



The Fiscal Decentralization Initiative
for Central and Eastern Europe

Reforming Property Taxation in Southeast Europe

A Comparative Review

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Introduction

Reforming Property Taxation in Southeast Europe (SEE) is the title of the Fiscal Decentralization Initiative (FDI) policy forum, held in May 2004, in Skopje, Macedonia. The three year program is a joint USAID-OSI (Local Government and Public Service Reform Initiative) undertaking in SEE, Central Asia and the Caucasus. At this two-day event, various authors presented papers on property taxation in five of the six countries that made up the former Republic of Yugoslavia. The author of the Croatian paper rightly expressed the common historical roots in the subtitle of his paper – *Evolving from a Shared Legislative Heritage*.

Each of the five papers gives an exposé on property taxes¹ in the respective country. The volumes as well as the approaches are quite different. In addition, almost every paper has a different time perspective, ranging from a strict focus on the actual existing situation, through a mixed analysis of an existing situation and expected developments, to an emphasis simply on expected developments or even developments desired by the author. This variety of approaches makes it difficult to compare property taxation in the five countries consistently and thematically.

For instance, Biljana Vusurovic from Montenegro straightforwardly describes the new Law on Property Taxes, its implementation and the problems that occurred, mainly because of poor planning and coordination; it is therefore the most practical of the five papers. The Macedonian paper, by Svetlana Janevska, mainly describes in a formal legalistic way, the existing Law on Property Tax as well as the new law under parliamentary procedure, due to become effective in 2005. The Slovenian authors, Neva Žibik and Dušan Mitrović, on the

other hand, give a short historic overview of the property tax system in their country and describe a new property tax system still under discussion. They further describe a system for mass appraisal, which will be introduced with the new Property Tax System in 2006.

Ante Pavić from Croatia chooses a broader approach. He discusses not only the commonly known Property Tax but also all taxes related to properties. Furthermore, the paper outlines possible directions for tax reforms in Croatia with a strong emphasis on a valuation system, based on coefficients calibrated to market value. The Serbian author, Boris Begović, describes the existing situation in the country and recommends computer based mass appraisal as the only acceptable system to establish the tax base for property taxes. He provides his personal opinion on taxation principles many times.

As said before, these different approaches by each of the authors make a consistent and thematic comparison of the five countries difficult. For that reason, I have chosen to extensively summarise the papers to make them more accessible to the reader. The summary only focuses on the most important aspects, whereas valuable detailed information remains in the original texts provided in the annexes. Thus, the summarised papers are chapter one through five of this volume. The sixth chapter gives a thematic comparison and describes some commonly encountered problems.

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Henri Schreurs
Editor

¹ The authors use various names, like Property (Tax), Real Property (Tax) and Real Estate (Tax). The editor will use invariably the word Property (Tax), which, according to UK-dictionaries stands for buildings and land (Tax).

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Croatia

1. Introduction

The European Charter on Local Self Government reads that local governments should have sufficient own source revenues to discharge their functions. In this respect, virtually all European Union countries, with the exception of Malta², have some form of property taxation. Some countries levy only taxes on land, others only on buildings, but most European countries levy a tax on both land and buildings. Almost all countries determine this tax on the property's value.

In most European countries, the taxable subject is the owner of the property. However, in countries where land registries are outdated, oftentimes the owner or the occupier is the taxable subject. The issue of regular updating and verifying land registries and property values is a problem in many countries. Valuation updates and revaluations have often been postponed for several years. This leads to inaccurate capital value estimates, erodes the tax base and reduces taxpayer confidence in a fair tax administration.

In terms of exemptions and relieves, it is difficult to find a common approach amongst European Union countries but they tend to be limited and targeted towards specific taxpayers such as governments, embassies, religious, cultural and historical institutions.

Property taxation in Croatia, as well as in most East European countries, is the result of a unique set of historical, political, and institutional facts and changes that shaped and influenced the types of government financing in this part of the world. Because of that, Croatia has no real value based property tax, but instead a range of property related taxes and fees. It is worthwhile to note that the majority of property related taxes in Croatia are local government's own resources.

2. Local Government Taxes and Fees

Croatia has four groups of taxes and fees, which are fully or in part local government own resources.

- Taxes shared between central and local government
- County tax
- Municipal/Town taxes
- Municipal/Town fees

For each tax and fee that belongs to these four groups, the central government sets the tax base and a range of rates. Local governments establish the taxable objects, set the rates within the determined ranges and decide on local exemptions. All proceeds are local own resources, except for the Property Transfer Tax, which is shared between central and local government on a forty/sixty percent basis.

2.1 Taxes Shared between Central and Local Government

The central and local government share many taxes, but the Property Transfer Tax is the only one related to property. The central government keeps forty percent of this revenue and sixty percent belongs to the municipality on which territory the rights transfer occurred.

The subject of taxation is the transfer of ownership rights of land and buildings. Transfer means any situation in which land or buildings change legal ownership, be it by purchase, donation, inheritance or swap. The tax base is the market value of the property on the date of transfer, i.e. the price of the property achieved or that could have been achieved. The market value is established on the date of the sales contract, inheritance deed or court sentence. The tax rate is five percent of the tax base. Citizens and legal or physical persons subject to the value added tax are exempted.

² Norway also does not levy property taxes; however, it is not a European Union member state.

The taxpayer is the one who acquires legal ownership of the property. In the case of co-ownership, each acquirer is liable for his share. Foreign persons, who are entitled to purchase property, must pay the property transfer tax, unless exempted by international agreement. The law specifies when the tax obligation arises. Generally, it is at the moment of entering into a contract or the moment that a court or administrative decision becomes legally valid.

