Land was enacted authorizing payments in the form of rent, taxes, or purchase price.
Each of these three taxes (on property of enterprises, on property of individuals, on land) is governed by separate legal provisions that specify the taxpayers, the objects of taxation, exemptions, rates and methods of computation, payment requirements, and the budgets to which the tax revenues are to be assigned. Rates have increased, but other provisions have remained virtually unchanged since 1991, except the Law on Enterprise Property Tax, which eliminated money in cash and on account from the asset tax base. These taxes remain in the 1998 Tax Code.

None of these taxes is levied on the basis of market value. The property tax on enterprises raises the largest amount of revenue, but collection rates are low, around 60 percent (table 6.3). The proceeds of the enterprise property tax are shared between regional and local governments. The revenues from the property tax on individuals and land taxes have been insignificant because of low rates, numerous exemptions, and the effects of inflation, although collection rates are higher. As the assignment of taxes and tax revenues set forth in the Basic Principles of Taxation has never been fully implemented, shares of tax proceeds are negotiated between federal and subnational governments, which then negotiate local allocations. The federal budget still receives a portion of land tax and land rent payments, although the land tax was intended to be local government revenue. Only the tax on property of individuals stays entirely at the local level (tables 6.4 and 6.5).

**Current System of Taxation**

**TAX ON PROPERTY OF ENTERPRISES.** The property tax on enterprises is a tax on the book value of assets, equipment, inventory, vehicles, and structures, using a Soviet form of accounting that is no longer consistent with economic realities. A maximum rate of 2 percent of the book value may be levied, but regional governments may establish a lower rate. The place of registration of the enterprise rather than the location of its buildings and assets determines which budget receives the revenues. Enterprises and other legal entities compute their own taxes in accordance with STS instructions, paying in two installments, with final accounting at the end of the tax year. Auditing of enterprise accounts is limited, because of the difficulty of evaluating replacement costs and depreciation taken from normative amortization schedules. Since 1994 enterprises have

| Tax on property (assets) of enterprises | 15,900.0 | 36,500.0 | 46,800.0 | 45,900.0 | 51,400.0 |
| Tax on property of individuals | 138.1 | 290.3 | 441.8 | 528.4 | — |
| Land tax and land rent | 3,265.6 | 5,262.3 | 9,435.9 | 11,027.0\(^a\) | 21,890.0\(^b\) |

---

3. Collection statistics are based on the anticipated revenue budgeted (and anticipated from prior collections). A collection rate of 69 percent was reported in 1997 and of 60 percent in 1998.

4. Land tax and land rent revenues are combined in revenue report statistics. According to the federal Budget Law, these revenues are typically divided among the federal, regional, and local budgets 30:20:50. The shares vary according to particular arrangements. For example, the city of Novgorod retains both the regional and local shares (70 percent) of land revenues. The Novgorod oblast replaces the lost revenue with other taxes and charges.
Table 6.4. Typical Shares of Land and Property Taxes among Federal: Oblast: Local Budgets, 1995–99

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on property (assets) of enterprises</td>
<td>0:50:50</td>
<td>0:50:50</td>
<td>0:50:50</td>
<td>0:50:50</td>
<td>0:50:50</td>
</tr>
<tr>
<td>Tax on property of individuals</td>
<td>0:0:100</td>
<td>0:0:100</td>
<td>0:0:100</td>
<td>0:0:100</td>
<td>0:0:100</td>
</tr>
</tbody>
</table>

Note: Sharing rates are the same for land rent as for the land tax.
Source: Federal law for federal shares; the budget laws of each of the federation subjects.

...been permitted to hire independent appraisers to prepare the cost and depreciation amounts for asset tax calculations. These appraisers have generally reduced their clients' profit or asset tax burdens by adjusting asset values and amortization.

TAX ON PROPERTY OF INDIVIDUALS. Individuals who own buildings and structures are taxed at a maximum rate of 0.1 percent of the inventory value established by the Bureau of Technical Inventory (BTI) or at the compulsory insurance value. Certain vehicles, not including automobiles taxed on the basis of engine power, are also included in the property tax base. Inflation indexes applied by some regional governments may have created even greater disparities in relation to a market value tax base. While most values for purposes of the tax are well below market values, inflation adjustments have increased the values (and taxes) of houses in rural areas in excess of observed market prices. Nevertheless, the 0.1 percent rate is so low that the amount due is less than the cost of collection.5

Seeking additional revenues, in June 1999 the State Duma approved increasing the tax on housing to between 0.1 and 2 percent of its BTI value. The higher rate may be applied by local governments to properties of higher value according to BTI value ranges set by the law. Although this is likely to increase taxes on apartments, which are automatically registered at privatization (especially on newer construction valued closer to market value by the BTI), the problem of collecting on unregistered, unfinished buildings remains. Much valuable new real estate escapes taxation by remaining “unfinished” and thereby unregistered by BTI. The Tax Ministry estimates that there are more than 5 million uncompleted houses that pay no taxes (Interfax Russian News 1999, August 17).

TAX ON LAND. Land taxes have a somewhat different structure than the other two taxes. Average rates per hectare for rural land and per square meter for urban land were established by law in 1991. The rates have been increased by annual coefficients in an effort to maintain revenue during monetary inflation, but have always underestimated inflationary increases. Within these average rates, legislative bodies of the federation “subjects” were authorized to fix minimum rates for various types of rural land and to set different rates for various economic and geographic zones of urban land. Land occupied by housing is limited to a tax of 3 percent of the zone rate.

In late 1998 the government proposed, and then canceled, an increase in land tax rates, but the 1999 federal budget law doubled the rates by specifying that a coefficient of 2 be applied to the rate schedule. The Revenue Ministry reported an increase in revenues of Rub 4.2 billion in the first three quarters of 1999, representing approximately 80 percent growth in the proceeds.

5. Moscow oblast gave up collecting the tax, because the cost of mailing tax bills exceeded the proceeds from the tax. The property tax on a two-room privatized apartment in a 12-year-old building is reported to be Rub 15 to Rub 20 (less than US$1) at most, according to Kochetov (1999).
Table 6.5. Proceeds of Land and Property Taxes as a Percentage of Budget Tax Revenue, 1995–99

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td><strong>Consolidated budget</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax on property of enterprises</td>
<td>4.40</td>
<td>7.70</td>
<td>8.00</td>
<td>8.40</td>
<td></td>
</tr>
<tr>
<td>Tax on property of individuals</td>
<td>0.04</td>
<td>0.06</td>
<td>0.08</td>
<td>0.10</td>
<td></td>
</tr>
<tr>
<td>Land tax and land rent</td>
<td>0.90</td>
<td>1.10</td>
<td>1.60</td>
<td>2.00</td>
<td></td>
</tr>
<tr>
<td><strong>Federal budget</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax on property of enterprises</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax on property of individuals</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land tax and land rent</td>
<td>0.11</td>
<td>0.19</td>
<td>0.44</td>
<td>0.45</td>
<td></td>
</tr>
<tr>
<td><strong>Regional and local budgets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax on property of enterprises</td>
<td>8.40</td>
<td>14.30</td>
<td>14.20</td>
<td>14.90</td>
<td></td>
</tr>
<tr>
<td>Tax on property of individuals</td>
<td>0.07</td>
<td>0.11</td>
<td>0.13</td>
<td>0.17</td>
<td></td>
</tr>
<tr>
<td>Land tax and land rent</td>
<td>1.63</td>
<td>1.90</td>
<td>2.54</td>
<td>1.99</td>
<td></td>
</tr>
<tr>
<td><strong>Local budgets (Novgorod Veliki)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax on property of enterprises</td>
<td>5.39</td>
<td>11.87</td>
<td>12.00</td>
<td>13.35</td>
<td>10.29</td>
</tr>
<tr>
<td>Tax on property of individuals</td>
<td>0.05</td>
<td>0.10</td>
<td>0.14</td>
<td>0.18</td>
<td>0.13</td>
</tr>
<tr>
<td>Land tax and land rent</td>
<td>6.70</td>
<td>5.58</td>
<td>8.94</td>
<td>8.21</td>
<td>9.85</td>
</tr>
</tbody>
</table>

— Not available.
a. The city retains both the regional and local share of these revenues.

