

Barriers to the use of property taxation in municipal finance¹

Abstract

Purpose The paper presents the findings from a series of case studies that examine the problems faced by countries seeking to introduce value-based recurrent property taxes to replace ones levied on the basis of area or inventory value. It identifies that two of the most significant barriers are the absence of comprehensive list of taxable properties and inadequate data on transaction prices. Both of these can be overcome with sufficient resources but this raises the question as to why governments are reluctant to do so in spite of the advantages of such a change.

Design/ methodology/ approach The paper makes particular use of case studies of Moldova, Poland, Serbia, and Turkey, which have explored the potential of introducing value-based recurrent property taxes, and the issues they have faced. The case studies have been produced by participant observers who have had the opportunity to examine developments over long periods of time. The case studies are set against a wider statistical analysis of the role of recurrent property taxes in tax systems.

Findings Putting in place comprehensive systems for registering properties and recording their characteristics and systematically collecting data on transaction prices require significant investment over a long period of time. This requires commitment on behalf of governments. Governments may be reluctant to support this because of the opposition such reforms can face unless confronted with compelling fiscal or external pressures to act.

Research limitations/ application The issues identified are ones that many countries seeking to introduce value-based recurrent property taxes will face and puts forward how they can be tackled. The case study countries are middle income ones with relatively well developed infrastructure, which low income countries may lack.

Practical implications The solutions to overcoming the barriers to value-based recurrent property taxes encountered in the case study countries are ones that are applicable to many other countries, who can learn from their experience.

Originality/ value The paper provides a perspective on overcoming the issues encountered in introducing value-based property taxes from the viewpoint of those who have been involved in working out ways of overcoming them and so provides insight that is a useful addition to the literature.

Key words Recurrent property taxes, value-based/ ad valorem taxes, Moldova, Poland, Serbia, Turkey

¹ The views expressed here are those of the authors and not necessarily those of the institutions who employ them.

Recurrent Property Taxes – the ubiquitous tax

The two words that can best describe recurrent or annual property taxes are ubiquitous and light. Recurrent property taxes are very widely used. Almy (2014), for instance, identified 166 countries with such taxes. To put this into context, the United Nations has 193 countries as members, so approximately, nearly 9 out of 10 countries have such a tax. In his compendium of property tax systems produced for the Lincoln Institute, Almy found 190 countries and territories out of the 225 surveyed has a recurrent tax on immovables (Almy, 2013). The reasons why recurrent property taxes are in wide use are not difficult to find. They fall on immovable assets and so are difficult to avoid. The tax base is a relatively simple one compared with taxes such as value added tax or corporate profits taxes. Levying them involves drawing up a list of the properties in an area and they are taxes that can be collected in situations in which governance is not well developed. They are widely used as local taxes to finance municipalities because the assets being taxed are immobile and there is no doubt as to the jurisdiction in which they are located. The ownership or use of a fixed asset indicates ability to pay and those who own or use these assets benefit from the provision of local services. Tax revenue does not leak across jurisdiction boundaries as happens with sales, income, or profits taxes.

Although widely used, the revenue raised through recurrent property taxes tends to be relatively low so that they can be argued to be a light tax. Figure 1 shows recurrent taxes on immovable property as a proportion of the Gross Domestic Product (GDP) in the countries of the Organisation for Economic Cooperation and Development (OECD). Although Canada and the UK raised 3.1 per cent of their GDP in the form of recurrent taxes on immovable property, the OECD average was only 1.1 per cent and 19 of the 35 countries raised less than the average. To elaborate on what this means, the UK in 2014 raised 8.4 per cent of the Gross Value Added less employee compensation in recurrent taxes on immovable property whereas 11 European Union member states raised less than one per cent (Grover et. al., 2017). The Gross Value Added less employee compensation can be taken as a proxy for the share of national income received by owners of land and capital. The gap between the countries that raise the highest levels of recurrent taxes on immovable property and the average tax take from this source indicates the potential for raising revenue that most countries forgo.

Insert Figure 1 here

The countries which are not members of the OECD, which for the most part are lower income countries, tend to raise little revenue from recurrent property taxes. Figure 2 uses OECD data to show the percentage of GDP raised using recurrent property taxes on immovable property for selected non-member countries. Although some like Singapore have income levels comparable with those of OECD countries, most have much lower incomes per capita. Out of the 41 countries for which the OECD has collected data, only four reached the OECD average percentage of GDP raised from recurrent taxes on immovable property. An IMF study of 30 middle and low income countries similarly found that only one country raised a higher proportion of its GDP in recurrent taxes on immovable property than the OECD average (Norregaard, 2013). A survey of property taxes in Africa identified only three