The taxpayer is required to submit the statement on the property transfer and any other document as evidence for the transaction, to the local Tax Administration Office within thirty days. Based on these documents, the tax administration establishes the property's market value. The taxpayer may appeal against the thus established value, in which case, the tax administration reviews the appeal and sends it to a commission to assess the property's market value.

A range of exemptions exists for the Property Transfer Tax. The most frequently applied and most significant are: central and local governments, legacies, foundations, the Red Cross and other humanitarian organizations; foreign diplomatic and consular agencies; persons acquiring the property in a procedure of return of confiscated property and land consolidation; displaced persons and refugees acquiring property by swapping against properties abroad; citizens buying a residential building or apartment. The same applies to protected tenants that buy a residential building or apartment in which they live; to persons acquiring properties in accordance with regulations on the transformation of social ownership into another ownership form; to first line inheritors that acquire properties on the basis of the agreement of life long support; to persons acquiring certain parts of a property by the termination of co-ownership, or in the division of shared property ownership up to the level of their share of its value.

2.2 The County Tax

The proceeds of the Gift and Inheritance Tax are own revenue taxes for the counties. It is levied on gifts and inheritances in cash, cash receivables, securities and movable properties. In a sense, it is the compliment to the above mentioned Property Transfer Tax, as far as gifts and inheritances are concerned. The Property Transfer Tax is restricted to immovable properties, whereas movable properties are subjected to the Gift and Inheritance Tax. The tax is levied from physical and legal persons that inherited or received a gift, at a rate of five percent over any cash amount and the market value of all other

assets. A number of exemptions exist, especially based on kinship and for donations to central and local governments.

Gift and inheritance taxes are not true property taxes because the reason for taxation is not the property itself but a special event related to it. The property itself serves only as a measure to determine the amount of taxes.

2.3 Municipal Taxes

Municipalities and towns are entitled to six different taxes. Four belong clearly to the property tax family. The other two clearly have a different nature.

The property related taxes are:

- Tax on vacation houses
- Tax on idle agricultural land
- Tax on vacant business properties
- Tax on undeveloped building plots

All four are quite similar, except for the type of property and the tax rates. For each tax, the taxpayer is the owner of the type of property mentioned in the title: vacation houses, idle agricultural land, vacant business property and undeveloped building plots. Each has a tax base related to the surface of the property, expressed in square meters or in hectares. The rates are different for each tax. The law determines one or more rate ranges and local governments have the discretion to set their own rates within those limits. Each law has its own set of exemptions, and local governments have some discretion to add others. All four taxes must be declared by March 31 and paid within 15 days.

The two other municipal, non-property taxes are the Company and Title Tax and the Tax on the Use of Public Areas. The first one is a kind of lump sum payment for any company that has a trade name. The local government determine the rates, which may not exceed HRK 2,000 a year. Companies that do not conduct any activity are exempted. Legal and physical persons that make use of public spaces are the taxable subject for the Tax on Public Areas.

2.4 Municipal Fees

A communal fee is levied on owners of residential and business spaces, garages and (undeveloped) building land. In addition, a communal charge exists for owners of building sites on which a building is constructed. Both are earmarked revenues: the communal fee to finance public services, such as sewage, cleaning, maintenance

of public spaces, unclassified roads, cemeteries and public lightning; the communal charge to finance new public infrastructure. The communal fee is generally paid on a monthly basis and the communal charge is, by definition, only paid once.

The communal fee is calculated as an amount per square meter, multiplied by two coefficients, one for the zone in which the property is located and another for the use that is made of the property. Local governments determine within legal limits the amount per square meter as well as the coefficients for zone and for use. The law gives a number of exemptions and local governments may add local exemptions. Some examples are properties from the army, properties for educational and health services and certain properties financed from the local budget.

The communal charge is calculated as an amount per cubic meter of the building to be constructed, multiplied by a coefficient for the zone in which the site is located. The charge cannot exceed ten percent of the average construction costs of the type of building as publicised by the Minister of Communal Economy.

The communal fee has all the features of a true property tax. However, it is theoretically a fee and not a tax because the proceeds are earmarked for communal services. The system is actually rather inequitable. Under the current area-based system, no distinction exists for qualitative differences between the same types of properties, located in the same zone. For instance, an old, run-down flat would have the same tax base as a same sized, newly renovated flat located in the same or similar zone. This inequality occurs because no relation exists between the tax base and the market value of the property. The communal fee as determined by the Law on Municipal Economy, is governed by fixed regulations and coefficients; it does not recognise market activity and is not transparent for taxpayers.

Contrary to the practice in countries with a market-based property tax, a great disparity exists in the taxation of individuals and legal entities and of rich and poor taxpayers. In some sample communities, businesses are taxed at effective tax rates six to ten times higher than for residential properties. Although businesses typically constitute just five percent of the tax base, they shoulder approximately seventy percent of the tax burden. This is not conducive for the business climate. This inequity may also be found within property classes. A luxury apartment, with a value of for example one million HRK, would pay an equal amount of communal fee as a same sized apartment in an old socialist apartment block in

the same or in a similar location, but with a value of say, half a million HRK or even less.

Each of the 521 local governments in Croatia, which administer a communal fee, has established a system to assess the amounts due by individual property owners, to issue bills and to collect the fees. They are responsible for maintaining property records in order to administer the fee. Municipalities that do not have the ability to develop, maintain, or manage their systems and databases may contract it out to private companies. There is no standard for data maintenance and controls. Generally, the local personnel in charge of levying and collecting taxes and fees are well trained.