*Source:* Calculations based on annual collection data from the State Tax Service and budget information from the Federal Treasury and city of Novgorod Veliki.

The land tax rate is the basis for setting the standard price of land, which was set at 200 times the land tax rate per square meter of land unit area (modified in 1994 to control prices and local government discretion). The locally established indexes have been found typically to exceed market value estimates, for example, Novgorod applied a multiplier of 200 in 1997 and 150 in 1998. The purposes of the law were to raise revenue and to encourage rational private land uses. The federal, regional, and municipal budgets receive the designated shares of land rent and land tax proceeds (tables 6.4 and 6.6), but local governments have greater flexibility in establishing rental rates, which are used as instruments both for budget revenues and for encouraging business growth.

**Implementation**

The STS calculates taxes for individuals and delivers tax bills annually before August 1. The taxes are payable locally in two equal sums, before September 15 and November 15. Enterprises calculate their own land taxes and pay in two installments. Taxes are paid locally and the shares of the proceeds are passed up to the higher levels of government.

Legislation passed in 1999 charges the State Committee on Land with the duty to conduct a new valuation on land by 2002, to be financed by the federal portion of land rents and taxes (Law on State Cadastre, effective January 1, 2000).

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6. The Conformity with Land Charges Act decree regarding the normative price of land specified that the Land Committee may recommend and the government may adopt land valuation zones for different land uses and establish progressive coefficients to the amount of the normative land price, but the amount of the normative land price must not exceed 75 percent of the level of market prices for land parcels in corresponding areas. City administrations may increase or decrease normative land prices, but not by more than 25 percent.
Table 6.6. Total Land Tax and Land Rent Revenue of Corresponding Budgets, 1995–99
(rubles millions)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal budget</td>
<td>186.9</td>
<td>422.5</td>
<td>1,070.4</td>
<td>1,070.9</td>
<td>3,270.0</td>
</tr>
<tr>
<td>Regional and local budgets</td>
<td>3,078.7</td>
<td>4,839.8</td>
<td>8,365.5</td>
<td>6,143.0</td>
<td>14,563.0</td>
</tr>
<tr>
<td>Consolidated budget</td>
<td>3,265.6</td>
<td>5,262.3</td>
<td>9,435.9</td>
<td>7,213.9</td>
<td>17,833.0</td>
</tr>
</tbody>
</table>

Note: In 1995, 1996, 1997 land tax and land rent were included in tax budget revenues. In 1998, 1999 land rent was excluded from tax revenues and considered as nontax budget revenues.

Source: Federal Treasury data.

The current taxes are not efficient in terms of revenue generation, and they have other serious drawbacks. The tax on enterprise assets inhibits internal modernization. Land payments for taxes and rent are unrelated and change frequently, discouraging investment and efficient land utilization. Higher taxation of buildings than of land discourages renovation and new construction. The administration of individual property taxes generally exceeds its proceeds, and the continued use of BTI inventory values based on size without reference to location within a jurisdiction results in significant inequities in taxation. The wide disparity between individual and legal entities’ property tax burdens has spawned widespread illegal registration of property ownership.

**Pilot Projects to Introduce Market Value-Based Property Taxation**

**USAID Technical Assistance Project**

The many deficiencies of the system have been recognized in studies of intergovernmental fiscal relations, housing, property rights, and land use. The general conclusion has been that a market value basis for property taxation should be introduced as soon as is practically feasible. As a result, the development of such a system for cities in the Russian Federation was among the technical assistance projects initiated by the U.S. Agency for International Development (USAID). Initially, the property tax project was considered an integral part of land privatization and real estate market development efforts. The 1995 task order for the project stated that its purpose reflected “the Russian Government’s aim of modernizing the existing property tax system in order to improve land relations, to provide municipal financing for local infrastructure and public works, and to stimulate private investment in various economic sectors of the country” (USAID 1995, p. 1). By the end of the year, objectives had been broadened to integrate the project into the general tax reform objectives of the Russian Federation and the USAID program. This development turned a relatively modest demonstration project into a full-scale tax experiment that would require complete data collection, property valuation, assessment, tax billing, and collection in at least one pilot city.

The USAID-funded property tax experts, in consultation with the relevant Russian organizations, developed the conceptual and technical framework. The objectives were to develop the necessary legal basis for an *ad valorem* real property tax, to identify appropriate pilot cities in which to develop the experiment, and to create a computer-assisted information management and mass appraisal system and the requisite administrative structure to enable the pilot cities to carry out each function necessary for an effective modern property tax system. Training of Russian personnel to administer the tax system and education of taxpayers and public officials were important components of the program, as was the publication of a “roll-out” manual to serve as a
guide and reference to other jurisdictions wishing to implement a market value-based property tax system in the future. The USAID project team included Russian experts in real estate economics and valuation and a consortium of international experts in the legal, technical, and administrative aspects of property tax systems. One goal of the project was to train Russian property tax experts.

The Experiment in Two Russian Cities

The cities of Novgorod Veliky and Tver were selected as the pilot sites in November 1995, and memoranda of understanding were signed with the oblast governors and the cities' heads of administration. Among the important criteria used in the selection process were significant privatization of enterprises, both land and residential properties, reform-minded government officials willing to commit to the program's objectives, and participation in property titling and registration reform through a prior real estate information system project. In early 1996, Novgorod oblast and the city of Tver appealed to the Russian government for authority to implement a market value-based property tax as an experiment.

A government decree in February 1996 formalized an interministerial working group headed by Deputy Minister of Finance S. D. Shatalov to prepare the concept of the real estate tax implementation in the Russian Federation. The working group consisted of representatives of the ministries of Finance, Construction, Economy, and Justice; the STS; the State Property Committee; the Russian Privatization Center; the Land Committee; and the mayors of the pilot cities. USAID and project officers participated in working group meetings.

The group developed guidelines and objectives for the introduction of the new tax that included revenue neutrality and retention of existing budget-sharing agreements between federal and regional governments at the time of the transition to a unitary real estate tax. The group was responsible for developing recommendations and gaining support for special legislation at the federal level to authorize the experiment. In 1997 and 1998, central government changes resulted in some adjustments to the group's membership and tasks, and in 1999 matters related to the experiment were consolidated under the direction of A. P. Pochinok, minister of taxation.

The international and Russian project team carried out the legal, administrative, and technical tasks required to develop the property tax system with the assistance of local personnel. In the pilot cities, local representatives of the property-related agencies, as well as the STS, were organized into administrative working groups to plan, coordinate, and carry out project activities. This was necessary because the BTI and the Land Committee, which held the greatest amount of property data, and the STS were not under the jurisdiction of the city administrations.

The practical problems in developing the new system were considerable. The information needed to construct a property tax cadastre was located in many different agencies. Building data maintained by the BTI needed to be linked to land records of the Land Committee and assigned a common property identification number. Market-sensitive data, such as property use and the condition of nonresidential property, were not included in the BTI inventory. The property inventory of the major industrial and commercial enterprises was not recorded by the BTI, and extensive field inspection needed to be undertaken. This fieldwork expanded the property base significantly. Maps were under the control of the Geodesy and Mapping Agency. Because foreigners were prohibited by law from possessing land maps and land coordinates were intentionally

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7. A consortium managed by the Center for Financial Engineering, Washington, D.C., with Dr. Joseph Eckert of National Economic Research Associates as chief of party and technical leader, was joined by the Center for Real Estate Analysis directed by Dr. Natalia Kalinina, as Russian project manager. In 1998 the project continued under the USAID Tax Reform Project directed by Georgia State University.
“distorted” to protect state secrets, special tax maps had to be organized to identify locational relationships.