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3 countries which exceeded the OECD average of recurrent property tax revenue to GDP, with
4 the average being 0.38 per cent and the tax being almost negligible in Francophone Africa.
5 However, in metropolitan cities it was a major source of revenue and they accounted for a
6 significant proportion of the revenue raised in this way in their countries (McCluskey et.al.,
7 2017) . These figures suggest that the untapped potential from raising additional revenue
8 using recurrent property taxes is even greater amongst lower and middle income countries
9 than amongst OECD members.
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16 An intellectual case can be made for greater use of recurrent property taxes. Their use reduces
17 reliance on consumption taxes that bear particularly heavily on low income groups, and taxes
18 on income, employment, and profits that can distort investment, reduce incentives for
19 employment and enterprise, and alter the balance between work and leisure and savings and
20 consumption (Grover and Walacik, 2018). They tax accumulated wealth rather than income
21 and so have less of an impact on future behaviour (Norregaard, 2013). They encourage the
22 productive use of land and discourage land hoarding (Malme and Youngman, 2001). By
23 targeting immovable assets, they are amongst the taxes least affected by globalisation and the
24 internationalisation of supply chains (Johansson, et.al, 2008).
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29 The light use made of recurrent property taxes has fiscal consequences. Local governments
30 can become more dependent on the use of inter-governmental fiscal transfers in the form of
31 grants from central government or tax sharing arrangements for national taxes rather than
32 fully exploiting their own tax resources. One can readily see how it may appeal to local
33 politicians to have a greater share of the cost of local services met by central government
34 rather than taxing their own citizens and to be able to blame central government for funding
35 shortcomings. This becomes problematic if the central government itself is under pressure
36 because of unsustainable levels of debt or current budget deficits, which could be reduced by
37 greater use of recurrent property taxes. For instance, the Second Economic Adjustment
38 Programme for Greece agreed with the European Union in 2012, involved increasing the
39 property tax and simplifying its rate structure (EU, 2012).
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45 If effective recurrent property taxes are not available, there is the danger that local
46 governments will resort to other means of raising finance that may be damaging, particularly
47 to business. For instance, in Serbia there were 15 communal fees, including ones on business
48 signage until their abolition in 2012 (Rašković et. al, 2016). In Serbia (until its abolition in
49 2014) and Slovenia businesses have paid an urban land use charge for buildings on land
50 retained in public ownership when the businesses themselves were privatised (Žibrik, 2016).
51 In Serbia the annual property tax is only the third most important source of revenue for local
52 governments after their share of income tax and fiscal transfers from central government. The
53 annual property tax contributed 14.3 percent of current local government revenue in 2015.
54 This masks considerable variations with the average proportion being 9.6 per cent but with a
55 range from 0.4 per cent in Trgovište to 22.8 per cent in Svilajnac (Vasiljević, 2017).
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3 Ways of raising local revenue can include pseudo property taxes in the form of developer
4 exactions or value capture devices payable in return for development consent or access to
5 infrastructure, for which the actual charges may bear little relationship to real costs. Poor
6 performance in collecting taxes can result in these instruments being seen as a pragmatic
7 substitute for other taxes. In Latin America developers commonly hand over 15 to 35 per cent
8 of the land (Smolka, 2013). In Serbia there are different rates for development fees charged
9 for access to infrastructure based on the cost of construction, the use of the property, and the
10 zone in which it is located (Rašković et. al., 2016). These are often higher in city centres,
11 where infrastructure is already in place, than greenfield sites, where the costs of connection
12 can be expected to be greater. Local government bodies advocate their use as value capture
13 devices (Žerjav, 2013), a suspicion that is strengthened by the fact that the development fee
14 forms a significant part of the incomes of many municipalities, particularly in the larger
15 urban areas. For low income countries the problem of low revenues from recurrent property
16 taxes is likely to mean problems with actually providing local services, such as education,
17 healthcare, clean water, roads, and sewage.
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24 The light use of recurrent property taxes is reflected in the role that they play in the tax
25 system. Figure 3 shows that on average for OECD countries, recurrent taxes on immovable
26 property generated just 3.4 per cent of tax revenues, though for the leading countries this was
27 9.6 per cent. Similarly, in only six of the non-OECD countries shown in Figure 4 did the
28 receipts from recurrent taxes on immovable property reach the OECD average contribution to
29 tax revenues.
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39 The central question is why are recurrent taxes on immovable property so lightly used in
40 many countries and generate relatively little revenue in spite of the ubiquitous nature of the
41 tax and the arguments in favour of levying it. This would suggest that there are impediments
42 in the way of greater usage of this type of tax. ~~The methodology employed in this article is~~
43 ~~to explore the~~ impediments using case studies of Moldova, Poland, Serbia, and
44 Turkey, countries that have in recent years sought to reform their systems of
45 recurrent taxes on immovable property and the issues that have been encountered in
46 doing so. The case studies have been produced by participant observers either working
47 for the implementing agencies or funding bodies or as valuers, and draw on a variety
48 of sources, including the analyses of laws and regulations, statistical analysis, and
49 interviews with stakeholders.
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55 **Recurrent Property Taxes – the problem**

56 Taxes can be levied using two main bases – by value (*ad valorem* taxes) or on a specific
57 basis, such as by volume, weight, or size. Recurrent property taxes can be levied on the
58 values of the properties, using evidence derived from market prices, or as specific taxes such
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3 as according to the size of the property. In reality, the latter can be modified by applying
4 coefficients to the rate per unit to reflect factors that influence the market price, such as the
5 form of construction or the zone in which the property is located. However, such
6 modifications mean that the assessment is not based on market prices even though the
7 coefficients may reflect factors that can play a role in influencing value. These modifications
8 are likely to mean that there can still be substantial variations in value even within a class of
9 property that is subject to the same coefficients. The sizes of the classes used generally result
10 in mixed collectives with each class containing properties that significantly diverge in value.
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15 Moldova provides an interesting contrast between the two approaches. In 2000 the parliament
16 approved a tax code which introduced value-based assessments (Buzu, 2016). Mass valuation
17 was launched in 2004 with the intention that all properties would be valued between 2004
18 and 2008. The plan was for an additional class of property to be added to the system each
19 year and that the new value-based assessment system would be implemented in stages.
20 Between 2004 and 2011 assessments were undertaken for residential properties in urban
21 areas, garages, commercial and industrial properties, and agricultural land with structures on
22 it, the new tax system being implemented in stages over the period 2007 to 2012. However,
23 only 12.5 per cent of properties were brought into the system as value-based assessments
24 were not carried out on agricultural land, rural housing, or special purpose properties, such as
25 power plants, railways stations, and airports. They continued to be assessed under the former
26 system. Agricultural land is assessed at a flat rate per hectare with an adjustment for the
27 fertility of cropland using a bonity system that places land into broad categories. Pastures and
28 hayfields are assessed at a flat rate. Rural housing is assessed on its historic replacement cost
29 adjusted for depreciation. The migration of the remaining properties to the mass valuation
30 system has been delayed as funds were not made available by the government for completing
31 property registrations and assessments. The result is a dual system with urban areas and
32 industrial and commercial properties in rural areas having been assessed on their market
33 values whilst agricultural land is assessed on its area and rural housing and special purpose
34 properties on their inventory values. Moreover, the periodic revaluations of the properties in
35 the mass valuation system have not been undertaken so that assessments no longer reflect
36 current market values.
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45 In Poland the way in which the recurrent property tax is assessed is determined by the type of
46 object (Walacik, 2016). For land the assessment is based on the area recorded in the cadastre.
47 In the case of agricultural land, it is adjusted for the type and class of land. For buildings,
48 assessment is based on the usable area. Work on reforming the tax system has been going on
49 since 1990, with large numbers of changes being made to the basic legislation, but without
50 bringing about a fundamental change to a value-based system. In 1994 the Council of
51 Ministers required the Ministry of Finance to determine the value of properties for tax
52 purposes. In 1998 the Ministry of Finance created a Department of Local Taxes and Cadastre
53 to prepare and implement property tax reform. A thorough reform of property taxation was
54 also proposed in 2012. Although a system for mass valuation and the legislation for it are in
55 place, the detailed guidelines have not been developed nor how the costs are to be met
56 determined.
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4 By contrast, in Serbia the recurrent property tax is, in principle, based on market values.
5 Taxpayers are divided into two groups. For those that keep records (such as corporate
6 bodies), assessment was based on the book value of properties, but since 2013 local
7 governments have been expected to use fair values (Rašković et. al, 2016). For other
8 taxpayers, which include unincorporated business and households, the average sales price per
9 square metre as at 31 December of the proceeding year for the zone in which they are located
10 is taken and applied to the usable area. The principal problem is one of capacity.
11 Responsibility for the annual property tax was transferred from central to local governments
12 in 2007-09 though without the resources to support it. There are 168 local authorities serving
13 a population of approximately seven million people, many of which are too small to reap the
14 benefits from economies of scale. As is discussed below, the cadastre does not accurately
15 record all properties, so that local governments cannot rely on a central source from which to
16 derive comprehensive tax rolls and the zones can be of such a size that there may be
17 significant variations in value within them.
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24 The annual property tax in Turkey has two parts, a buildings tax and an urban and rural land
25 tax. Although assessed by local governments, the valuation methods are determined by
26 central government. Taxpayers provide municipalities with information about their properties.
27 Building valuations are calculated using a depreciated replacement method. Although
28 construction costs are determined each year by the Ministries of Finance and Urbanization
29 and Environment, the depreciation rates were set in 1982. Land values are determined by
30 valuation commissions that take into account factors that should influence the values of
31 streets and main roads. Until recently, there was no requirement for licensed valuers to be on
32 valuation commissions. Pilot studies in the Fatih district of Istanbul and the Mamak district of
33 Ankara undertaken in 2013-14 indicated that the annual property tax assessments would need
34 to be 2.94 and 1.88 times higher respectively for these to reflect market values (Güneş and
35 Yildiz, 2016).
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41 The problem with area-based property tax assessments or ones based on something like
42 the inventory value, replacement cost, or an average value in a zone or use type that
43 covers a wide group of properties is that governments do not know what the effective tax
44 rate is on any individual property. For instance, large low-value properties can be taxed
45 more highly than smaller but more valuable ones. The effective rate at which the tax is
46 applied is likely to vary within the groups to which properties are assigned. Taxes levied
47 on this basis can be argued to be inequitable and are unlikely to reflect ability to pay.
48 Those taxpayers in possession of more valuable properties, who have the ability to pay
49 more in tax, are not identified as properties are not classified by value. They are likely to be
50 in the same tax group as properties whose unit value is much lower. In such circumstances,
51 tax rates have to be set at levels that are affordable by all. Even though effective tax rates
52 vary between taxpayers, those in possession of low value properties can still pay the tax.
53 But the result is that tax revenues could be increased if recurrent property taxes were
54 value-based are foregone and tax yields are depressed.
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3 If recurrent property taxes are not to be lightly used but to make a more significant
4 contribution to tax revenues, then governments need to levy them ~~based~~ on current values of
5 properties so that they can reflect ability to pay. Such an approach is also more equitable
6 since taxpayers can be charged the same effective tax rate as their peers. If governments are
7 to levy recurrent property taxes on a value basis, there are some formidable obstacles that
8 have to be overcome. It requires governments to move away from assessments based on
9 mixed collectives containing properties of different value ~~and to move~~ either to individual
10 valuations based on market value or the clustering of properties that are of similar value. This
11 requires greater knowledge by governments about the market values of properties and how to
12 apply them to the majority of properties for which there have been no recent transactions to
13 derive tax assessments.
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19 In each of the four countries examined, there is recognition that the current situation is
20 unsatisfactory. Moldova has recently taken out a World Bank loan to improve its land
21 registration and cadastre. This will also finance the extension of its mass valuation system to
22 those properties not currently included and the revaluation of the properties currently within
23 the mass valuation system (World Bank, 2018). Both Serbia and Turkey are engaged in land
24 registration and cadastre improvement projects using World Bank loans that have
25 components on property valuation and taxation. Evidence from these countries and others in
26 the Europe and Central Asian Region of the World Bank that have engaged in property tax
27 reforms indicate that there are a number of problems that have to be resolved as preconditions
28 for successful programmes. First and foremost, there must be a political willingness to reform
29 the current system and momentum to introduce value-based property taxation. There are also
30 various technical issues that have to be resolved. The cost of overcoming them and the time
31 this takes should not be underestimated, and these can be a test of political resolve.
32 Governments are likely also to have to overcome opposition from taxpayers and within
33 government before the resources and sustained commitment needed can be realised.
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40 **Barriers to recurrent property tax reforms: (1)The lack of comprehensive land records**