Local governments' databases are generally incomplete and not regularly updated, resulting in incorrect bills. They do not receive any assistance in updating property records from ministries, which may collect information relevant to the administration of the communal fee. The Ministry of Justice, for example, maintains the official registry for property rights but does not share the information with local governments, which are often unaware when property changes hands. As result, communal fee bills continue to be addressed to the previous owner. The same occurs when a property owner constructs an addition to his home, which has never been recorded in the communal fee database.

3. Possibilities for Reform

Croatia is exploring ways to decentralise and reform the finance system for municipalities. The aim is to improve the intergovernmental transfers system and to develop a fair and efficient way to administer municipal own revenue source. The ultimate goal is to reduce municipal reliance on transfers from the central government. One of the main sources for future municipal revenues should be a value based property tax.

Development and transformation of the communal fee into a true market value based property tax would achieve multiple objectives and improve the fairness of tax burden allocation. It would support the decentralisation process and provide municipalities with a stable and relatively easy to manage own revenue source. It sends signals to the property market, which might improve efficiency of land utilisation. Finally, it might increase local governments' financial capacity needed to finance large public investments, once the country receives European Union pre-accession funds.

Property sales data are already available, appraisal skills and knowledge do exist and some studies suggest

that modern mass valuation methods could be introduced in a short period. Two options exist to introduce a real property tax in the future: the recalibration of the existing communal fee coefficients or the introduction of a value based system.

3.1 Calibration of Coefficients

The existing coefficients for the communal fee can be recalibrated to the market value of property, to simulate an elementary value based property tax with coefficients for the zone in which the property is located, and for its use. One would still follow the same formula to calculate the communal fee, only the coefficients would now more accurately reflect the average value of the property in each zone and for each category of use. In this way, the communal fee can simulate a value based tax.

The current coefficients are largely the result of political decisions by the local council. First they determine the total amount of revenue they would like to raise and secondly how to spread this amount over the various property classes. Generally, they place the greatest burden on business properties because of a widely held perception of relative wealth.

A case study in a specific municipality revealed that the coefficients for the use of property for businesses are mainly determined by the ability to pay. This confirms the absence of any relationship to the real value of the property. Although businesses represent just five percent of taxable properties, their revenue contribution is seventy percent. Furthermore, the distribution among different business classes varies widely because the coefficients for the use of the property range from one to ten. Unfortunately, this coefficient variety does not have much relationship with differences in market value. Based on a revenue neutral change, the rates and coefficients for zone and use were recalibrated to simulate the estimated market value. The coefficients and rates that resulted were quite different from the ones actually applied.

Introduction of recalibrated coefficients for the communal fee does not require a new law or major changes to existing laws. To introduce recalibrated coefficients, only the Law on Communal Economy needs amending. Another reason to start with this interim step towards a real value based property tax is the property market in Croatia. Although it is developing fast, it does not yet have the maturity favourable to introduction of a value based property tax.

3.2 Legal Reform and Institutional Frameworks

Local governments already administer the communal fee and an efficient transition to a property tax system would be possible. Local governments will be able to move quickly to transform their communal fee departments into property tax departments. Croatia is well positioned to implement it quickly, should the central government so choose. The current communal fee is a locally based tax and local governments are solely responsible to survey the properties, file the data, make assessments, distribute the bills and collect the revenues. The lines of control between various state agencies are not complex. As a result, the technical and human capacity to administer a value based property tax already exists at the local level. The responsibility vested in local governments, without interference from an overbearing central authority, will facilitate the development of property tax departments. What they do need is guidance from the Ministry of Finance on specific actions to manage the transition to a property tax.

At the national level, a new property tax law, based on market value or on market calibrated coefficients, is needed. It should provide a global framework to reach a minimum level of uniformity among local governments. Uniformity should exist across taxable objects, taxable subjects, exemptions, tax bases, property classifications, assessment ratios for various types of properties, general guidance on rates and administrative procedures. A supervising authority should be established, to certify local governments that meet certain minimum standards and ensure compliance with legislation and other central government regulations. For recalibration, the supervising authority should provide local governments with a new schedule of communal fee coefficients. Additionally, a procedure for non-judicial appeal should be introduced.

Finally, the property tax should become general purpose revenue, allowing local governments to spend the revenues at their own discretion.

3.3 Fiscal Cadastre

A database with all taxable objects will be indispensable for the implementation of any property tax system. Each municipality needs to identify all properties within its territory. This will require some prototyping to establish the best methods for developing a complete and correct database. It would be efficient to as much as possible use information already available from other resources, whether at the local or central governments level. These

data can be matched with communal fee payments to discover unrecorded properties. The challenge will be to establish procedures for coordination and cooperation for efficient exchange of information between the various organisations. In addition to the exchange of information, some field surveys remain necessary, to verify whether basic information and property characteristics in the database are correct.

One of the major tasks for local governments is to develop a fiscal cadastre for registration of all information necessary to administer the property tax. The fiscal cadastre can be organised either at local or central government level. A procedure must be established for data exchange between the various organisations that will make use of the system. The State Geodetic Administration, with assistance from the World Bank, is developing an integrated legal/ fiscal cadastre, which will store information on ownership, property rights and property characteristics. Local governments should organise their fiscal cadastrals in compliance with this central cadastre, i.e. by property rather than by owner, as is the current practice. In turn, the State Geodetic Administration must be able to store property characteristics, available in and needed for the local cadastrals.

One of the new cadastre developments will be a scheme for unique Parcel Identification Numbers (PIN) and surveying parcels' geographic x-y coordinates. However, it will take several years before this feature is fully developed. Nevertheless, the local fiscal cadastrals should already be developed so that a property's PIN and parcel's x-y coordinates can be easily included, whenever they become available.