In addition to physical descriptions, the various legal rights to property needed to be identified at a time when new laws on registration of property rights were being introduced and no central registry existed. It was not acceptable under Russian law to assign tax liability to the property itself (in rem). Thus the development of the cadastre was more complicated, because tax lists of legal and individual taxpayers could not be matched readily with property and land registration records. This also made tax impact analysis difficult.

Information access and integration as well as institutional coordination were major challenges, requiring sustained local leadership and commitment to maintain interagency cooperation and meet work schedule goals. Such practical problems led the project team to design a new modular-based software package for property tax information rather than attempting to customize a foreign package designed for a different institutional setting.

The USAID project provided each city with the software and hardware for constructing a property tax information management system. The system was designed to include interrelated modules to perform all the functions needed for assessment administration, including data entry and maintenance, mass appraisal, assessment, and statistical analysis (see Eckert 1998). On-site project staff installed the systems in Tver with assistance of city employees, beginning with the data management and valuation modules. The real estate information system previously installed for property registration purposes was used as the initial data source. Mathematical valuation models were designed and tested for different property types (apartments, detached houses, and industrial and commercial properties). These systems were then introduced in Novgorod Veliky by city employees, with technical visits and advice from project staff.

Implementation: Legal and Political Issues

In July 1997 the Law on the Property Taxation Experiment in the cities of Novgorod Veliky and Tver was adopted by the Russian State Duma, approved by the Federation Council, and signed by President Yeltsin. The law granted authority to the two cities to establish a tax on real property, to determine the valuation methodology and the tax rates, and to implement the tax in 1997-98. The law defined all real property as taxable, except property exempted under foreign treaties, and limited the assessment of residential property to no more than 50 percent of its market value. Local dumas were given the right to grant additional exemptions. The law also suspended the existing taxes on land, property of enterprises, and property of individuals in the cities when the local legislative body approved the new tax. The passage of this law made it possible for officials of the two cities to begin serious deliberations in preparation for drafting the local regulations necessary to go forward with the experiment.

Tax impact studies prepared in both cities indicated that a relatively high level of taxation for commercial and industrial property would be necessary to replace the revenues of the suspended taxes. The existing enterprise property taxes include inventory and some movable property as well as real estate, and are taxed at an amount up to 2 percent of their asset balance sheets. In a number of cases, current asset worth under the Soviet-era accounting system exceeded market value. The current individual property tax rate, in contrast, is negligible at a mere 0.1 percent of BTI inventory value. The impact analysis focused debate on what level of taxation was supportable for individual property taxes and the cost of exemptions, privileges, and tax benefits, as well as the need to examine other budget components, particularly land leases and housing rents and subsidies.

To maintain revenue neutrality and budget-sharing agreements and minimize increases for small businesses and residential taxpayers, the city of Novgorod Veliky concluded that the new market value-based taxes could not be implemented abruptly and simultaneously. Replacement
of all three existing taxes with the market value-based tax on real property would result in both substantial budget revenue decreases and dramatic shifts in tax burdens, which were not acceptable outcomes (see tables 6.7 and 6.8).

City officials, therefore, began designing a concept and plan to soften the impact by establishing the timetable and means by which the current taxes were to be replaced and to identify which taxpayers would be affected during a transition period. They proposed that the law authorizing the experiment be amended to permit local flexibility and an extended period of time for implementation. Both the interministerial group and USAID approved this proposal; it was considered an advantage that the transition concept could be designed at the local level and reflect the characteristics of each municipality.

During this period, the technical preparations by the administrations in Novgorod Veliky and Tver, with the support of project advisers, reinforced the local commitment to implementation. Assessment notices were issued in April 1999 to all Novgorod Veliky enterprise owners with property subject to the new real property tax, and taxpayers were given opportunities to review and discuss their values, the first test of an informal appeals process still in its design stage.

The draft amendment to permit these changes and extend the time for implementation was submitted to the Russian government in October 1998 and approved by the State Duma in June 1999. Initially rejected by the Federation Council, it was finally passed and signed by President Yeltsin in November 1999. During deliberations, the bill was modified to include maximum tax rates that could be set by the local governments. The law now provides for continuation of the experiment through 2003, with the procedures and timing for replacing the taxes on land, property of enterprises, and property of individuals to be determined by the representative bodies of the local governments. The tax sharing arrangements between the federal, oblast, and local governments remain unchanged. The maximum real property tax rates are apartments, detached houses, residential units, and dachas, 0.5 percent; garages (for one or two cars), 1 percent; real estate used for industrial production, 2 percent; and all other real property, 5 percent.

First Steps

The Novgorod oblast Duma adopted a law on December 29, 1999, authorizing implementation of the real property tax experiment in Novgorod Veliky. The city Duma adopted the legal acts to

Table 6.7. Estimated Changes in Tax Burdens for Legal Entities, Examples from Novgorod Veliky, 1998

<table>
<thead>
<tr>
<th>Sector</th>
<th>Building area (sq. m.)</th>
<th>Assessment of building, market value (rubles)</th>
<th>Land area (sq. m.)</th>
<th>Assessment of land at market value (rubles)</th>
<th>Total asset tax: market value of property (rubles)</th>
<th>Land tax: total estimate for 1998 (rubles)</th>
<th>Current property tax totals (rubles)</th>
<th>Current payments/rate of real property tax payments ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Machine building</td>
<td>2,660</td>
<td>957,227</td>
<td>13,317</td>
<td>862,942</td>
<td>36,403</td>
<td>20,400</td>
<td>73,182</td>
<td>2.01</td>
</tr>
<tr>
<td>Construction</td>
<td>2,116</td>
<td>2,262,177</td>
<td>5,169</td>
<td>500,993</td>
<td>55,263</td>
<td>8,187</td>
<td>56,436</td>
<td>1.02</td>
</tr>
<tr>
<td>Printing industry</td>
<td>4,328</td>
<td>2,411,628</td>
<td>7,879</td>
<td>1,089,693</td>
<td>129,974</td>
<td>12,420</td>
<td>142,394</td>
<td>2.03</td>
</tr>
</tbody>
</table>

Note: The tax burden varies significantly by industry and by enterprises within an industry.
Source: Center for Real Estate Analysis, Novgorod Veliky.
introduce the tax on January 28, 2000. The first stage, implemented on January 31, replaced the enterprise property tax and land tax with a 2 percent tax on the market value of real property for those enterprises that own both the land and improvements. Enterprises leasing land continue to pay land rent and the full assets tax on inventory and movables at the 2 percent rate. This change affects only a small group of taxpayers, with relatively small land plots, who will benefit from a reduction in taxes. In part, the rationale is to encourage other enterprises to purchase their land and increase the demand (and value) of municipal land now under lease. If this occurs, the purchase prices paid to the city will compensate for the loss of the enterprise tax revenue.

It is intended that the real property tax will be extended to property of individual taxpayers in 2001, at a rate of 0.1 percent of market value for residential property, 0.5 to 1 percent for garages, and 2 percent for other property. This will be an increase in the individual tax burden, but the change will not be implemented until 2001, after the 2000 elections. In 2002 and 2003 the intention is to apply the new tax to all taxpayers. At this stage, the hope is that increases in real property values will compensate partially for the removal of the tangible assets of enterprises from the tax base, but land rents will likely be increased to make up the shortfall.

In Tver, initial preferences were to retain the assets tax and initially replace only the land tax and the individual property tax with the real property tax on property owned by individuals.

In preparing for implementation, the property tax departments in Novgorod Veliky and Tver refined valuation models and conducted field review and quality control measures. The valuation models were decomposed into formulas with base values per square meter and various adjustment coefficients and then presented to the Novgorod Veliky Duma for official approval, in accordance with Russian legal requirements that mandate legislative approval of both tax base and rates. Regulations on the methodology for valuation and the procedure for resolving appeals were also adopted by the city Duma.