41 Taxes on immovable assets ought to be difficult to avoid. Immovable assets are by their
42 nature almost impossible to conceal. The problem is that such assets may not be recorded and
43 recurrent property taxes require there to be a comprehensive and accurate list of properties.
44 This implies that there is a cadastre, in which properties are listed, and a register of property
45 ownership recording transactions so that taxpayers can be identified. As Slack and Bird
46 (2014) have noted, the effectiveness of recurrent property taxes depends on the quality of
47 land administration. Informal construction undermines the accuracy of the cadastre, which
48 may not record what actually exists on the ground, and informal transactions mean that the
49 land registry may not be an accurate record of land ownership.
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54 Serbia has a history of informal land markets and construction. During the socialist period,
55 approximately 75 percent of agricultural land was part of private family farms and land
56 transactions were mainly conducted informally. During the 1970s there was rapid urbanisation
57 resulting in unplanned and illegal developments. Violent conflicts in the former Yugoslavia
58 during the 1990s resulted in almost half a million refugees and internally displaced persons
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3 having to be housed, often through informal development. Property rights were often not
4 registered because of obsolete land books and a dual system in which land registration was
5 the responsibility of the courts and the cadastre was maintained by the Republic Geodetic
6 Authority (RGZ). Only since 2012 has there been a unified system operated by RGZ for the
7 whole country (Rašković et. al., 2016). Investigations by municipalities in 2015-16 into
8 objects that were not legally constructed and/or registered as part of legalisation procedures
9 uncovered over 2 million informal objects (Republic of Serbia, Ministry of Construction,
10 Transport and Infrastructure, 2017). More recent estimates have suggested that the number of
11 informal objects may be as high as 5 million ([http://www.rgz.gov.rs/vesti/2865/vest/blic-o-](http://www.rgz.gov.rs/vesti/2865/vest/blic-o-broju-objekata-koji-nisu-upisani-u-katastar-nepokretnosti)
12 [broju-objekata-koji-nisu-upisani-u-katastar-nepokretnosti](http://www.rgz.gov.rs/vesti/2865/vest/blic-o-broju-objekata-koji-nisu-upisani-u-katastar-nepokretnosti)). These reinforce findings from
13 earlier studies. In 2012 a study by GIZ reported that 37 per cent of municipalities estimated
14 that the level of unregistered properties in their jurisdictions was between 20 and 40 per cent
15 (Arsić et.al., 2012) and comparisons between databases in Arandelovac and Indija found
16 significant numbers of properties receiving utilities, such as electricity, but not paying the
17 annual property tax (Rašković et. al., 2016). As utilities are supplied by companies and not
18 municipalities, they have separate billing systems from those used in property taxation.
19 Properties which have not been formally registered or for which all the procedures for
20 securing building approval have not been followed have in the past been able to obtain utility
21 connections and obtain supplies of services like electricity and water for which they have
22 been billed.

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31 In response to this problem RGZ₂ over the period 2017-18₂ extracted buildings from satellite
32 images to create a Buildings Register that includes all taxable objects, whether legally
33 constructed or registered or not. The process of legalising informal developments is a
34 complex and time-consuming one so that this was deemed to be a more efficient approach
35 than updating the cadastre. In effect, a fiscal cadastre has been created. Statistics from
36 satellite images indicate that there are about 5 per cent of registered buildings that need to be
37 removed from the cadastral records as they do not exist. The number of unrecorded buildings
38 varies according to the type of settlement and economic development of the area but pilot
39 studies found that there were roughly an equal number of unrecorded buildings as those
40 actually recorded in the cadastre (Republic Geodetic Authority, 2017-18). Work has also
41 been underway to digitise paper documents containing information about buildings collected
42 during field inspections by local governments as part of legalisation procedures and to create
43 a Condominium Register following legislation in 2016 requiring these to be registered
44 (Rašković et. al., 2018). This work should result in a comprehensive record of taxable objects
45 together with their addresses. As RGZ is responsible for maintaining the addresses register,
46 each object will have a unique identifier which can be used in a wide range of databases. The
47 Government of Serbia has decided to create central system for recurrent property tax. It is
48 a task for the Office for IT and eGovernment.