Building a fiscal cadastre is time consuming and requires the unification of databases with several types of information, including taxpayer information and a description of the property and its characteristics like size and location. Data on property characteristics, most of which are now only available in written form at the Ministry of Finance's Tax Department must be entered into the database.

It will take a lot of effort to create the databases and to enter the necessary data; however, one advantage is that local governments already have their communal fee databases, which can serve as a useful foundation for a fiscal cadastre. They already contain such basic information as the property address, owner, land zone, location, area and property class. Local governments need to collect additional information on property characteristics such as: total number of rooms, bedrooms and bathrooms; type of building material and construction; current state of repair, etc. Other agencies, especially the Ministry of Finance's Tax Department, utility companies, and mortgage banks have computerised data that would be useful for both cadastre development and establishment and management of a property tax system. Procedures should be developed to share this information.

The Ministry of Finance should also collect information on these property characteristics for the Capital Transactions Tax. It is currently computerising those data collected by government assessors who verify property sale prices to control compliance with the law. Once in computer format, this data may be transferred to local governments to help them establish their own fiscal cadastrals. Local governments that collect communal fees could ask taxpayers to self-declare their property characteristics on the back of their communal fee bill at the time of payment, or separate questionnaires could be distributed. The goal is to minimise the need to survey, if possible, to the point where surveyors only need to visit a few properties to verify the accuracy of data and to collect unreported data. The burden to collect property characteristics should be borne entirely by the community. Donor assistance should be limited to guidance and training related to procedures, software and methods related to the proper use of the fiscal cadastre.

The development of a fiscal cadastre is not only the biggest task that municipalities face but also the most important, as the entire property tax system depends completely on the quality of the data available in the fiscal cadastre.

Macedonia

1. Introduction

The Law on Property Tax in force in 2004, had been introduced in the year 1994. Macedonia was in a decentralisation process and needed a new law to transfer the property, inheritance, gifts and property transfer taxes to municipalities. It was anticipated that this transfer of competences would enhance the municipalities' interest in collecting these taxes and would improve citizens' understanding of the relationship between revenues from taxes and services offered by municipalities.

The new Law on Property Tax was in parliamentary procedure in 2004 and scheduled to become effective from 1 January 2005³. The paper presents the existing law, in parallel with the new one.

2. Subject to Taxation

Property tax in Macedonia is, under existing law, levied on legal entities and physical persons that own property, and on movable property, if not directly used for performing an activity. The draft law extends the range of taxpayers to the users of property, in case the owner is unknown or unavailable and for state-owned property. In certain cases the person who usufructs the property, is considered to be the taxpayer⁴. If more than one person owns the property, each of them is liable, proportional to each share of ownership. The government is exempted from property tax. Municipalities do not receive the authority to levy taxes on movable property.

³ Although Parliament passed the new Law on Property Taxes in 2004, the new directions have not been devolved to the municipalities in 2005 but will be in 2006.

⁴ The new law mentions usufruct, but does not specify the cases in which usufruct instead of ownership is subject to taxation.

3. Tax Base

The tax base for property tax is the market value⁵ of the property and is based on a self-assessment by the taxpayer, to be submitted to the Public Revenue Office (PRO). However, if the PRO considers the assessed value unrealistic, they determine the value themselves, by comparison with similar properties. The draft law transfers the assessment procedures to a commission to be established by each municipality. These commissions must assess properties based on the methodology for the valuation of the market value of property, proposed by the Ministry of Finance and passed by the government⁶. The Ministry of Finance shall control the assessment by the municipal commissions to ensure that the methodology is properly applied.

4. Tax Rates

The existing law has one uniform rate of 0.1 percent. Under the new law a range from 0.1 to 0.2 percent is envisaged. Municipal councils receive discretion to set the local rate within this range. Furthermore, municipal councils can increase the rates on unused agricultural land by a factor of three to five. The taxes for residential buildings and apartments, occupied by the taxpayer and his family, will be reduced by fifty percent.

⁵ Although the methodology reads: market value is the value of property that could be reached in the free market at the moment of tax duty, the result is not a market value at all but a proxy, based on price per square surface meter, adjusted by a number of coefficients for location, type of construction, etc.

⁶ The Macedonian Government adopted the methodology on 22nd June 2005.

5. Exemptions

Both the existing and proposed law provide a whole range of exemptions, which can be grouped according to ownership, purpose and location.

Ownership: property owned by governments, foreign diplomatic and consular representatives, international organizations, the national bank (introduced by the new law) and religious communities. **Purpose:** buildings and premises used for business activities of the taxpayer, except use for administrative purposes; facilities for training, professional rehabilitation and employment of disabled persons; agricultural land used for agricultural production; land used for ground and underground excavation in mining and geologic research; facilities for protection of land, water and air; cultural monuments (introduced by the new law); infrastructure and; all public facilities owned by a government body. **Location:** residential buildings in mountainous, rural settlements, as determined by the Government.

6. Assessment and Collection

The Public Revenue Authority's regional offices, part of the Ministry of Finance, assess and collect the property tax. The new law devolves this authority to municipalities. The taxpayer is obliged to submit their tax return by 31 January in the year for which the tax is assessed only if the data from his previous tax return has changed. For new tax liabilities that occur in the course of a year, the taxpayer is obliged to submit a tax return within 15 days. The tax return must be submitted to the Public Revenues Authority on whose territory the property is located. The PRO is obliged to take a decision, at the latest by 31 March, and to send the decision on the assessed tax to the taxpayer. The new law devolves all competences from the PRO to the Office of the Mayor. When property is inherited, the court is obliged to submit the decision on inheritance within 15 days to the PRO, which is obliged to assess the tax on inheritance and send its decision to the taxpayer within 30 days. This competence will also be devolved to the Mayor's office.