This experiment has demonstrated that a legal and administrative structure can be developed for Russia. Mass appraisal models, using available information, can recognize and reflect the evolving real estate market and produce reasonably accurate valuations for equitable taxation, and local government officials can manage the tasks necessary for assessment administration (Kalinina and Gulyaeva 1999 provide a detailed description of the valuation methods and experiment results). Moreover, the implementation of this new tax represents a major political accomplishment by local officials in the Russian environment.

The full benefits of the substantial investment of time, effort, and money in the property information base and valuation, as well as in staff development and administrative organization, will not be realized until the tax is fully implemented. Nevertheless, these efforts have contributed to regional progress toward strengthening real estate markets, stimulating privatization,
institutionalizing democratic reforms, and developing a potentially expanding revenue source for local government.

Current Issues and Future Developments

The General Economic Reform Agenda

Russia's progress in making the transition was slowed by the domestic and global monetary crises of 1997 and 1998 that threatened its stability and economic growth, although its economic performance has improved, according to the International Monetary Fund (Camdessus 1999, p. 2). Nevertheless, there is "a long road of reform lying ahead" (Camdessus 1999, p. 6) that requires changes in public and corporate governance to foster transparency, accountability, and adherence to the rule of law that will create a more secure and attractive environment for the return of Russian savings from abroad and encourage international investment. This call for structural reforms echoes the Organisation for Economic Co-operation and Development's 1997 recommendations: "The revival and sustained growth of the economy should be promoted through renewed efforts to enforce the rule of law, enhance competition, improve the budgetary process, strengthen capital markets, facilitate bankruptcies and liquidations, reform the tax system, and attract foreign investment" (OECD 1997, p. 22).

Among the reforms needed are those to improve fiscal relations between levels of government; current arrangements do not permit retention of increases in locally raised revenues. There is little incentive to improve local revenue capacities when the proceeds must be shared with higher levels of government. A market value-based tax on real property that provides a potentially expanding source of revenue for regional and local governments may offer greater incentives for intergovernmental finance reforms and further other needed basic tax and institutional reforms.

The Future of Property Taxation

The pilot projects have demonstrated that a broad range of policy considerations can arise in the development of a market value-based property tax. These issues include new economic expectations in the use and allocation of land and in the role of public versus private sectors in economic growth and development. The ability of local self-governments to exercise independent judgment and fiscal management, to balance revenue needs against political risks, and to incorporate considerations of tax burden sharing, taxpayer fairness, and financial predictability have all been demonstrated. Concepts of fairness, transparency, and accountability have been explored.

The substantial political, administrative, and technical efforts needed to bring these pilot experiments to implementation have placed a greater burden and larger expectations on the local governments of Novgorod Veliky and Tver than would have been expected in a nationwide implementation. The political courage required of local officials to be guinea pigs for the introduction of a new tax may result in both its risks and its benefits being overstated. Nonetheless, in a nation as large and diverse as Russia, such experiments seem prudent before making a new concept such as market-based taxes on real estate universally applicable. Until the experiments are fully implemented and the model disseminated to other localities, a full analysis of the benefits and costs of this approach will not be possible. Nevertheless, various central government ministries and regional governments are following closely the developments in Novgorod Veliky and Tver to decide whether a property tax system, based on the experiment, should be replicated in other municipalities. A conference in Novgorod Veliky is being planned to disseminate information and lessons learned from the project to other local government in northwest Russia.

Hampering property tax reform are the still unresolved matters of property rights and land ownership, the incomplete registry of real properties, and the number of agencies that have control
over segments of property-related information. In addition, the project has identified real estate appraisal, property tax administration, and the legal framework for real property taxation as areas in need of change or improvement.

**Real Estate Appraisal.** The federal Law on Appraisal Activity in the Russian Federation provided strong support to single property (fee) appraisal by requiring independent appraisals for many transactions, including lease contracts. Under the law, federal, regional, and local governments are not permitted to appraise property for privatization, rent setting, and other purposes. Although valuation by public officials is not prohibited for tax purposes, the government may be disadvantaged in disagreements with taxpayers who engage private appraisers to estimate their assets tax base. The use of mass appraisal techniques has been viewed as undesirable competition by private appraisal groups, largely because of confusion about mass appraisal and its uses. The techniques applied in Novgorod Veliky and Tver have demonstrated that emerging markets can provide information adequate for market value models, and that mass appraisal was both efficient in time and cost and sufficiently reliable for tax base assessment.

The demonstration of tax base estimates from a fiscal cadastre has provoked interest in mass appraisal techniques for rent-setting purposes. St. Petersburg increased its rent revenue by Rub 480 million in 1998 by changing to market-oriented mass appraisal for nonresidential properties. The method has been declared part of official policy by the Ministry for Management of State Property. Additional official recognition of mass appraisal and education in its techniques and applications would be helpful.

**Property Tax Administration.** The system of land and building tax administration is inefficient and costly. The Tax Ministry (formerly the STS) delivers tax bills to individuals by hand, requiring signature of the receipt in order to enforce payment. Legal entities assess their own assets and calculate their taxes, but tax administrators have no independent basis or capacity for determining accuracy. Tax obligations are listed by taxpayer name, not by property identification.

When the experiment was implemented in Novgorod Veliky, the city administration issued assessment notices, but the responsibility for calculating the taxes remained with the taxpayers, who applied the tax rate to the assessed value. Tax authorities will track compliance and accuracy in tax returns and eventually establish a tax record base related to property. This approach saves the cost of delivering tax bills and concentrates on compliance monitoring, while the city will eventually be able to identify properties without taxpayers and begin attachment procedures. These new property-based records will have the benefit of moving *in personam* taxation toward *in rem*, within Russia’s existing legal framework. Whether or not this or other changes will be adopted, the search for more efficient and effective tax administration is of high importance.

**Legal Framework for a Real Property Tax.** The implementation of the new tax in Novgorod Veliky faces legal challenges based on perceived inconsistencies between local laws and various federal laws. It is expected that further amendments will be required for the experiment to proceed to its next stage. In addition, it is anticipated that part II of the Federal Tax Code, when adopted by the State Duma, will include the legal framework for the “real estate tax.” Part I of the 1998 code designates it as a regional tax that will replace the land tax, assets tax, and individual property tax when enacted by the regional government. This differs from the law governing the experiment in Novgorod Veliky and Tver, which assigns the real property tax to local governments.

The code reflects renewed interest among oblasts in the market-based tax on property as a more reliable and expanding revenue source and as a component of investment initiative packages for international investors. Increased revenues are needed to replace the decrease in
subnational shares of the VAT, and from possible reductions in the corporate income tax, and results have been disappointing from the new sales taxes, which have been difficult to collect. Some oblasts are not yet ready to accept greater financial independence for their local governments, but others may allocate the tax to cities and raions within their territory.

Under the code, enactment of the real estate tax will eliminate the land tax and the individual property tax, thereby removing important revenue sources from local government and reducing their fiscal independence. Although it is expected that the oblasts will assign the proceeds of the real estate tax mainly to local governments, it would be desirable to establish the minimum share in part II of the code, at least for an introductory period. In the long run, a more transparent process that would ensure a stable annual local revenue source would be preferable to annual negotiations over allocation of tax shares.

Administrative considerations also need to be addressed, such as the placement of property register and valuation functions and the development of an appropriate administrative appeal process. Notwithstanding these issues, it now appears likely that a market value-based real estate tax will be among the tax reforms permitted by the new Tax Code.