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56 Turkey, like Serbia, has undergone rapid urbanisation with the average compound rate of
57 urbanisation over the three decades starting in the 1980s being over 4 per cent. A permissive
58 tenure regime granted squatters on urban public land legal status. Many cities were unable to
59 accommodate the growth in their populations, and it is estimated that between 30-60 per cent
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3 of all urban housing stock was informal. Between 1949 and 1990 there were eight amnesties
4 legalising informal housing (World Bank, 2014). The latest regulation in this field was made
5 with the Temporary Article Number 16 being added to the Zoning Law on May 11, 2018. It
6 is foreseen that at around 13 million immovable properties will be legalised with this
7 amendment. The application deadline has been set as the end of October 2018. The Turkish
8 Government is expecting to raise 40 billion Turkish Liras (6.5 billion USD) of income with
9 this measure. Similarly, the response to incursions on to degraded forest lands has been to sell
10 them to the occupiers, usually farmers from neighbouring villages, thereby legalising the
11 trespass. It is not clear that the system for recording properties has kept pace with
12 urbanisation and Turkey is known to have an issue with illegal densification in which
13 buildings are replaced by larger ones and extra storeys added to permitted developments.
14 There has, though, not been the same systematic study of the extent to which properties are
15 accurately recorded in the land registry and cadastre that there has been in Serbia. There is
16 though some anecdotal evidence. The Mayor of Altindag in Ankara has reported how he was
17 able to boost tax revenues and increase municipal expenditure by targeting illegal
18 constructions to the extent that his municipality has even had funds to spend on services that
19 are not officially its responsibility, such as the construction of schools. Even if the
20 information is recorded accurately, it may not be useable unless the data models are
21 consistent. In Turkey, TKGM (the cadastre and land registry agency) is responsible for the
22 Land Registry and Cadastre Information System (TAKBIS) and the Spatial Property System
23 (MEGSIS). These official records have a lack of data standardisation so that reliable
24 information is difficult to obtain. Some data fields have been structured in text format in
25 which users are able to choose what to write and others cannot be classified systematically
26 because of legislative issues. “Data is not hidden, but remains a mystery” (Yildiz and Güneş,
27 2018).

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37 In Moldova the completion of the mass valuation system has been held up by initial first
38 registration being incomplete or inaccurate. Approximately 85 per cent of private lands have
39 been registered but the extension of the mass valuation to include rural properties requires the
40 completion of the system of initial registrations, an aspect of which is the collection of data
41 about each property. Past registrations were not always undertaken accurately resulting in
42 errors in the form of registered titles with graphical parts that have not been defined spatially,
43 overlapping registered parcels or buildings so that boundaries are ambiguous, and titles with
44 no corresponding graphical part. Public lands in the ownership of the state and local
45 governments account for 45 per cent of the land area but only 7 per cent of this is currently
46 registered. Of the estimated 1.1 million unregistered parcels, 325,000 are in the public sector
47 (World Bank, 2018). These parcels need to be delineated as they include lands, such as
48 pastures, which abut on to private lands. The completion of the first registrations is budgeted
49 to cost 15.3 million euro.

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55 In Poland the issues with property information systems have been less to do with the
56 completeness of the records and more to do with records not being unified or accessible
57 electronically. The property right registers are kept by district courts. The cadastre is
58 maintained by starosts (district councils) and provides entry into the land and mortgage
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registers and, therefore, the physical characteristics of the property. It should not matter for property taxation purposes whether there are different bodies maintaining the various registers providing that the principle of the EU's Inspire Directive are met so that users are able to access them electronically for their own purposes. Work on computerising court registers began in 1995. Since 2010 the land and mortgage registers have been accessible via the Ministry of Justice's website. Entries into the paper books have been discontinued but the migration of the books into electronic databases has not been completed. Access to data in the cadastre is through paper systems and the information in it is not linked to the register. It is anticipated that by 2020 the Construction of an Integrated Real Estate System (ZSIN) will be operational so that there will be a central repository of cadastre data sets and exchanges of data between the cadastre and the property registers (Grover and Walacik, 2018).

Barriers to recurrent property tax reforms: (2) Availability of transaction price data

Value-based recurrent property taxes can only be implemented if there is evidence of transaction prices. Depending on the tax base – whether it is the annual or capital value – and how the market operates – whether access to property is by purchasing or renting it – information is needed about sales prices, rentals, and yields. Value-based property taxes take the transaction prices for those properties that have changed hands during a given time period and use them to estimate the market prices of comparable properties. This is typically done using mass valuation systems in which statistical models are derived which identify the principal characteristics that determine price and their influence on it. Where governments require purchase prices to be declared when transactions are registered, the registry is an obvious source of transaction price data. ~~Similarly, if there is a property transfer tax, then declarations made by those buying and selling property should provide a database of property prices. If transactions have to be completed through notaries, then they should have knowledge of transaction prices since these determine their fees. Data on sales prices is available~~

One of the main factors to undermine transparency in property markets is the cost of transactions. The costs include financial ones such as registration fees and property transactions taxes, but also include the time and difficulty involved in registering transaction, particularly if multiple agencies are involved, there are complex data requirements that owners must satisfy, or there are a large number of stages to the process. Under the influence of the World Bank's Doing Business league tables, one of the areas of which is registering a property transaction, there is pressure on governments to simplify and reduce the number of procedures and to lower costs, or else be "named and shamed" over their performance. However, for countries seeking to adopt value-based property taxes there can still be issues to overcome, particularly about the accuracy of the data collected.

