VALUATION FOR PROPERTY TAX PURPOSE.
ANALYSIS OF THE EU TRANSITIONAL COUNTRIES

Ion ANGHEL, Bucharest University of Economics, Romania

Ciprian SIPOS, The West University of Timisoara, Romania

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Abstract:

The design of real estate property tax system is in the last period a subject for debate, attracting attention in the political, social or academic debates. This is due because taxation on real estate property could be: new source of revenues, new source of economic growth, a source of stability and a way to avoid future crisis. The analysis of taxation of property in EU transitional countries reveals the need of developing the real estate tax system, including the valuation for tax purpose to increase the connection between the base of valuation with market value.
The actual system of valuation for property tax purpose in the EU transitional countries is not enough developed to sustain an effective tax system, including the necessity to move the tax intensity from labour taxes (that discourage employment) towards taxes on consumption and property.

1.Emphasis on taxation of property in the EU countries

The design of real estate property tax system is in the last period a subject for debate, attracting attention in the political, social or academic debates. This is due because taxation on real estate property could be:

a)<u>New source of revenues</u>. In a couple of European countries there is an important need to find new financial resources; the fact that real estate taxes are quite low in many countries create the opportunity for this countries to obtain a convenient not expensive and short term solution.

b)<u>New source of economic growth</u>. There are recent studies which identified taxes on real estate property as one of the least detrimental to GDP (see e.g. Johansson *et al.* (2008) and Arnold *et al*. (2011). In this context there are couple of voices which sustain the necessity to move the tax intensity from labour taxes (that discourage employment) towards taxes on consumption and property.

c)<u>A source of stability</u>. Taxes on property are recurrent and offer an important advantage of a high stability of tax revenue flow, which facilitates a reliable budgetary planning. This could be an important issue for indebted economies, an attractive feature particularly for highly indebted countries, for which an increasing in stability of revenues are very important in achieving good debt financing conditions on the global capital market.

d) <u>A way to avoid future crisis</u>. There are many voices which consider the favorable tax treatment of mortgages as one of the important contributing factors to the housing price bubble that has played an important role in the crisis in several countries. In this context, it is important to ensure a more balanced tax treatment of housing (see European Commission (2011a).

On the other hand, decision to increase property taxes might offer some opportunities for limiting 'boom and bust' cycles in real estate prices, by reducing excessive price increases in the boom phase.

Both an increase in property transaction taxes and an increase in recurrent housing taxes might in principle dampen price booms.

An increase in transaction taxes will generally reduce the after-tax return to the owner of property, upon realization, and therefore should reduce the propensity to bid prices upward. Recurrent taxes do the same as they make holding property more expensive. There is some evidence as to either effect:

Crowe et al.(2011) find that, using data for 243 U.S. areas, a one standard deviation increase in property tax rates is associated with a 0.9 percentage point decline in average annual price growth (compared to annual growth of around 5.6 percent per year). Furthermore, the Crowe et al (2011) paper finds that these taxes reduce volatility: a one standard deviation increase in tax rates cuts it by about one fourth.

2.The analysis of taxation of property in EU transitional countries.

The property tax system is founded by a number of principles: uniformity, neutrality, stimulation of direct investment, transparency, public acceptance, buoyancy and cost effectiveness.

- Uniformity: implies proportional taxation in correlation with the “ability to pay”. A market value based system could represent a fiscal benefits because avoid the case in which taxpayers paying less than they might be willing to accept.
- Neutrality: a efficient tax system not distort economic decisions and encourage an optimal mix of factors of production (capital, workforce, management and land).
- Stimulation of Direct Investments. Tax preferences and incentive are sometimes used to attract investment in a particular area.
- Transparency is a characteristic of democratic society.
- Buoyancy is related with the ability of tax to rise or to fall in accordance with the economic evolution.