Appendix: Other Taxes Applicable to Real Property

Municipal rent revenues charged to both legal entities and physical persons have attributes of taxation, because local governments establish the rents and the revenues are used for public services and general development purposes. Rental rates are determined with budgetary needs, and sometimes economic investment incentives, in mind, rather than on the basis of competitive market rental rates, although market considerations have begun to force their way into the equation. Municipal officials have to balance the loss of this stable revenue source against selling and taxing these properties in less than optimal markets. However, the staggering maintenance needs of buildings and the amount of subsidized municipal housing units that remain throughout the federation will continue to drain municipal budgets and argue for privatization of many of these costly assets.

Real property is subject to inheritance and gift taxes when the total value exceeds Rub 850 or 80 times the monthly minimum wage, respectively, and is taxed at between 5 and 20 percent of BTI normative values. Inheritances and gifts within the immediate family are exempt.

References and Bibliography


Property Taxation in Armenia

Richard Almy with Varduhi Abrahamian

General Background

Armenia, founded in the third century as a Christian state, endured centuries of rule by the Ottoman, Persian, and Russian empires until the end of World War I. Following the Bolshevik revolution in 1918, an autonomous state was established for a brief time in the eastern part of Armenia in what had been part of the Russian Empire. Independence was lost to Russian control in November 1920. Status as a separate republic within the USSR was granted in 1936, but potential for conflict was created by placing mainly Armenian regions within the borders of Azerbaijan.

With the collapse of the Soviet Union, the Republic of Armenia declared its independence in 1991. Conflict with Azerbaijan over the Armenian region of Nagorno-Karabakh drained economic resources and created a refugee problem. In addition to these economic disruptions, Armenia had suffered a devastating earthquake in 1988. As a result, the country's only nuclear power plant was shut down as a precautionary measure.

At the same time, unrest in the Republic of Georgia and historic enmity toward Turkey disrupted trade and added to the energy, fuel, housing, and food shortages that idled Armenia's research and manufacturing industries, especially during severe winters in 1992 and 1993. Real gross domestic product (GDP) declined more than 60 percent during this period, and Armenia experienced hyperinflation in 1993, largely because it remained in the Soviet ruble zone.

By 1994 economic conditions had begun to improve. Armenia was one of the few countries of the former Soviet Union to report economic growth that year. The restarting of the nuclear power plant improved the power situation. A cease-fire with Azerbaijan permitted improved trade with Iran and Turkey, and greater stability in Georgia resulted in improved trade with that country as well.

Armenia is a landlocked country with a land area of 29,800 square kilometers and a population of 3.7 million, of which about 70 percent is urban. About one-third of the population lives in the capital city of Yerevan.

Postcommunist Reforms

Since independence, Armenia's government has pursued wide-ranging democratic and market reforms, although they often clash with the country's international and economic instability. Needs outstrip resources, and prioritizing needs is extremely difficult. As a result, changes in reform initiatives are frequent and many institutions are in a perpetual state of transition.

Monetary and Fiscal Reforms

In November 1993 Armenia established an independent central bank, introduced the dram to replace the ruble, and began pursuing a tight monetary policy. Inflation was reduced to about 8 percent by 1998, and Armenia has pursued a price liberalization program.

To introduce a tax system capable of supporting the government in a market economy, Armenia created the State Tax Inspectorate (STI) in 1991 (now the State Revenue Ministry); enacted the
basic Law on Taxes and Duties in 1992; and introduced the enterprise profits tax, personal income tax, and value added tax (VAT) in 1993. A tax on land was introduced in 1994 and a separate tax on property in 1995. The growth of a large underground economy was estimated at more than 36 percent of GDP calculated on a factor cost basis and at more than 44 percent on an expenditure basis in 1996 (EIU 1998). Corruption and the lack of a taxpaying culture also contributed to lost revenue potential. In just one year, from 1993 to 1994, tax revenues declined from about 16 percent to about 13 percent of GDP. Arrears totaled approximately 20 percent of collections.

To address these problems, changes were made to the VAT and excise tax laws in 1997 that shifted collection from the vendor to the buyer. This change encouraged domestic exports, and fully taxing imports at the border resulted in an estimated 20 percent decline in the underground economy. Other reforms included revised profits tax and property tax laws to create a more favorable climate for industry and to stimulate investment. The new property tax law removed inventory from the tax base, and the revised profits tax provided lower, progressive rates for enterprises. The 1997 reforms produced dramatic results: a 59 percent increase in revenue from VAT and excises. Overall, since 1996 tax revenue has nearly doubled (table 7.1). Budgeting and financing procedures were also reformed in 1997 with the adoption of the Law on the Budgetary System.

Devolution

Armenia has begun to break down the centralized power structure of the Soviet era. A new constitution was adopted in July 1995. The National Assembly then approved the Law on Territorial Administration creating new regional governments (marzer), which in many respects are administrative units of the central government. In 1996 the Law on Local Self-Government established genuine local governments (hamainkner or communities). There are 11 marz (down from 38 administrative districts) and 930 urban and rural communities (about the same number as before, but the number of council members is drastically reduced). Yerevan, with a population of 1.2 million, has special status and is treated as a marz with 12 neighborhood communities.

(dram millions)

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<td>73,775</td>
<td>89,911</td>
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<td>VAT</td>
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<td>Excise</td>
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<td>2,388</td>
<td>11,323</td>
<td>18,679</td>
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<td>900</td>
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<td>490</td>
<td>623</td>
<td>3,915</td>
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<td>0</td>
<td>210</td>
<td>608</td>
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<td>Nontax revenue</td>
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<td>17,997</td>
<td>19,575</td>
<td>14,473</td>
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<tr>
<td>Grants</td>
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<td>19,031</td>
<td>9,671</td>
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<td>9,058</td>
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<tr>
<td>GDP</td>
<td>187,065</td>
<td>522,256</td>
<td>660,310</td>
<td>798,555</td>
<td>951,901</td>
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Note: Dram 506 are approximately equivalent to US$1.
Source: International Monetary Fund data.
The Law on Local Self-Government establishes many recognized principles of local government, including subsidiarity. Communities have locally elected leaders with specified powers and duties, making possible greater efficiency, accountability, and transparency. Communities are headed by an elected council and an elected chief (mayor or deputy mayor in cities). The law establishes state-delegated, mandatory, and voluntary powers. The first two must be funded and performed regularly. Voluntary powers depend on the availability of resources. In addition to regular activities, such as budgeting and finance, communities must provide a variety of communal and cultural services, including land use planning and control; business regulation; and the operation and maintenance of utilities, roads, and publicly-owned buildings. Some social services, such as health and primary and secondary education, remain the responsibility of the central governments and the marz.

The law also establishes the principles of appropriate revenue assignment and gives communities limited fiscal autonomy. Communities have a dedicated source of revenue in that they receive 95 percent of land and property taxes, as well as subventions and other autonomous sources of revenue, such as user charges and fees. Thus far, lease fees from municipal property have not emerged as a crucial source of revenue, because privatization reforms preceded local government reforms.

Establishment of Private Property Institutions

Armenia has been developing the institutional framework needed to establish, protect, and facilitate the transfer of privately owned real property.

Legal Framework

Much of the legal framework needed to establish private property rights has been created. The constitution establishes the right for citizens to own real property. The Land Code, adopted in 1991, essentially covered only agricultural land. The Law on Real Property, adopted in 1995, introduced the concept of land as property, identified rights in real property, and put into place a modern framework for transferring property, including mortgaging and the creation of a legal cadastre. The Law on Local Self-Government gave local governments the right to own property, in particular, communal services property such as utilities.

Privatization

During the Soviet period, many houses were privately owned, including many city houses, farmhouses, and dachas built by their owners. These properties constituted an estimated 40 percent of the total housing stock, which is estimated at 750,000 units. Restitution has not been an issue in Armenia because of the devastation caused by Turkish invasions during the early 20th century, and because most existing buildings date from the Soviet period.

Although land was nationalized during the Soviet era and, hence, was not considered to be property, many homeowners were given the right to use specific plots of land (either permanently or indefinitely), and specific land allotments were also made to organizations.