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3 In Turkey the mass valuation pilot studies undertaken in Fatih and Mumak identified that the
4 transaction prices declared should be 2.5 and 2.1 times greater respectively than those
5 actually declared (Güneş and Yildiz, 2016). Because it was suspected that transaction prices
6 were under-reported, the mass valuation models made use of mortgage valuations rather than
7 declared prices. Mortgage valuations can only be undertaken by licensed valuers, who are
8 members of the Association of Appraisal Experts of Turkey (TDUB – *Türkiye Değerleme*
9 *Uzmanlari Birliği*), a professional organisation authorised by the Capital Markets Board
10 (CMB). The CMB has adopted International Valuation Standards as the basis for the
11 valuations it regulates and TDUB can discipline members who breach valuation standards.
12 Property transactions in Turkey are subject to a land registration fee of four per cent of the
13 transaction price. Some buyers and sellers appear to evade this by declaring lower values,
14 often based on the tax value, which, as the pilot studies showed, is only a fraction of the
15 market price. This is more difficult where the purchase is financed by a mortgage as the
16 mortgage charge must also be registered. Approximately 22 per cent of sales are financed
17 using mortgages, but this varies within the country from 45 per cent in metropolitan cities to
18 15 per cent in some smaller ones. When multiple sales of a property take place over a short
19 period of time, the declared price can fluctuate markedly according to whether a mortgage
20 has been taken out or not (Yildiz and Güneş, 2018). Reducing the rate at which land
21 registration fees are levied could improve the quality of data by making their evasion less
22 worthwhile, particularly if this was to be accompanied by stronger enforcement action in
23 challenging declarations that look to be unrealistic. The pilot studies suggest that a lower rate
24 applied to true transaction prices is capable of generating a similar level of income to the
25 present fee structure. Policymakers are understandably reluctant to undertake such a radical
26 move in case fee income declines if there is no Laffer curve effect in which lower rates boost
27 activity and revenue. An alternative that has been proposed is to develop an on-line valuation
28 databank for tax valuations using the valuations produced by TDUB members as a proxy for
29 transaction prices.

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40 Moldova has similarly experienced issues with obtaining accurate transaction price data. It
41 has been estimated that as many as 90 per cent of the property sales contracts understate the
42 true prices (Buzu, 2016). This is surprising given that notaries' fees are calculated as a
43 percentage of sales prices (0.1 per cent) but interviews with notaries indicate that they are
44 reluctant to challenge the information they are given. The property transfer tax is only 0.5 per
45 cent. The reason for the inaccuracy though would appear to be the way in which the
46 capital gains tax functioned. This was levied at 12 per cent of the taxable difference
47 between the declared price and the tax valuation, (which is 20 per cent of the entire
48 difference between the declared price and appraised tax value), encouraging buyers and
49 sellers to declare the purchase price to have been at the tax value. Tax values were mainly
50 produced between 2004 and 2009. Proposals to change this so that residential properties are
51 exempt from capital gains tax unless sold within five years should mitigate the problem
52 for this class of property. Growth in the mortgage market should result in more accurate
53 information, though this may be undermined by proposed changes in the regulation of
54 valuers. Companies must employ valuers who have been licensed by the Agency for
55 Land Relations and
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3 Cadastre (ALRC). ALRC set standards, accredited university programmes that valuers must
4 take as initial entry qualifications, required would-be valuers to gain appropriate supervised
5 experience in practice, tested them on their competence, and disciplined those who breached
6 standards. A new law will abolish the role of ALRC. Instead valuers will only be required to
7 gain an initial qualification from an accredited certification body and renew this every five
8 years. MOLDAC, the Moldovan accreditation body, will accredit these certification bodies.
9 In the absence of more reliable information, the mass valuation system made use of proxies
10 including asking prices, information from realtors and valuers, and prices achieved at
11 auctions.
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16 For Serbia the problems with obtaining reliable price information have been more procedural
17 than about accuracy. There is a property transfer tax levied at a rate of 2.5 per cent of the
18 market price or the contract price, whichever is the higher. The Tax Authority uses statistical
19 techniques to identify what it considers to be declarations that are below the market price and
20 has a robust attitude towards collecting what it considers to be the appropriate level of tax.
21 Buyers are usually responsible for paying the transfer tax and there is a 15 per cent capital
22 gains tax on the difference between the disposal and acquisition values, so buyers have no
23 incentive to collude in under-declarations. Until a licensed valuer system was introduced in
24 2016 under pressure from the International Monetary Fund (IMF), mortgage valuations were
25 undertaken by court experts appointed by the Ministry of Justice. They were experts in
26 construction but did not necessarily have valuation qualifications. Unlike Turkey, mortgage
27 valuations would not have been a useful proxy for market prices. The new system introduced
28 valuation standards aligned with International and European Valuation Standards, accredited
29 training bodies, and a rigorous examination system. The first examinations under this system
30 were held in January 2018, in which a pass rate of 14 per cent was achieved, indicating that in
31 the past, valuations may not always have been reliable proxies of market prices.
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38 Buyers and sellers of property submit information about the transaction to three bodies:
39 notaries who authorise the contract and register it with the Ministry of Justice, the Tax
40 Authority, which collects the property transfer tax, and RGZ, which registers the transfer.
41 Before the creation of notaries, contracts were registered with local courts. The problem has
42 been that the various databases have not been able to communicate with each other. A
43 National Spatial Data Infrastructure law is expected to be promulgated which will embody
44 the EU Inspire Directive principles. Two approaches have been adopted to resolving the
45 problem. RGZ developed a Sales Price Register in 2012, which extracted data from sales
46 contracts and manually entered them into a database. Initially the contracts came from local
47 courts but since 2014, have come from notaries. From 2014 market reports have been
48 published. The public have access to certain data from the Sales Price Register - the
49 approximate location of the sale, price, purchase date, real estate type, area, and transaction
50 type (such as sale or transfer between relatives). Professionals (mainly banks, valuers, and
51 realtors) have access to more detailed data, such as precise location (parcel number, street and
52 street number), number of floors for buildings or floor of an apartment, number of rooms, and
53 if encumbrances exist (Rašković et. al., 2018). Interviews indicate that professionals have
54 welcomed the information that the Sales Price Register provides and it appears to have
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3 improved market transparency. The manual entry system was not a sustainable approach in
4 the long run and runs counter to the philosophy of having a “one-stop shop” in which
5 those engaged in property transactions can supply the necessary information once with it
6 being supplied electronically to the various agencies that require it. Work is underway to
7 develop means of communications through databases with the relevant data about
8 properties needed for mass valuation being collected at the property contract stage.
9 Contracts are sent by the notary system to eFrontDesk developed by RGZ and thence to
10 the Sales Price Register and the Real Estate Cadastre, and are available for the Tax
11 Authority.
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16 Securing comprehensive and accurate lists of properties and their characteristics and
17 good quality information about transaction prices is an immense undertaking that
18 requires significant upfront investment. This is before work is undertaken on modelling
19 values, using the models to generate assessments, and billing taxpayers. It may be argued
20 that once the system is established there are economies of scale so that administrative
21 costs are low as a percentage of the tax yield and the costs of valuation per property are
22 modest. In Moldova the costs per valuation were €0.36 per apartment in 2004 and €1.4 per
23 residential block in 2005 (Buzu, 2016). This compares with €17 per assessment in 2014 in
24 the Netherlands (Kuijper and Kathmann, 2016), the Dutch costs probably reflecting
25 higher labour costs than in Moldova. Implicit in the development of value-based
26 recurrent taxes is the assumption that the tax rate will be set at a level that makes the
27 investment in the system worthwhile. Collection systems may also have to be improved
28 so that rates of default and the costs of collection are minimised. All of which implies
29 that there needs to be significant political support behind the move to value-based recurrent
30 property taxes and the administrative effort needed to achieve a successful outcome, and to
31 ensure that resources are made available for completion of the tasks.
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38 Some countries have successfully made the transition to a value-based recurrent property tax
39 from an area-based system of which Lithuania is a notable example (Almy, 2016). Others,
40 though, have encountered problems. In Slovenia, a well-designed value-based property tax
41 system has not been implemented as it was ruled in 2014 to be unconstitutional (Žibrik,
42 2016). In Moldova the move from area-based to value-based property taxation ran out of
43 traction so that the reforms were not applied to most rural properties. The issue was that the
44 costs of extending the system would fall primarily on central government, particularly that of
45 completing initial registrations of rural properties, whereas the benefits from enhanced
46 revenue would be reaped by local governments (Buzu, 2016). The government under
47 financial pressure had limited resources available. Policymakers appeared at that time not to
48 recognise the link between local government finances and those of the government as a whole
49 and therefore the desirability of investing in enhancing revenue from recurrent property
50 taxation. The decision in 2018 to enter into a World Bank loan to complete initial land
51 registration and improve the cadastre and to extend the mass valuation system should bring
52 about the completion of the transition from area-based to value-based property taxation.
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58 Poland’s journey started in 1993 but there are no signs of a value-based recurrent property tax
59 being implemented any time soon (Walacik, 2016). In 2008 Turkey borrowed 135
60 million euro from the World Bank for a land registry and cadastre modernisation
14 project, which