In the new EU countries there are some constraints on real estate taxes

- Past history of collectivisation of land ownership and subsidised housing
- Little role for real estate taxes in a centrally planned economy as limited private ownership of land
- Many inhabitants now occupy dwellings whose value is out of line with their incomes because of privatisation and restitution
- Weak infrastructure of real estate markets
- Poor transparency in real estate market;

Because of this pattern in Romania and probably in other new EU countries a few of principles of the property tax system are not fully realized. The uniformity, transparency and buoyancy is not realized in Romanian tax system,

In the last 16 years the gap between new EU countries and EU 27 remain significant in terms of taxes on property in GDP. In 2010 the average New EU countries is around 0,7% in GDP vs 1,3 % average EU countries. Also differences between countries is important: the lowest tax rate is Estonia and Slovakia (0.4% in GDP) and the highest is 1,2% in GDP in Poland.

TAXES ON PROPERTY - TOTAL % GDP, 1995 - 2010

		1995	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**Revenues** 2010 mil E
1	Bulgaria BG	0.3	0.2	0.1	0.2	0.2	0.2	0.2	0.3	0.3	0.4	0.4	0.6	0.7	0.7	0.5	0.5	187
2	Czech Republic CZ	0.5	0.5	0.6	0.6	0.5	0.5	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4	662
3	Estonia EE	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.2	0.2	0.3	0.3	0.4	51
4	Hungary HU	0.5	0.6	0.6	0.6	0.6	0.7	0.7	0.7	0.8	0.8	0.8	0.8	0.8	0.8	0.8	1.1	1,105
5	Latvia LV	1.0	1.0	1.1	1.2	0.9	0.9	0.9	0.8	0.8	0.8	0.7	0.6	0.9	0.7	0.7	0.9	154
6	Lithuania LT	0.7	0.8	0.7	0.7	0.8	0.7	0.6	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.5	0.5	147
7	Poland PL	1.1	1.1	1.1	1.1	1.1	1.1	1.3	1.4	1.4	1.3	1.3	1.2	1.2	1.2	1.2	1.2	4,194

8	Romania RO	0.3	0.2	0.2	0.4	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.8	1.0	0.8	0.8	0.9	1,038
9	Slovakia SK	0.5	0.6	0.6	0.6	0.6	0.6	0.5	0.6	0.6	0.5	0.5	0.4	0.4	0.4	0.4	0.4	277
10	Slovenia SI	0.6	0.5	0.6	0.7	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	219
	EU 27	1.2	1.2	1.3	1.3	1.4	1.4	1.3	1.3	1.4	1.5	1.5	1.5	1.5	1.4	1.3	1.3	256,465
	EU 17	1.2	1.3	1.4	1.4	1.4	1.5	1.4	1.4	1.4	1.5	1.6	1.6	1.6	1.4	1.4	1.3	168,945
	% average 10 new EU vs EU 27	-51%	-51%	-54%	-50%	-54%	-54%	-51%	-51%	-54%	-58%	-59%	-60%	-56%	-55%	-52%	-47%	

Source: Taxation trends in the European Union

Also the level of taxes on property in total taxation represent an important gap between new EU countries and EU 27. In 2010 the average New EU countries is around 2,2% in total taxation vs 3,6 % average EU countries.

TAXES ON PROPERTY - TOTAL % total taxation, 1995 - 2010

		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
1	Bulgaria BG	0.8	0.8	0.3	0.8	0.8	0.8	0.8	1.0	1.1	1.1	1.3	1.9	2.1	2.2	1.9	1.9
2	Czech Republic CZ	1.5	1.5	1.6	1.7	1.5	1.5	1.5	1.5	1.5	1.1	1.2	1.2	1.2	1.2	1.2	1.3
3	Estonia EE	1.0	1.1	1.1	1.1	1.1	1.3	1.2	1.1	1.1	1.0	0.9	0.8	0.7	0.9	1.0	1.0
4	Hungary HU	1.2	1.5	1.5	1.6	1.6	1.7	1.8	1.8	2.1	2.2	2.2	2.2	2.0	2.1	2.0	3.0
5	Latvia LV	3.0	3.2	3.3	3.6	2.8	3.2	3.1	2.9	2.8	2.7	2.3	2.0	3.0	2.3	2.7	3.1
6	Lithuania LT	2.6	2.8	2.4	2.2	2.4	2.4	2.1	2.1	1.9	1.7	1.5	1.4	1.2	1.3	1.7	2.0
7	Poland PL	2.8	2.9	3.0	3.1	3.3	3.5	4.0	4.4	4.2	4.2	4.0	3.7	3.4	3.5	3.8	3.7
8	Romania RO	1.0	1.0	0.7	1.3	1.9	2.2	2.5	2.4	2.7	2.6	2.5	2.9	3.3	3.0	2.9	3.1
9	Slovakia SK	1.3	1.5	1.6	1.6	1.7	1.7	1.7	1.7	1.7	1.7	1.6	1.5	1.4	1.3	1.5	1.5
10	Slovenia SI	1.4	1.4	1.7	1.9	1.9	1.7	1.7	1.6	1.5	1.5	1.5	1.6	1.6	1.5	1.6	1.6
	EU 27	3.2	3.3	3.4	3.5	3.6	3.7	3.6	3.6	3.7	3.9	3.9	4.0	4.0	3.8	3.6	3.6
	EU 17	3.4	3.5	3.6	3.7	3.8	4.0	3.7	3.7	3.8	4.1	4.3	4.3	4.3	3.9	3.7	3.6
	% average 10 new EU vs EU 27	-48%	-46%	-49%	-46%	-47%	-46%	-43%	-43%	-44%	-49%	-51%	-52%	-50%	-49%	-44%	-38%