Property tax is assessed according to data in the tax return from taxpayers' business books and other data available to the PRO. The tax return form is comprised of three parts. First, data on the taxable subject (the taxpayer) followed by data on the taxable object (the property) and finally data on movable assets. The tax return is accompanied by an attachment, which contains a great number of data to be provided by the taxpayer. Finally, the taxpayer declares the value of the property, which is

the basis for the PRO's calculation of the amount of tax due. If the PRO considers the declared value unrealistic, it either makes a comparison with similar properties or does an onsite assessment and determines the value of the property to be taxed. The new law maintains the form and contents of the tax return procedures and documents⁷; however, the taxpayer does not need to declare its value. The municipal commissions for determining the market value of the property will do this.

Property tax is due quarterly in the middle of each quarter or within 15 days from the day the decision is submitted to the taxpayer.

7. Complaints and Infringements

The Macedonian Constitution guarantees the principle of a two instance complaints procedure. Taxpayers may lodge complaints against the decision of the PRO to the Ministry of Finance within 15 days. A complaint does not delay the collection of the assessed tax. Under the new law, this competence will be devolved from the PRO to the mayor.

Both the existing property tax law and the new one have sanctions for infringement. Taxpayers will be fined if they do not submit timely tax returns. The taxpayer can be punished if they hinder enforced collection and/or if they change the status of the property left for safeguarding. Furthermore, the Mayor's office has a number of measures to oblige third parties to cooperate in the forced collection of taxes due. Taxpayers can ultimately be subjected to both fines and imprisonment of 30 to 90 days if they do not cooperate.

The new law prescribes fines if the person responsible in the municipal administration fails to apply the methodology for assessing the market value of the property as well as the Mayor's office if they fail to adopt a decision on property tax before the given deadlines.

The law has further procedures for securing the payment of taxes in arrears, for refund of taxes paid in excess or incorrectly paid taxes, and for enforced collection.

⁷ The Ministry of Finance must issue a new model for tax returns because the taxation of movable properties is not devolved to municipalities.

8. Pilot Project

The collection rate of property tax is generally low in Macedonia. In the period 1999–2002, the highest collection was sixty percent in 2000, the lowest was in 2002 with only fifty percent. This poor collection was mainly ascribed to the PRO, which focused primarily on taxes that have greater importance for central governments coffers, like VAT, excises, profit and personal income tax. The collection rate for property tax was expected to become one hundred percent with the devolution of its administration to local government in 2005⁸.

In 2003, prior to the implementation of the new law, the Ministry of Finance concluded a Memorandum of Cooperation with four pilot municipalities. This memorandum enabled the four municipalities to assess and collect the property taxes and land fees as a delegated competence. The competent state bodies and institutions were to provide all the data needed to update the records necessary for assessment and collection of the taxes and fees. Employees of PRO could temporarily be transferred to the pilot municipalities. All four pilot municipalities encountered major problems in accessing the database of the Ministry of Internal Affairs for registration of motor vehicles subject to taxation, as well as to the cadastral database of the State Geodetic Office.

9. Cadastres

Macedonia has two different databases for property. The land cadastre (old) and the property cadastre (new), both reside under the competence of the State Geodetic Office. The new cadastre will gradually replace the old one, established in 1940 and updated in 1954, 1960 and 1970. It contains records on the ownership of property, land surveys and the base of the buildings. However, the records of this old cadastre are not reliable evidence for ownership of property rights, and many are incomplete, due to poor recording over the course of many years and

exacerbated by problems related to the return of state owned land to former owners. Illegal buildings are not recorded in the old cadastre, unless the owner submits the necessary documents to obtain the required licenses. Owners request registration of their illegal buildings upon submission of tax returns and payment of the property taxes. However, such requests are rejected.

The new cadastre is based on a complete re-survey of the property, of both land and buildings. It contains information on the age of buildings, construction material, number of floors, size of flats, number of rooms and their use, and size of the buildings. The new cadastre is a reliable record for registering the rights to property, including certain liabilities arising from the property, such as mortgages. Title deeds can be issued based on the new cadastre. The new cadastre also contains detailed information on illegal buildings, but no title deeds are issued for such properties until the appropriate licenses and technical documentation are approved by the Ministry of Transport and Communications.

A separate fiscal cadastre determines the tax base and is used for preparing and calculating tax liabilities. This fiscal cadastre should be updated with data from the land cadastre. Unfortunately, this process advances slowly. Although the land cadastre and the PRO do exchange data, the fiscal cadastre is far from being a true copy of the data in the land cadastre. The fiscal cadastre maintained by the PRO lists assessed value and other related property related information, taxpayer information, and tax liabilities, paid taxes, arrears and penalties.

Most information in the fiscal cadastre is derived directly from taxpayers' tax returns because no cross checks with other databases such as the land cadastre or the Ministry of Internal Affairs, are possible. Furthermore, the PRO also lacks sufficient resources to carry out on-site controls to verify the information provided by the taxpayer or to find properties that are not registered at all.

⁸ Although Parliament passed the new Law on Property Taxes in 2004, the new directions have not been devolved to the municipalities in 2005 but will be in 2006.

Montenegro

1. Introduction

In the year 2000, Montenegro started a decentralisation process to devolve more authority from central governments to local governments. Among others, a new Law on Property Tax replaced the old property law. This new law should harmonise Montenegro's tax system with international tax practices and the European Charter on Local Self-Government. A gradual implementation was planned, to allow local governments to properly prepare for their new responsibilities.