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3 included 4.96 million euro for a property valuation component (World Bank, 2008). This
4 resulted in mass valuation pilot studies in two municipalities and the development of policy
5 proposals (Güneş, and Yildiz, 2016). There has been limited progress towards value-based
6 property taxation since the conclusion of this loan but in September 2018, the Ministry of
7 Finance published a *New Economic Program* for the period 2019-21. The policies include
8 reorganising the tax system “so as to introduce a real estate appraisal system..... and charge
9 title deed fees and property taxes based on real values of properties” (Republic of Turkey,
10 2018). As was noted above, legislation in Serbia supports the use of value-based property
11 taxation but the responsibility for implementation lies with local governments, which had
12 received relatively little support from central government. However, In 2015 Serbia borrowed
13 32.6 million euro from the World Bank for a Real Estate Management Project of which 6.6
14 million euro is for a valuation and property taxation component primarily to develop a sales
15 price register, undertake mass valuation pilot studies, and establish a buildings register
16 (World Bank, 2015). Work to realise these objectives is now underway, including a proposed
17 mass valuation law that will enable the Ministry of Finance to connect all the
18 participants in the process.
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25 These experiences raise the question as to why governments seem to be so reluctant to
26 support the development of value-based recurrent property taxes in spite of the case in favour
27 of doing so. It is true that there are significant costs, particularly for putting in place the initial
28 infrastructure, but soft loans from bodies like the World Bank and bilateral donor aid is often
29 available providing that it is possible to demonstrate that the financial benefits outweigh the
30 costs. Several reasons can be put forward. The support of ministries of finance is needed as
31 they are ultimately responsible for taxation policy and determine whether loans from bodies
32 like the World Bank or commitments to bilateral donors can be entered into. Policymakers do
33 not necessarily take a whole of government approach to public revenues and expenditure and
34 so may not appreciate that what happens in one part of the public sector has repercussions on
35 others. Thus, the impact on intergovernmental fiscal transfers from the inability of local
36 governments to maximise their own revenues is not always appreciated. Ministries of finance
37 can find themselves out of their comfort zones when dealing with property taxation. It
38 involves what is for many policymakers an alien world of property valuations, land registers
39 and cadastres. Exploiting the potential of value-based property taxes runs counter to the
40 prevailing philosophy of “one-stop shops” in which taxpayers, particularly companies, can
41 deal with a single point of contact for the range of taxes they have to pay rather than separate
42 agencies (Grover et. al, 2017). The particular technical demands of recurrent property taxes
43 mean that they are likely to require different institutions for their assessment and collection
44 than other taxes.
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52 Governments are likely to be wary of the political consequences of making changes to the
53 ways in which recurrent property taxes are levied. Monkam and Moore (2015) have argued
54 that they are neglected because they are highly visible and unavoidable. Their intrusive nature
55 is not calculated to make them popular even though they raise much less revenue than many
56 taxes, such as consumption taxes, that can be imposed more stealthily. The use of property
57 values as the base will inevitably increase the tax burden on some taxpayers. They are likely
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3 to be vocal and active in their opposition whereas the beneficiaries may well be inarticulate
4 and disorganised. Cases where change has commanded support have tended to be where
5 additional income has been generated in a relatively painless manner. This enables public
6 support to be garnered through increased expenditure on popular items and by providing
7 more generous relief to some taxpayers particularly adversely affected by the change. These
8 include asset-rich cash-poor groups, such as pensioner households. In transition economies
9 the privatisation of housing resulted in some households gaining ownership of properties they
10 would never have been able to have bought. As owner occupied housing is not an income
11 generating asset, this can present problems for those with low incomes residing in valuable
12 properties bought in the past, when their incomes were higher, or ~~the~~-acquired as a result of
13 restitution, privatisation, or encroachment amnesties. If there are significant numbers of
14 properties that had previously escaped taxation through not being registered, something that
15 is likely if there has been rapid urbanisation, then the potential for raising greater revenue
16 whilst at the same time reducing tax rates, increasing public expenditure, and applying more
17 generous reliefs exists. Where this is not possible, consideration needs to be given to
18 implementing change first for industrial and commercial property and, only when the benefits
19 from increased tax revenue feed through into public expenditure, should the new approach to
20 property taxation be applied to residential property occupied by voters. This raises technical
21 issues since mass valuation can generally applied more readily to residential properties
22 because of the higher numbers of transactions and availability of price data. For industrial
23 and commercial properties, it may be necessary to use income-based valuation models rather
24 than those using comparable sales prices. As shorter leases are generally not registered,
25 securing rental and yield data is likely to be more of a challenge than for sales prices of
26 residential properties.
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36 External events can make feasible policies that previously seemed impossible to bring about.
37 Although Serbia's national debt has fallen from its peak of 74 per cent of GDP in 2016 and
38 there was a budgetary surplus in 2017, previous debt levels were regarded as being
39 unsustainable. As the World Bank noted, "The global financial crisis exposed the structural
40 weaknesses in Serbia's economic growth model and prompted the need for fiscal
41 consolidation and an acceleration of the unfinished transition to a market economy"
42 (<https://www.worldbank.org/en/country/serbia/overview#>). In 2014 \$1 billion was siphoned
43 out of three of Moldova's largest banks, Unibank, Banca de Economii, and Banca Sociala,
44 leading to a bail--out that absorbed half of the government's annual budget (Monahov and
45 Jobert, 2017). The Turkish economy has proved to be vulnerable to external events,
46 particularly increases in US interest rates. The exchange rate for the lira fell by 38 percent
47 in the first nine months of 2018 and the central bank increased its interest rate from 8 per cent
48 to 24 per cent. These provide the backdrop to the *New Economic Program* published in
49 September 2018. These examples all point to governments being willing to accept pain from
50 tax reforms if the economic circumstances and related external pressures require it.
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56 **Conclusions**