Source: Taxation trends in the European Union

For real estate taxes there is an important distinction between *recurrent taxes on real estate property,* which typically take the form of annual payments due by the owner, whose amount is linked to a measure of the value of the property and *transaction taxes* that are typically charged on the occasion of the sale or transfer of the property.

Regarding the recurrent taxes in the last 16 years there is a clear distinction between new EU countries and average EU 27, with a gap around 27% in 2010 average 10 new EU countries vs EU 27.

RECURRENT TAXES ON IMMOVABLE PROPERTY - TOTAL % GDP, 1995 - 2010

		1995	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**Revenues** 2010 mil E
1	Bulgaria BG	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.3	0.3	98
2	Czech Republic CZ	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	346
3	Estonia EE	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.2	0.2	0.3	0.3	0.4	51
4	Hungary HU	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	299
5	Latvia LV	1.0	1.0	1.1	1.2	0.9	0.9	0.9	0.8	0.8	0.8	0.7	0.6	0.8	0.6	0.6	0.8	138
6	Lithuania LT	0.3	0.4	0.4	0.4	0.4	0.4	0.5	0.5	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.4	102
7	Poland PL	1.0	1.0	1.1	1.1	1.1	1.1	1.3	1.4	1.3	1.3	1.3	1.2	1.2	1.2	1.2	1.2	4,121
8	Romania RO	0.3	0.2	0.2	0.2	0.4	0.5	0.6	0.5	0.5	0.5	0.5	0.6	0.7	0.6	0.6	0.7	844
9	Slovakia SK	0.4	0.5	0.5	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	277
10	Slovenia SI	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	173
	EU 27	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	158,130
	EU 17	0.5	0.6	0.5	0.6	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	88,079
	% average 10 new EU vs EU 27	-30%	-39%	-37%	-33%	-34%	-33%	-29%	-31%	-34%	-34%	-37%	-39%	-33%	-36%	-34%	-27%	

Source: Taxation trends in the European Union

For real estate transaction taxes is also a very important gap between new EU countries and average EU 27, with a gap around 70% in 2010 average 10 new EU countries vs EU 27.

TRANZACTION TAXES ON IMMOVABLE PROPERTY - TOTAL % GDP, 1995 - 2010

		1995	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**Revenues** 2010 mil E
1	Bulgaria BG	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.3	0.4	0.5	0.5	0.3	0.2	89
2	Czech Republic CZ	0.3	0.3	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.2	0.3	0.3	0.3	0.3	0.2	0.2	316
3	Estonia EE	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0
4	Hungary HU	0.4	0.5	0.4	0.4	0.5	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.5	0.6	0.5	0.8	806
5	Latvia LV	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	56
6	Lithuania LT	0.4	0.4	0.3	0.3	0.3	0.3	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	45
7	Poland PL	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	73
8	Romania RO	0.0	0.0	0.0	0.2	0.2	0.2	0.1	0.1	0.2	0.2	0.2	0.3	0.3	0.2	0.2	0.2	194
9	Slovakia SK	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0
10	Slovenia SI	0.2	0.2	0.2	0.2	0.3	0.2	0.2	0.2	0.1	0.1	0.2	0.2	0.2	0.2	0.1	0.1	46
	EU 27	0.5	0.6	0.6	0.7	0.7	0.7	0.7	0.6	0.6	0.7	0.8	0.8	0.8	0.7	0.6	0.6	98,335
	EU 17	0.7	0.7	0.8	0.8	0.9	0.9	0.8	0.8	0.8	0.9	1.0	1.0	1.0	0.8	0.7	0.7	80,866
	% average 10 new EU vs EU 27	-68%	-72%	-75%	-76%	-74%	-76%	-80%	-77%	-73%	-79%	-79%	-76%	-75%	-71%	-73%	-70%	