Efforts to privatize the 380,000 state-owned apartments began in 1989, when registered tenants could buy their apartments for a nominal price. The attractiveness of the offer doubtless depended on the location of the apartment and the tenant's purchasing power and willingness to assume responsibility for maintenance. About 40,000 units were privatized during the four years of this program. In 1993 a new, free housing privatization law was passed under which tenants could acquire their apartments for a nominal processing fee. In the first 16 months of that program 108,000 more units were privatized. Legislation is in place to convert apartment buildings into condominium structures, but few have been converted.
The adoption of the Land Code made it possible to privatize farmland. Most agricultural land in Armenia has been privatized, although the central government reserved 126,000 hectares of primarily pastureland, which can be rented. In addition, owners of houses can privatize the plots on which their houses are situated (up to 400 square meters in urban areas and 600 square meters in rural areas). There are over 310,000 family (peasant) farms and about 1,200 collectives, but the average holding is less than 1.5 hectares and much farming is at a subsistence level. Since February 1994 it has been possible to sell agricultural land on the open market. Lack of access to credit, however, has hampered the development of land markets.

Except for land under houses and a few housing development plots, urban land has not been privatized. The reasons are complex, ranging from concerns about private stewardship to a lack of up-to-date master plans, a lack of systems for allotting land and registering land titles, and the absence of a pricing mechanism. Armenia has called on international donor organizations to help establish appropriate systems.

Between 1994 and the end of 1997, about 7,271 enterprises were privatized through vouchers or cash auctions. Voucher privatization did not bring in substantial amounts of revenue, however, and since 1998 the government has used the cash sale method to complete the privatization process. While most small enterprises have been privatized, progress has been slower with large industrial enterprises (EIU 1998).

Progress also has been made in establishing capital markets, although the lack of access to capital hampers purchases, and most sales are on a cash basis.

**Cadastral and Titling Systems**

Armenia lacks modern legal and fiscal cadastres. Historically, the only cadastral system was the Soviet agricultural land cadastre. There now is widespread recognition of the need for proper map-based legal and fiscal cadastres to serve the needs of property market participants and to improve control over the property tax base. In June 1997, the National Assembly addressed these needs by authorizing the creation of the Cadastre Department, nominally under the Ministry of Justice.

The Cadastre Department’s functions include property title registration, property valuation for tax purposes, and monitoring. It is organized along functional lines, with registration and valuation departments, and it is in the process of establishing mapping and informatics departments. Registration, inventory, and valuation operations are decentralized in 46 field offices, including four in Yerevan. The Cadastre Department began title registration in January 1998. Loans from the World Bank and assistance from the United States Agency for International Development and the European Commission are supporting land and title registration projects in Armenia. The projects involve modernizing registration procedures, compiling digital cadastral maps, updating the inventory of buildings, and integrating land and building databases.

The title registration process borrows from the procedures for Soviet-era passports. In the case of newly privatized property, the owner must present the Cadastre Department with the passport and governmental permits for ownership or use rights to the property and pay the fees for registration and establishing the valuation before receiving a new passport. In subsequent transfers, the buyer presents the contract for sale, which previously has been approved by a notary, and the existing passport. Prices are freely negotiated, but actual prices are seldom declared.

During the agricultural land privatization process, local councils made the temporary allotment decisions to transfer land to private owners. Prior to the establishment of the Cadastre Department, the Agricultural Surveying Institute in the Ministry of Agriculture (Armgyprozyom or Gyprozyom) was responsible for issuing new passports identifying the land under the control of each owner. Neither the local councils nor the Gyprozyom maintained an accessible ownership register. Only 2,000 passports had been issued at the time the land tax was introduced, and only 50,000 had
been registered by 1997. Estimates of the total number of rural and urban land plots range between 635,000 and 750,000. With financial assistance from the European Commission, the new Cadastre Department set a goal of registering 75,000 properties in both 1998 and 1999.

Registration fees can be substantial (the minimum fee was dram 600, approximately US$110 in 1999), and the process can be slow unless extra fees are paid for expedited service. Public access to ownership information is limited. The requirement that owners pay for a valuation for property tax purposes as part of the title registration process created an incentive not to register property. There are an estimated 340,000 structures in Armenia and an estimated 750,000 housing units, which are approximately evenly divided between apartments (mostly in Yerevan) and single-family houses (mostly in rural areas). Estimates of the total number of ownership units range between 650,000 and 850,000, not including "illegal" structures built without official approval.

Property Markets

Yerevan has an active apartment market, and there is a market for houses and offices. There also is a rental market for stores and offices, with supply generally exceeding demand. Markets in other regions are also emerging, as in the Ararat Valley, where several sales of agricultural property occur per month and successful auctions of residential building plots occur occasionally.

Real Estate Professions

Donor agencies have attempted to establish associations of brokers and appraisers, such as the Armenian Real Estate Association, an umbrella organization of selected brokerage organizations, rather than a real estate professional association open to all. There is interest in licensing brokers and appraisers in government and professional groups.

Taxation of Real Property

Armenia has two broadly based recurring taxes on real property—a land tax and a property tax—because land was not included in Armenia's definition of property. At first, the property tax base was idealistically broad, encompassing most enterprise assets (which were taxed on the basis of balance sheet values), buildings, vehicles, aircraft, watercraft, and livestock owned by individuals. At the same time, a complex pattern of different bases, rates, and exemptions shielded many taxpayers from significant property tax burdens. In 1996 land and property taxes made up approximately 26 percent of the total revenues of local governments. Land taxes currently benefit rural communities more than cities.

Following its general pattern of tax reforms, Armenia is in the midst of a transition from first- to second-generation taxes on property. The new property tax base includes buildings and fewer moveables. Property owned by enterprises is now valued and taxed on the same basis as property owned by individuals. Buildings and most land are (or will be) taxed on the basis of cadastral values, which incorporate market factors and are closer to market values.

From the outset Armenia has had a strategic approach to the introduction of taxes and reforms related to taxes on real property. The aim of the first-generation laws was to introduce separate taxes on land and property as part of a diversified revenue system and to accustom Armenians to paying taxes and contributing to the costs of government, because such taxes would be difficult to evade. The aims of the second-generation tax laws are to simplify administration and eventually to harmonize the land and property taxes.

Although not yet accomplished, Armenia's goal is eventually to merge the taxes and base the new tax on market values. In 1997 the National Assembly adopted the new Law on Property Tax
to replace the 1995 law. The new law came into force on January 1, 1998, although some provisions did not become effective until 1999. This new property tax law reflects the National Assembly's desire to control all the variables that affect property tax burdens (the definition of taxable property, the basis for taxation, tax rates, and exemptions and privileges). Consequently, the law contains the valuation formula that formerly was promulgated by government regulation. Moreover, the 1997 law removed governmental (executive) discretion in setting property tax rates on enterprise assets. All tax rates are now fixed in legislation.

**General Features of Taxes on Immovable Property**

The power to tax property continues to rest with the central government, which originally received the revenues from all taxes. As noted earlier, the new local governments began to receive 95 percent of land and property tax revenues in 1997. Now local governments receive all property tax revenues.

People subject to the land tax include owners of land and users of state-owned land, and those subject to the property tax include owners of taxable structures and movables. In practice, ownership or use rights must be registered before taxes are levied.

The Law on Taxes governs the enforcement of tax liabilities. Interest penalties accrue at the rate of 0.1 percent per day for the first 90 days of delinquency. From 91 to 365 days the rate is 0.3 percent per day. Both legal and physical persons are subject to penalty. After one year the STI may apply to the courts to recover the taxes due, and liens may be attached to bank accounts and cash. When these funds are insufficient, liens may be attached to property, which may be sold at auction to recover the debt. Any money remaining after satisfaction of the tax liability and auction expenses is returned to the taxpayer. Liens may also be attached to a taxpayer’s receivables.