57 Recurrent property taxes are widely used with most countries in the world having them.
58 However, they are lightly used raising relatively little revenue either as a percentage of GDP
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3 or total tax revenue in each country. There is a significant gap between the revenues raised by
4 the countries that make most extensive use of them and that of typical countries. This
5 difference points to the untapped potential from recurrent property taxes. This matters
6 because of the role that such taxes play in a tax system. By falling on immovable assets, they
7 are appropriate for use as local taxes but it also makes them relatively immune from impact
8 globalisation has had in particular on company taxes. They are relatively neutral and by
9 falling in wealth, can help to reduce the impact of taxes on consumption, income, and
10 employment.
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15 The relatively light use of recurrent property taxes seems to reflect the tax base used in many
16 countries. Rather than being levied on the market values of properties, they often tax by area
17 or inventory or cadastral value. The tax rates may be moderated according to factors such as
18 location or construction type but the overall result is that properties that differ widely in value
19 are placed in the same tax band. Governments respond to not knowing what the effective tax
20 rate is on any individual property by setting low rates that are affordable by all taxpayers,
21 thereby forgoing the tax revenue that some property owners could afford to pay. If recurrent
22 property taxes are to generate higher revenues then they must be levied on the basis of market
23 values.
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28 There are some significant barriers that governments must overcome to do this. They need to
29 have comprehensive tax rolls that identify all the properties that should be taxed and their
30 characteristics. This is a particular challenge in countries where there has been rapid
31 urbanisation or significant levels of informal development or transactions. Governments need
32 to draw up fiscal cadastres and this often requires the creation comprehensive cadastres and
33 land registers. Fiscal cadastres usually contain more comprehensive information
34 about properties than general cadastres, which may be limited to data about parcel
35 boundaries and land uses. As has been shown in Serbia with the use of satellite imagery,
36 it is necessary to collect accurate data about buildings. Information also has to be
37 collected about the characteristics of the buildings. This may be possible through data
38 collected from buyers and sellers when property is transferred but may also require surveys to
39 be undertaken to establish the initial fiscal cadastre. Reporting structures so that the
40 property tax administrators can learn from spatial planning and building control
41 authorities what changes are made to buildings help to ensure the currency of the fiscal
42 cadastre.
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49 Governments also need to access good information about transaction prices so that data about
50 those properties for which there have been recent transactions can be used to
51 value comparable properties. Significant investment may be required to establish systems
52 such as sales price registers which generate comprehensive information about transaction
53 prices. This may require governments to ~~tackle~~ under-reporting of ~~transaction~~
54 ~~prices~~ during property transactions to evade fees or taxes and to prevent due to
55 informal transactions. or tax or fee evasion. High levels of transfer taxes or fees
56 provide an incentive for under-reporting real transaction prices whereas carefully
57 structured capital gains taxes that buyers may be faced with when they in due course
58 sell the property can discourage collusion between buyers and sellers in declaring false
59 prices since it will not be in the interests of buyers to have recorded
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3 an artificially low base price from which capital gains are calculated. The use of mortgages to
4 finance purchases with mortgage valuations being carried out by licensed valuers diminishes
5 the opportunity for under-declaration where charges like mortgages have to be registered.
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8 The investment involved in tackling these technical issues is substantial and takes time to
9 realise. Governments have to be willing to maintain momentum for reform for a significant
10 period of time. There are governance obstacles that can stand in the way of this. Taxpayers
11 may object to reform on the grounds that they fear (correctly in some cases) that the tax
12 burden will increase. The potential beneficiaries, by contrast, are likely to remain silent or be
13 disorganised. Governments need to address the reasonable fears of those households who
14 lack liquidity to meet higher tax bills because they are cash poor but asset rich. It can be
15 difficult to find champions of reform in government as property taxes require specialist skills
16 and an approach that is very different from taxes on incomes, consumption, or employment.
17 Many countries with low revenues from recurrent property taxes could raise the funds needed
18 for investment in this area through World Bank loans. Their willingness to do so may require
19 external stimulus. Economic crisis and the need to increase tax revenues can make
20 possible what was previously thought to be unattainable.
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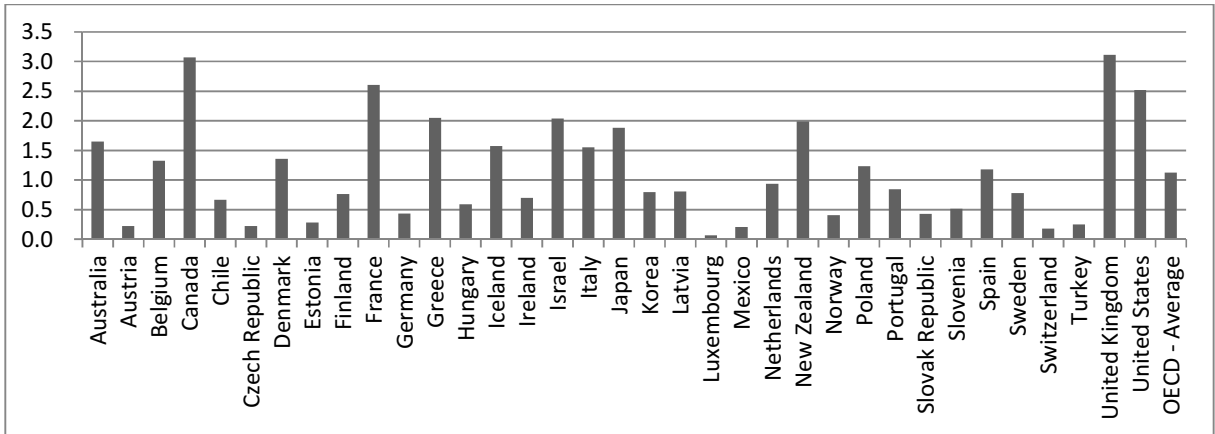
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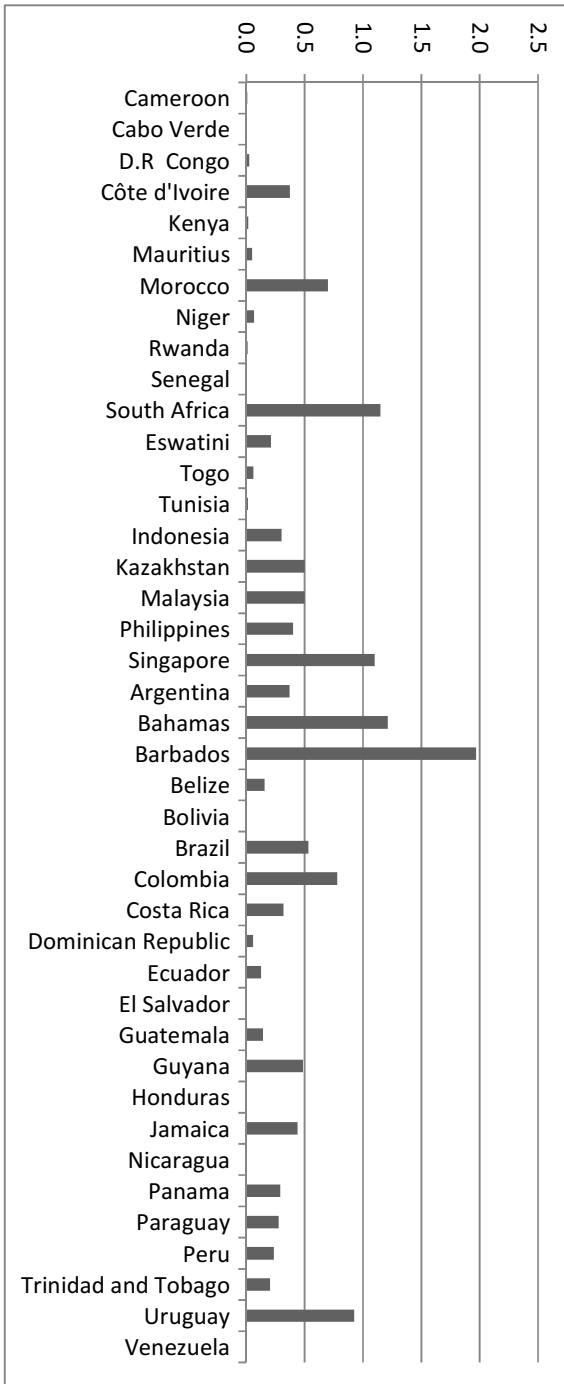
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41 *Tenure Journal*, Vol. 15 No. 2, pp. 83-99.
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Figure 1 Recurrent Taxes on Immovable Property as a Percentage of the Gross Domestic Product of OECD countries, 2015