Source: Taxation trends in the European Union

Regarding the buoyancy based on the correlation between the market value evolution of residential properties and evolution of real estate taxes we found the absence of correlation between the ability of tax to rise or to fall in accordance with the economic evolution.

NOMINAL HOUSE PRICE INDICES , 2000 = 100%

		1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
1	Bulgaria BG	100.8	100.0	100.3	102.2	114.6	169.1	231.0	264.9	341.5	426.7	335.6	301.7
2	Czech Republic CZ	85.6	100.0	106.9	132.5	146.7	146.5	148.3	148.4	191.8	217.1	-	-
3	Estonia EE	-	-	-	100.0	119.7	170.9	242.7	293.5	314.6	224.9	151.4	-
4	Hungary HU	53.8	100.0	117.3	134.5	160.4	173.0	177.2	186.3	195.2	197.3	184.9	174.4
5	Latvia LV	-	-	-	-	-	-	-	-	-	-	-	-
6	Lithuania LT	-	-	-	-	-	-	-	-	-	-	-	-
7	Poland PL	-	-	-	-	-	-	100.0	139.6	191.2	198.7	196.8	205.2
8	Romania RO	-	-	-	-	-	-	-	-	-	-	-	-
9	Slovakia SK	-	-	100.0	139.6	194.9	225.0	201.9	235.8	292.0	356.6	317.0	304.6
10	Slovenia SI	-	-	-	-	-	-	-	-	-	-	-	-

Source: Hypostat 2010, European Mortgage Federation

3.Valuation for property tax in EU Transitional Countries. The case of Romania

Valuation for property tax in Europe offers special challenges because each country has a different definition of real estate property (for example in some countries the real estate property is divided into physical components (land and buildings) for tax purpose), different approach on real property value and taxation, different level of development in valuer's profession etc.

The development of the Single European Market has opened the local markets (including real estate markets) to global competition. Business competitiveness now depends primarily on efficiency and the real estate tax could be an important issue for a couple of industries.

Bases of Valuation

Regarding bases for valuation in real property taxation process all three alternative approaches for the valuation bases are used in Europe.

a)Comparison Approach (Capital Value Approach) is normally based on the open market value of the subject property.

b) Income Approach (The Rental Value Approach) is based on the capitalization of the potential Net Operating Income (NOI) of the property

c) The cost approach is related with the market value of the land plus the cost of construction. .

Many of the new EU countries (including Romania) have used the unit approach due to objective and subjective reasons.

As objectives explanations not to use market value as a base for real estate property tax: lack of reliable real estate market information (limited and restricted property market), insufficient resources to develop mass appraisal system etc.

A subjective reason is related with political decisions; many politicians are afraid to approve changing into the basis for valuation in taxation process because an expected increasing in real estate property tax

It is anticipated that in many of this new EU countries will found a changing to a value-based system from actual unit approach system when resources and political circumstances permit.

Reevaluation of the Tax Base

One important issue in valuation for property tax analysis in analyzing new European countries property tax systems is whether the valuations on which the tax is charged are up-to-date.

There are also differences between countries: some countries have not revalued their tax bases for many years but others (developed countries) undertake revaluations of properties regularly to maintain a good correlation between the market value and value for tax purpose.

In some cases countries used indexation as a solution to keep value of properties for taxation closed to market situation but this is a questionable solution because

In majority of situations, the index is a single figure applied to the entire region and usually for all kind of property.