The old Law on Property was not in accordance with basic taxation standards and was rather complicated. The tax was levied and collected by the central government's Department of Public Revenue. Local governments did not play any role, but received fifty percent of the revenues collected on their territory. As a source of revenues, the property tax was rather insignificant, according to some analyses, less than one percent of the central government's budget and less than five percent of municipal budgets. Furthermore, the collection rate was very poor, below forty-three percent.

Under the new law, municipalities may levy and collect property taxes, beginning in the year 2003. The revenues are one hundred percent municipal own resources. The law replaced the nominal valuation system with market value. The Ministry of Finance was required to promulgate a market based valuation methodology that would allow municipalities to implement the law and the Departments for Public Revenue and Property were supposed to facilitate implementation by providing the municipalities with data needed to support the new valuation principle.

2. Municipal Decrees

The new Law on Property Tax devolved the responsibility of levying and collecting property taxes to municipalities. The law obliged the Ministry of Finance to enact the Valuation Methodology before October 2002 and municipalities to issue a decree, establishing the amounts

of corrective coefficients and the rates. However, the methodology was not timely enacted. When the deadline of October 2002 passed and the date to send tax bills, 31st May approached, the Ministry of Finance promised to allow municipalities to use the nominal valuation system from the old law. This would enable municipalities to collect taxes for the year 2003 and prepare properly for the following year.

Based on this promise, a USAID sponsored assistance programme ordered the development of software that would allow municipalities to issue the same tax bills as the Department of Public Revenue provided in the past. All municipalities received that software and computer equipment. However, the Ministry of Finance developed its own version and published the official Valuation Methodology for Determining Property Market Value in April 2003.

The dilemma for municipalities was either to develop a new market value system, in accordance with the official valuation methodology issued by the Ministry of Finance, or to use the valuation system developed under the USAID sponsored assistance programme. The market value system required a lot of fieldwork and municipalities ran significantly behind schedule for issuing tax bills. This meant a considerable loss of revenues, especially for municipalities along the coast. Finally, only one municipality decided on the market value methodology. All others opted for the old law's nominal valuation system, and used the database from the Department of Public Revenue to produce tax bills. This approach did not require much time. The remaining question was whether this was acceptable, given the market value methodology published by the Ministry of Finance. Generally, the ministry allowed municipalities to use the alternatively developed system, but with the obligation to enact a municipal decree to introduce property tax. Such a decree would at least ensure that municipalities levied and collected taxes legally. In order to prepare for the adoption of this decree, municipalities spent several weeks establishing coefficients and tax

rates, which caused further delay in the preparation and issuance of tax bills.

Most municipalities lacked the knowledge and experience to design this decree. They received considerable outside assistance. A sample decree, which allowed for the use of data from the Department of Public Revenue, had been distributed to all municipalities in Montenegro. The Decree to Introduce Property Tax, Coefficients and Tax Rates, gave municipalities the legal right to issue tax bills. On average, those bills had been printed by mid-September; three months later than the date set by law. Even in 2004, municipalities calculated the taxes, according to the old Law on Property and not according to the valuation method from the new law. The only improvement in 2004 was that municipalities had sufficient time to prepare, print and deliver the bills.

3. Assessment and Rates

Any property not exempted by law is subject to taxation (a taxable object). This includes land, buildings, units of buildings, other structures and buildings whether or not owned separately from land. The taxpayer (taxable subject) is the owner of property as of 1st January of the tax year. When the owner is unknown or undetermined, the occupant (user) of property may be deemed the taxpayer. If more than one person owns a property, each of them will be a taxpayer proportional to his or her share. For use of building rights, the owner of the land pays taxes on the land whereas the owner of the structure pays for the structure.

The new Law on Property Taxes introduced a system of valuation by assessors, however the valuation methodology, initially only introduced for the year 2003 but also applied in the year 2004, was just a continuation of the old nominal valuation approach. Municipalities have the discretion to set the tax rates in a range from 0.08 percent to 0.8 percent. They are obliged to establish the rates for different types of property in the previously mentioned Decree for Property Tax, Coefficients and Tax Rates.

The author gives four examples to illustrate that municipalities lost considerable revenues by using the Valuation Methodology and setting rates too low.

4. Property Registry

According to the Law, the Ministry of Finance should prescribe the structure and content of property registers. The USAID sponsored assistance programme

proposed a property based register that would make it easy to determine whether any properties were omitted. Nevertheless, the Valuation Methodology issued by the Ministry of Finance mandated a taxpayer based register, thus continuing the earlier practice of the Department of Public Revenue. The database from the Department of Public Revenue was not adequate and the municipalities tried to update them. According to estimates in some municipalities, up to forty-five percent of taxpayers were not registered.

5. Tax Declaration

The law obliged municipalities to prescribe the structure and content of tax declarations and to deliver them to the taxpayers. For that reason, the USAID sponsored assistance programme developed draft declarations for: (1) residential property, (2) commercial property, (3) industrial and special purpose property and for (4) agricultural, forest and other undeveloped property. Unfortunately, the municipalities did not show any interest. For this and several other reasons, the municipalities were late with the tax declarations and even raised the question if delivery for the year 2003 was worthwhile at all. They did not see any need to hurry with tax declarations, but rather focused on legal regulations and procedures and the preparation and printing of the tax bills.

6. Data Exchange

During the transition period, two governmental agencies were responsible for providing data to municipalities. The DRE was to provide data on currently registered properties and their owners. Their cooperation was not fruitful. They provided databases, however in an incompatible format and without any instructions. No municipality was able to use the data.