**Land Tax**

Land is classified by use. The four main types of land—agricultural, urban, ecological, and all others—reflect Soviet-era classifications. Agricultural land includes plots allotted for farmhouses and dachas. Urban land includes developed plots and plots allocated for development. Estimates of the total number of rural and urban land plots range between 635,000 and 750,000.

Agricultural land is assessed and taxed differently from nonagricultural land, but type of owner is not a factor because, originally, enterprises could not own land. Agricultural land is taxed at 15 percent of the income that a plot of land hypothetically could produce, based on the class of soil typical for the cadastral district. These classes were recorded in an agricultural cadastral developed during the Soviet era, and cadastral incomes per hectare generally are regarded as below market incomes. The incomes used for lands classified as irrigated have been controversial, because irrigation systems were generally inoperative because of fuel shortages during the 1990s. Land area figures are also regarded as inaccurate because of the limited resources of the Ministry of Agriculture’s surveying unit.

Under the law, nonagricultural land was to be taxed on the basis of cadastral values per square meter, but these values were nonexistent in cities, and the law was silent on how they were to be developed. The STI claimed it must use the same values as for unused agricultural land, adjusted by approved location coefficients. Tax rates on nonagricultural land depend on use and location. Industrial land in cities is taxed at 1 percent of cadastral value and outside cities at 0.5 percent. Forest land is taxed at 1 percent of the average value of unusable land. Other land is taxed at 0.1 percent of cadastral value.

Exemptions apply mostly to public purpose owners or users of nonagricultural land. There is a 50 percent exemption for agricultural land used for research purposes, and there are temporary exemptions for qualifying new agricultural undertakings.
Table 7.2. Land Tax Statistics, 1994–98

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<td>Total number of assessed taxpayers</td>
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<td>469,000</td>
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<td>Physical persons</td>
<td>460,000</td>
<td>460,000</td>
<td>460,000</td>
<td>487,019</td>
<td>505,398</td>
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<tr>
<td>Estimated total taxes due (dram millions)</td>
<td>1,310</td>
<td>2,663</td>
<td>2,300</td>
<td>3,510</td>
<td>3,719</td>
</tr>
<tr>
<td>Legal persons</td>
<td>300</td>
<td>303</td>
<td>300</td>
<td>—</td>
<td>3,109</td>
</tr>
<tr>
<td>Physical persons</td>
<td>1,010</td>
<td>2,360</td>
<td>2,000</td>
<td>—</td>
<td>610</td>
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<tr>
<td>Total taxes collected (dram millions)a</td>
<td>0</td>
<td>1,720</td>
<td>1,750</td>
<td>2,094</td>
<td>1,295</td>
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<tr>
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<td>390</td>
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<td>303</td>
<td>302</td>
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<tr>
<td>Physical persons</td>
<td>0</td>
<td>1,330</td>
<td>1,450</td>
<td>1,790</td>
<td>992</td>
</tr>
</tbody>
</table>

— Not available.


Source: STI data.

Agricultural land taxes are due in two equal installments on November 15 of the tax year (after most crops are harvested) and April 15 of the following year. Currently, about 55 percent of the amount due is collected by the deadline, and enforcement measures generate another 15 percent (table 7.2).

Under a draft of the new Law on Land Tax, both agricultural and nonagricultural land would be taxed on the basis of capital value, and the Cadastre Department has been charged with developing valuation methods. The department is considering a general multiplicative model for valuing all types of land. Land value would be a function of four factors (size, use, location, and quality), and would be calculated by multiplying land area by a base rate and by applicable adjustment coefficients. The base rate could vary with use or with location, and there could be size adjustments.

Property Tax

In a carryover from the Soviet era, the property of individuals (physical persons) was assessed and taxed differently from property owned by enterprises (legal persons) under the 1995 Law on Property Tax. The 1997 law continues, although reduces, the importance of these distinctions, so that enterprises that lack the status of a legal person are treated the same as a legal person. Farm enterprises are treated as physical persons.

The new law contains major changes with respect to the taxation of movable property. Except for vehicles, watercraft, and property included in the definition of structures, enterprise moveables, including livestock and aircraft, are no longer taxable. Livestock were removed from the tax base because of administrative difficulties (discovering the animals, identifying their owners, and identifying the community that should receive the tax on free-ranging animals) and negligible revenues of about dram 1 million (US$2,000). The reasons for removing aircraft have not been revealed, but the change would be beneficial to Armenian Airlines.

Under the old law, structures and taxable moveables owned by enterprises were taxed on the basis of their values in the enterprises’ balance sheets. Means of transport were assessed on the basis of engine power. Structures owned by individuals were assessed on the basis of values produced by a valuation regulation, although part of that value, based on family size and the minimum monthly salary, was not taxable. The aim of this measure was to provide property tax relief for poor property owners. The new law obtains roughly the same result through a progressive rate structure. Under the old law, all structures owned by individuals were taxed at 0.2 percent. Under the new law, the marginal rates on primary residences range between 0.0 percent
The Development of Property Taxation in Economies in Transition

(for values under dram 3 million) and 0.8 percent (for values over dram 40 million). At an exchange rate of dram 500 to the U.S. dollar, the progressive rate structure exempts the first US$6,000 in value. Individually owned summer houses and garages are taxed at 0.2 percent.

Under the old law, the government set the rate of taxation on enterprise property within the range of 0.2 to 0.8 percent. Now, the rate on buildings of public and production importance is 0.6 percent. The rates on means of transport ranged between 1 and 3 percent of the official minimum monthly salary under the old law. Under the 1997 law, the basis of assessment remains engine power, and rates are expressed in dram per horsepower. However, there are several classes of engines, with more powerful ones taxed at higher rates.

Under the 1995 law exemptions followed typical international patterns, including exemptions for agricultural buildings and partial exemptions for veterans and the disabled. The new law clarifies that property owned by local governments is exempt. Local governments also have the power to grant exemptions when there is a need, although they are ignored when subventions are calculated. Several specific types of property have been exempted, including certain railway structures, road construction equipment, and historic properties.

The new law continues the requirement that enterprises make quarterly payments. Under the old law, individuals had the same payment schedule as farmers. Now, individuals may pay any amount at any time as long as taxes are paid in full by December 1 of the year after the tax year in question. The aim is to increase payments by individuals and reduce the expense of collection efforts (table 7.3).

The difficulties with introducing the new property tax led the National Assembly to excuse physical persons from paying the tax in 1995 and 1996, and the deadline for paying 1997 property taxes was extended to July 1998.

Under the original valuation regulation, Soviet-era estimates of replacement costs of structures were modified by coefficients designed to make taxable values reflect some market factors. Basic cost rates per square meter or per cubic meter were adjusted upward to convert from Soviet rubles to Armenian dram and to account for inflation (which required a multiplier of 75,000). Then the indexed costs were adjusted downward for factors that were assumed to diminish the value of the structure. The highest possible valuation was 0.98 of the inflation-adjusted base rate and the lowest was 0.00945. The factors reflected in the valuations included structural integrity, age, available infrastructure and facilities, story, and geographic location.

The new law contains separate multiplicative valuation formulas for apartments and for detached houses and ancillary structures. The formula for valuing apartment units is comparatively straightforward, but the formula for houses is exceptionally complex. For houses, each story is valued separately on a cubic meter basis, as are fences and ancillary structures. In 1997

<table>
<thead>
<tr>
<th>Table 7.3. Property Tax Statistics, 1994–98</th>
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<tbody>
<tr>
<td>-----------</td>
</tr>
<tr>
<td>Total number of assessed taxpayers</td>
</tr>
<tr>
<td>Legal persons</td>
</tr>
<tr>
<td>Physical persons</td>
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<tr>
<td>Estimated total taxes due (dram millions)</td>
</tr>
<tr>
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<td>Physical persons</td>
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<td>Total taxes collected (dram millions)</td>
</tr>
<tr>
<td>Legal persons</td>
</tr>
<tr>
<td>Physical persons</td>
</tr>
</tbody>
</table>

— Not available.
Source: STI data.
typical apartments in Yerevan were valued in the range of US$8,000 to US$20,000. Values were estimated to be 40 to 50 percent of market prices, but the new valuation formula is expected to produce values that approximate 85 percent of market prices.