Sources of Data for Valuation

Many EU countries used a computerized cadastral system to record property-related information (including economical data), and as part of the assessment process different levels of government usually exchange information.

The nature and implementation of such systems is very different in EU countries, usually the system is in development in developing countries.

In some cases, valuation and comparable evidence may be made available at the request of the taxpayer but normally in new EU countries this is not applicable.

Non-Market Valuation methods

Some transitional countries continue not to rely on market value in other words no using direct market evidence in valuation of properties for taxation. A group of “experts” defines a number of factors which are presumed to affect the property value. There is a group of factors like as: population, urban infrastructure, the general quality of the area, quality of the construction etc.

The basic approach is to develop a “gravity” model to create a territorial indices and a map of the tax area of the city or of the village.

In Romania the real estate tax base is different for tax payers (individual vs companies) and for real estate components (land and building).

The tax base for land is based on non market valuation and for the building could be market value for companies (due to international accounting standards requirements – fair value) or acquisition cost (if the company decide not to reevaluate fixed assets). The quality of valuation is also an issue for the uniformity of the real estate tax system in Romania.

Regarding the transaction tax on immovable properties the tax base is the declared price with a minimum tax base established in accordance with yearly “valuation catalog” realized by Romanian Chamber of Notaries.

4.Development of market value real estate taxes in the new EU contries

There is a real need to develop a real estate tax sistem based on market value indication of properties because the postive effecs on social and economic activity.

Achievement of this objective need the existence of preconditions for the development of market value real estate taxes:

- A political agreement
- The ability to create and maintain a fiscal cadastre.
- The existence of an adequate quantity of qualified valuers and adequate valuation standards
- Data on market prices being available to those carrying out tax valuations.

Also realising a shift from actual status to another base for real estate tax need to take in consideration a set of acceptable outcomes and consider;

- Taxpayer acceptability;
- Resource implications;
- Practical and political considerations;
- National, cultural and social environment

An important element in this process is related with the existence of an adequate quantity of qualified valuers and adequate valuation standards. In the most new EU countries the profession is very young and in many countries the number of qualified valuers seems to be insufficient to support a fully functioning real estate tax system based on market values.

The valuation profession in new EU countries

	Country	Year	No indiv.valuers	Professional Association
1	Bulgaria BG	2009	950	Chamber of independent appraisers
2	Czech Republic CZ	1992	1,250	The Czech Chamber of appraisers
3	Estonia EE	1995	n.a.	The Estonian Association of Apprasers
4	Hungary HU	1991	110 (and 330 companies)	Hungarian Real Estate Association
5	Latvia LV	1995	72	Latvian Association of Property Appraisers
6	Lithuania LT	1994	156	Lithuanian Association of Property Appraisers
7	Poland PL	1994	3,000	The Polish Federation of Valuer's Association
8	Romania RO	1992	5,220	National Asscotiation of Romanian Valuers
9	Slovakia SK	2003	26 (companies)	Slovak Chambers of Apprasers
10	Slovenia SI	n.a.	n.a.	Slovenian Institute of Auditors

Source: http://www.tegova.org/

Conclusions

The design of real estate property tax system in the last few years is a subject for debate, attracting attention in the political, social or academic debates. This is due because taxation on real estate property could be: new source of revenues, new source of economic growth, a source of stability, a way to avoid future crisis etc.

The actual system of valuation for property tax purpose in the EU transitional countries is not enough developed to sustain an effective tax system, including the necessity to move the tax intensity from labour taxes (that discourage employment) towards taxes on consumption and property.

For the EU transitional countries in this context there is an opportunity to modernize the real estate tax system in accordance with the general accepted principles: uniformity, neutrality, stimulation of direct investment, transparency, public acceptance, buoyancy and cost effectiveness.

One of the major issue is the valuation base which must be related with real estate market value.

There are some preconditions for the development of market value real estate taxes like as: existence of a political agreement, the existence of a reliable fiscal cadastre, the existence of an adequate quantity of qualified valuers and adequate valuation standards etc.

An important element in this process is related with the existence of a well developed valuer’s profession. In the majority of new EU countries the profession is very young and number of qualified valuers is insufficient to support a fully functioning real estate tax system based on market values.

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