Property Valuation and Taxation for Fiscal Sustainability and Improved Local Governance in the ECA Region

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SUMMARY

Property taxes on average contribute to 1.8% of the GDP in OECD countries but in some countries contribute over 4% of GDP. However, the figure can be as low as 0.3% of GDP in many developing and transition countries. Apart from political choices between revenue collection strategies, there are two main reasons why developing and transition property taxation yield is low compared with developed countries: (a) property tax evasion due to incomplete and inaccurate fiscal records, and (b) outdated property valuation standards and methods resulting to lower than market value taxation values. The consequences of low property tax yields include weaknesses in local government finances, intangible opportunities for multinational companies to avoid taxes through the use of transfer pricing to shift earnings to other countries, and heavier taxation of incomes and earnings, with a correspondingly lower burden of taxation falling on wealth and assets. Applying appropriate property valuation systems to property taxation is a delicate process that often requires incremental introduction to gain legitimacy and avoid undesired consequences. While enhanced property taxation systems can close tax leakages and are thus fairer, new taxation values can also be a burden to the poor in the interim. Their introduction needs to be accompanied by careful socio economic impact evaluation since there are inevitably losers from this process. Transitional arrangements are often necessary to moderate the impact asset rich - cash poor households, typically pensioners and on businesses to avoid failure resulting from tax revaluations. This paper looks at the role of land register and cadastre based property valuation and taxation systems in improving fiscal sustainability and local governance. This paper presents the results of a study financed by the World Bank's ECA Public Financial Management Trust Fund and implemented by the land teams of the Bank's Social, Urban, Rural & Resilience Global Practice (GURDR) and FAO's Climate, Energy and Tenure Division. The paper will set out the findings of case studies of ECA countries at different stages of maturity in terms of their property valuation and taxation systems. The case study countries are: Lithuania and Russia which have strong mass appraisal and property taxation systems; Moldova where the mass appraisal system is operational but requires some enhancements; Azerbaijan and Turkey that are piloting mass appraisal systems; and Croatia and Serbia which are in the early stages of considering options for mass appraisal system. The paper discusses best practices in property valuation and taxation systems, as well as a guidance available for other countries—both within and outside ECA. The case studies shed light on how to improve valuation and taxation methodologies, enhance revenue collection, and designing, implementing, and evaluating fiscal decentralization and sub-national finance reforms. This paper will represent a significant contribution to better understanding of the problem of municipal finances and inform regional and global policy related to mass appraisal systems in ECA region and beyond.