Administration

Originally, responsibilities for the assessment of properties owned by individuals were divided between two self-funded inventory and registration offices, one covering Yerevan and the other the rest of the country. These offices were outgrowths of Soviet-era inventory bureaus, and they made few efforts to reform past procedures. Moreover, valuation of buildings was part of the title registration process. These arrangements, a short timetable, insufficient funding, and technological limitations, exacerbated by a lack of heat, electricity, and fuel for transport, all contributed to difficulties with introducing the property tax in 1995 and 1996. By 1997 funding for valuation was provided and responsibility for assessment and valuation was transferred to the new Cadastre Department.

Land and property tax records are organized by taxpayer within the territory of the STI's regional offices. There are no cadastral maps or a property (cadastral) numbering system, and the STI's regional offices suffer the same hardships as the inventory offices. Collection remains the responsibility of the STI. To overcome inadequate ownership records and the lack of a taxpaying culture, the STI initially relied on contacts with the former local councils to obtain information on agricultural landowners in order to send assessment forms and tax bills. Although taxpayers were supposed to make payments in person at local STI offices, few did so. Consequently, the STI used the services of cooperative local treasurers and, when necessary, visited taxpayers to collect taxes directly.

After the introduction of the property tax, the STI reorganized its land and property tax collection responsibilities, which required one-quarter of its total staff of 1,600. Considering this to be an excessive number, the government decided in May 1998 that local governments should collect land and property taxes from physical persons.1

The STI has long been a force for fiscal and tax reform and has had a strategic vision. Under the minister of finance since 1995, the STI has played a major role in drafting tax legislation and in developing the methods used in tax administration. The Cadastre Department now also takes an active role in both policy and procedure formulation.

Taxpayer Rights and Responsibilities

In addition to tax notices, the new Law on Property Tax provides for a notice of valuation in revaluation years. The Law on Taxes gives Armenian taxpayers a general right of appeal to tax administrators and to the courts. In the case of land and property taxes, taxpayers may appeal the actions of the local governments and the Cadastre Department, as well as the actions of the STI. However, these avenues are largely untested.

When a taxpayer challenges the actions of an employee of a regional tax inspectorate, the appeal must be lodged with the employee's supervisor within 30 days of the action. If the taxpayer is not satisfied, further appeal may be made to the central tax inspectorate, which has established a special appeal committee. Decisions on appeals to the regional and central tax inspectorates must be made within 30 days. Further appeals may be made to the Primary Court.

1. However, Prime Minister Sarkasian dismissed about 20 elected heads of local administrations for failing to meet budget obligations and being "unwilling to enforce unpopular measures like land taxation ahead of local elections due in November," according to The Armenia Report (News Briefs October 15, 1999).
whose decision is final unless the procurator appeals to the Supreme Court of the Republic of Armenia. The Primary Court must render its decision within 10 days, and its decision is effective after 10 days.

The Law on Taxes provides administrative and criminal penalties for failing to fulfill duties under the law. Administrative penalties for minor infractions are in the range of dram 10,000 to dram 20,000. In the case of criminal evasion of taxes, imprisonment for two to five years is possible, plus fines of dram 500,000 to dram 1 million and confiscation of property. When the infraction is by a legal person, the penalty is assessed against a responsible official.

Current Issues and Future Developments

Three connected issues are likely to influence developments related to property taxation in Armenia in coming years: realizing the revenue potential of land and property taxes, reducing the costs of administration (or increasing cost-effectiveness), and creating open and efficient property markets.

The designers of Armenia's tax system have envisaged land and property taxes as the major source of tax revenue available to local governments, but revenue targets have not been achieved. Low revenues have led some Western experts to question the viability of such taxes for cities, possibly because they did not understand that the land tax has essentially been an agricultural land tax designed for rural communities, and that substantial revenues from the property tax were not possible until recently. In any event, success in realizing revenue potential will depend on efforts to develop a taxpaying culture, devise effective collection methods, complete the registration of private property, and build a map-based fiscal cadastre linked to a modern legal cadastre. Advances in financial information systems will make possible both better estimates of revenue potential and actual revenue yields. At present, the STI has difficulty in obtaining timely and accurate statistics from regional offices that lack modern computer systems.

The STI understands the need to reduce administrative expenses. Its goal is to reduce resources devoted to collection efforts and focus on more appropriate functions, such as auditing. Its immediate strategy includes public relations campaigns to explain the need for taxes, help taxpayers fulfill their obligations, and emphasize the consequences of not paying taxes. The STI has advocated making local governments responsible for collecting property taxes from individuals, because of their stake in the outcome, although it acknowledges the need for training local officials and monitoring their performance. The STI hopes the new payment provisions in the Law on Property Tax will help increase the flow of voluntary payments from individuals.

Traditional inventory procedures used in title registration and valuation are similarly inefficient, because the production of a passport requires a field inspection to update the property description manually on a new form. An inspector can inventory only about two houses or four apartments per day. An appraiser can calculate the value of about six properties per day.

International donors are poised to help with the creation of a modern legal cadastre and other activities designed to improve land markets, but the challenge is to reach agreement on technical standards among the donors and the Cadastre Department. Although interested in computerization, the department currently envisages only a more elaborate version of the existing paper-based passport system to record information about the current titleholder, to value the property for tax purposes, and to serve traditional inventory needs on a single form. Only Cadastre Department officials and the property owner would have ready access to current title information, and a comprehensive picture of past and current interests in a property would be difficult to obtain.

A long-standing issue related to property registration and taxation is what to do about illegal property such as houses and other structures erected without official permission, enclosed balco-
Property Taxation in Armenia

There is reluctance to register or tax such property because to do so would signal official acceptance of the status quo. Even though some illegal property represents spontaneous solutions to housing shortages decades ago, there is reluctance to grandfather even long-standing illegal uses, because of fears that precedents would be set. At the same time, requiring occupants to demolish all illegal structures or face punishment would cause an outcry. Thus such property remains untaxed as long as registration is a prerequisite for taxation.

Other property-related issues include unfinished construction and idle industrial facilities associated with the earthquake and the collapse of the Soviet Union. Some propose punitive taxation of such structures to encourage utilization or transfer. Others propose exemptions to make completion or utilization more affordable. Neither strategy confronts the reality that construction methods that made sense in the late 1980s will, in many instances, not make sense in a 21st century market economy.

Although formal market monitoring programs have not been initiated, most officials have a general knowledge of market activity and prices. Opinion is divided as to whether property markets are sufficiently formed to provide reliable indicators of market values, particularly for such governmental purposes as taxation. Consequently, the Cadastre Department currently favors a built-up, civil engineering approach to valuing buildings and to valuing land based on a combination of agronomy and proximity of tangible factors, such as infrastructure. Purely economic analyses remain a novelty, although strong proponents of market reforms advocate their use. To help resolve such issues, the U.S. Agency for International Development has proposed technical assistance in urban property valuation as an adjunct to assistance with tax and fiscal reform and with land title registration.

Appendix: Other Taxes and Fees Applicable to Real Property

The real property transfer tax is 2 percent of the declared value or the official price, whichever is greater. There is a Soviet-era tax on inheritances that is based on official values. A basic notary fee of dram 1,000 (dram 30,000 for enterprises and dram 5,000 for inheritances) may be charged. Individual gains on the sale of property are not taxable. Land and property taxes are deductible from business income.

References and Bibliography

Armenian laws, regulations, reports in English are available at the International City/Country Management Association office in Yerevan.


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