On the other hand, the Department of Public Revenue was very cooperative. Their representatives participated actively in a number of activities, provided information whenever needed and delivered data to municipalities. Their director offered the municipalities the services of its experienced staff that would become redundant. However, only one municipality made use of this offer. The new methodology for determining property market value was quite similar to the previous one applied by the Department of Public Revenue. Therefore, the municipalities took over their data and software application to produce the tax bills for the years 2003 and 2004.

All changes regarding ownership of property need to be reported to the court but no provision exists that would oblige courts to inform municipalities of ownership changes. The Bureau for Statistics collects prices for newly built spaces from construction companies but only for five municipalities. Those data are used to calculate average square meter prices. The Bureau for Statistics publishes these data, usually not earlier than May or June of the following year.

7. Exemptions and Reliefs

The law provides a great number of exemptions, generally based on ownership or destination.

Ownership

Central and local governments; organisations that discharge public service functions; the Central Bank; diplomatic or consular offices; international organizations if stipulated by a treaty; religious organisations; NGOs.

Destination

Public roads, streets, squares, parks, ports, railroads, airports, protected forests, national parks and cultural monuments.

A special exemption exists for owners, if the tax base does not exceed € 5,000 and the property is not used for profit. Municipalities could not properly apply this exemption because their software had no provision to group and add up taxable objects that belonged to the same taxpayer. From various discussions with municipal staff, it became clear that some taxpayers establish NGOs in order to avoid taxation.

The tax for the owner of a building or apartment that serves as his main residence will be reduced by twenty percent for the taxpayer and ten percent for each family member of his household respectively, to a maximum of fifty percent.

8. Collection

The property tax can be paid in two equal instalments, due June 30 and November 30. Payments can be made by bank transfer or cash at municipal offices. Some municipalities have an active collection system of teams that deliver the tax bills and collect the taxes at the same time. The Property Tax Department registers the amounts collected and can report on actual collection against out-

standing tax bills. Municipalities should raise interest if outstanding taxes are not paid timely, however they are not able to implement this provision and do not calculate this interest at all.

Discussions revealed the importance of organizing public campaigns to educate the public. Some campaigns have been organised, including the utilisation of local media, but greater efforts are needed.

9. Appeal and Enforcement

The Law on Tax Administration gives taxpayers the right to appeal. However, confusion exists about how to apply the law. As a result, some municipalities require submission of an appeal directly to them, while other municipalities direct appeals to the Department of Public Revenue. The municipalities that deal actively with appeals print and deliver new tax bills if it becomes clear that the complaint of the appellant was correct. However, the appeal issue needs clarification to avoid confusion.

Regarding enforcement measures, municipalities do block legal entities' bank accounts, but they have not used any enforcement measurement against physical persons so far.

10. Municipal Tax Office

Before the introduction of the new law, municipalities had no actual experience with tax administration. A crucial factor for a successful implementation was undoubtedly an adequate organisation and properly skilled staff. The implementation started in January 2002, which allowed municipalities time to designate, train and educate staff for this new activity.

During field visits, it turned out that generally people had been informed verbally about their new duties at the Property Tax Office. Although changes took place in some municipalities, the implementation process in 2003 ran behind schedule and sometimes created a challenging working atmosphere, which continued in some municipalities into 2004.

Municipalities had not developed working procedures for implementation of the new law. Under a USAID sponsored project, the Urban Institute produced a Property Tax Assessment Manual, and trained a group of assessors to become trainers on topics like assessment, tax collection, appeals and property tax administration. This training of trainers system should create an internal network of municipal experts, which will be able to find solutions for common problems. The manual and training

along with the over one year of experience will enable tax offices to successfully execute the new system.

11. Conclusions and Recommendations

Significant steps have been made to implement the new Law on Property Tax. Continuous technical assistance is necessary and the following activities should be emphasised in the period to come:

1. Change the existing Valuation Methodology and provide training on its implementation.
2. Provide technical assistance for property tax officials in all municipalities, with an emphasis on education, job descriptions, qualifications of employees, new working standards and procedures.
3. Develop an ongoing educational program that covers all aspects of property tax.
4. Develop software for 2004 that is able to generate various kinds of reports.
5. Upgrade the existing software and simultaneously develop new software that complies with the Valuation Methodology.
6. Encourage municipalities to develop plans for field review. Develop a user friendly property record card. Provide technical assistance for the preparation of tax declarations.
7. Establish sound lines of communication and information exchange with other municipal departments that can provide information on completeness and correctness of the property database.
8. Prepare and implement an educational campaign for all citizens.
9. Establish a national association of assessors.

Serbia

1. Introduction

Serbia has three laws on taxes that are related to property. Of them, the Property Transfer, Inheritance and Gift Tax, are not true property taxes. The only tax levied because of the property itself is the Property Tax. All taxes are uniformly applied throughout the country. They are administered, levied and collected by the central government's Tax Administration through its local units. The revenues of both taxes are fully transferred to local governments, but they are only a relatively small part of the country's total tax revenues. Their share of 2003 revenues was one percent for the Property Transfer Tax, one tenth of a percent for the Inheritance and Gift Tax and one and a half percent for the Property Tax.

Local governments themselves administer, levy and collect one property related revenue source, the Compensation Fee for the Use of Urban Land. This fiscal instrument was introduced in all republics of the former Yugoslavia in 1970s, within the framework of social ownership of urban properties. It could be seen as a substitute within a system that ideologically did not allow for property taxes. Those ideological obstacles do not exist anymore and the Compensation for Use of Urban Land could easily be included in the Property Tax because it lost its reason for existence.