Source: OECD (2017) *Dataset Revenue Statistics – Comparative tables, 4100 Recurrent taxes on immovable property*, <https://stats.oecd.org/index.aspx?DataSetCode=REV#> (accessed on 20 September 2018)

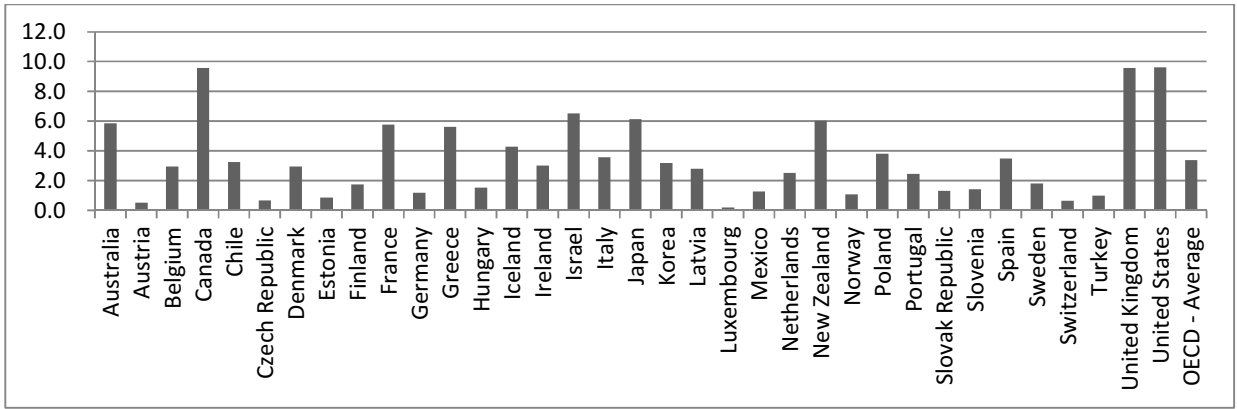
Figure 2 Recurrent Taxes on Immovable Property as a Percentage of the Gross Domestic Product of in selected non-OECD countries, 2015



Source: OECD (2017) *Dataset Revenue Statistics – Comparative tables, 4100 Recurrent taxes on immovable property*, <https://stats.oecd.org/index.aspx?DataSetCode=REV#> (accessed on 20 September 2018)

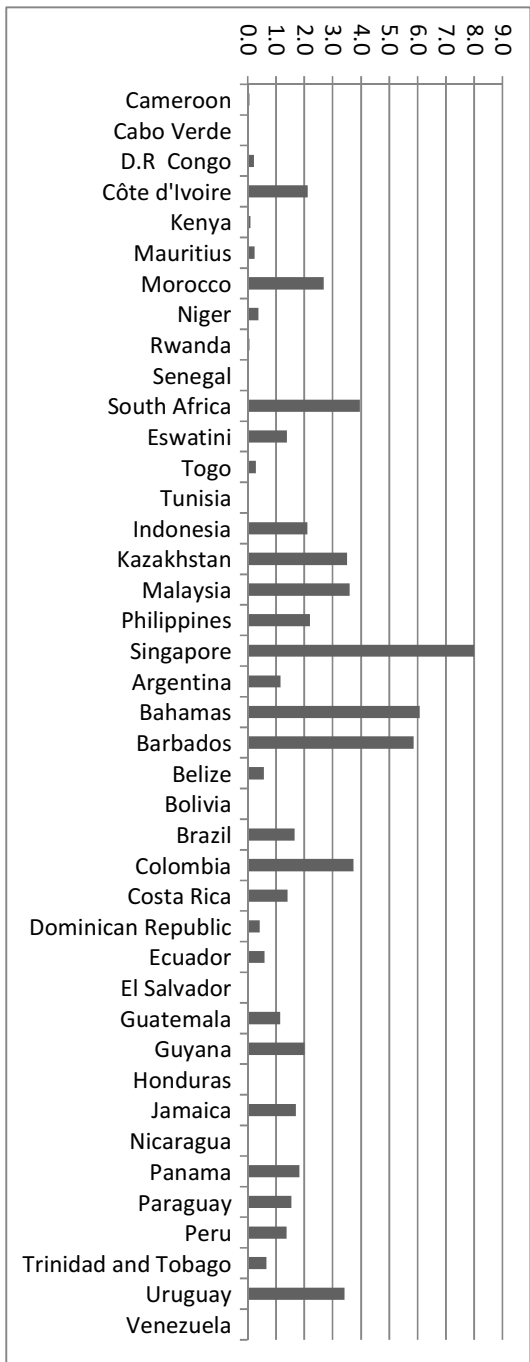
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Figure 3 Recurrent Taxes on Immovable Property as a Percentage of Total Tax Revenues of OECD countries, 2015



Source: OECD (2017) *Dataset Revenue Statistics – Comparative tables, 4100 Recurrent taxes on immovable property*, <https://stats.oecd.org/index.aspx?DataSetCode=REV#> (accessed on 20 September 2018)

Figure 4 Recurrent Taxes on Immovable Property as a Percentage of Total Tax Revenues in Selected non-OECD countries, 2015



Source: OECD (2017) *Dataset Revenue Statistics – Comparative tables, 4100 Recurrent taxes on immovable property*, <https://stats.oecd.org/index.aspx?DataSetCode=REV#> (accessed on 20 September 2018)

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