2. Property Transfer Tax

The Property Transfer Tax is levied on the sale of property. The rate is five percent, based on the sales price or, if higher, the market value. Taxpayers have an incentive to report low sales prices and therefore the tax authorities are entitled, within ten or sometimes twenty days, to assess whether the reported price is below market value. Taxpayers can file appeals with the National Tax Authority and ask for a review by the Supreme Court. An appeal, however, does not suspend the obligation to pay the taxes in due time. Appeals are relatively costly for the Tax Authority and therefore, their estimates are

generally slightly below the real market value to reduce the number of appeals. Sometimes assessment problems may occur because of low numbers of (recorded) property market transactions, which make it almost impossible to establish market values. Obviously, this is less problematic in large cities than in sparsely populated areas. Evasion of the Property Transfer Tax is very rare, because the cadastre registers any transfer of ownership against proof of payment of the Property Transfer Tax. Nevertheless, some tax evasion, by means of fictitious loan contracts, remains.

3. Inheritance and Gift Taxes

The Inheritance and Gift Taxes are levied in case of succession. The rate is three percent of the first 200,000 dinars (approx. € 28,500) in second order of succession, and five percent of any additional amount. Otherwise, both inheritance and gift tax are five percent.

4. Property Tax

Owners of property or property rights are subjected to property tax. Almost two and a half million taxpayers are registered and no other direct tax exists with such a high number of identified taxpayers. Many tenants obtained property rights of socially or state owned residential properties at very favourable conditions. As a consequence, any decision on property taxes will have a significant socio-political component. This applies to both the tax rate and the way the tax base is determined. Political considerations and the room for populist policies make property taxation different to other forms of taxation.

Taxpayers may voluntarily file their declarations with the local branch of the Tax Administration, with documents that prove of ownership. The rate for Property Tax is progressive and is divided into four brackets.

< 6 million dinars (€ 86,000):	0.4 percent
6–15 million dinars (€ 215,000):	0.8 percent
15–30 million dinars (€ 430,000):	1.5 percent
> 30 million dinars:	2.0 percent

This system is complicated, non-transparent and creates incentives for taxpayers to decrease the value of their tax declarations. It also creates an incentive to gift property to successors of the first order because shared ownership reduces the total tax burden.

4.1 Tax Base

The tax base for the property tax is the market value on December 31st of the previous year. Generally, market value is assessed by a formula of basic and adjusting elements. Basic elements are floor surface and average square meter market prices for comparable properties whereas adjusting elements are location, quality and depreciation. This method may result in significant differences between assessed market value and real market value, which is the value that could be realised on the free market.

The first factor that causes this discrepancy is an inadequate use of statistical data. The average market price per square meter, as a basic indicator to calculate the real market value, is determined by the sales prices of newly built apartments. However, these sales prices might be quite different from the real market value of a particular property. One important reason is that they do not include the cost to develop building sites and are systematically underestimated. Unfortunately, using data from the declarations for Property Transfer Tax, which is more accurate, is only allowed if the statistical bureau lacks relevant data.

The estimated average market price per square meter is adjusted by two coefficients, one for location and one for quality; both may not exceed the value of one. This methodological mistake increases the systematic underestimation of the tax base. Finally, the estimated price is adjusted with an annual depreciation rate of one and a half percent, with a maximum of seventy percent. Although methodologically acceptable, depreciation of one and a half percent a year is unreasonably high.

The artificially low square meter prices and low coefficients for location and quality and high depreciation rates, result in a substantial underestimation of the tax base for taxpayers that do not keep accounts. For those who do keep accounts, the tax base is the value of the property as shown on their balance sheets. This

also reduces the tax base because book values are often well below market values. Furthermore, a substantial amount of arbitrariness exists in the determination of market value. For example, the value of the coefficient for quality of the property is frequently based on an inaccurate description of the building, resulting in an incorrect coefficient value.

4.2 Exemptions and Reliefs

All owners whose tax base does not exceed 250,000 dinars are exempted from the Property Tax. Effectively, the limit is substantially higher because of the above mentioned underestimation of the tax base. Although no exemption or relief based on affordability exists, this provision combined with certain tax reliefs has a de facto similar function. Further exemptions are based on ownership such as State authorities, diplomatic missions and consular offices, roads, historical monuments and public utility buildings. Others are based on use for educational, cultural, scientific, social welfare, health, humanitarian or sports purposes. Finally, agricultural buildings are exempted from the Property Tax. One can argue that this exemption favours one specific activity without any economic rationale since many other activities are in an even worse economic position than agriculture.

Taxpayers who live in their own apartment receive a discount of forty percent and an additional ten percent for every household member, up to a maximum of seventy percent. If this measure is intended to be a kind of welfare protection for the poor, it is too generous for well to do tax payers since it applies to any household, regardless of their financial position. Since this tax relief is exclusively for households, it results in higher effective tax rates for businesses. If the goal is to reduce the tax burden for people with small incomes, it would be better directed to the target group only. In its present form, it unnecessarily and substantially reduces fiscal revenues.

Tax evasion is significant for three reasons: (1) the self-assessment system in which the taxpayer voluntarily files his tax returns; (2) large numbers of unregistered properties because the cadastres are not up to date; and (3) illegal buildings that are not registered at all. Taxpayers do not have any incentive, as they do for the Property Transfer Tax, to file their tax returns voluntarily.

5. Compensation for the Use of Urban Land Fee

The Compensation for the Use of Urban Land Fee (Compensation Fee) is administered, levied and collected by local governments. All criteria, measures for compensa-

tion and rates are regulated by local ordinances. The rate, depending on location and use, is calculated per square meter of floor surface. The fee is levied from the owner of the building for private ownership, and from the tenant for social ownership. This fee has a strong resemblance to the Property Tax. It is levied from property owners or tenants and the amount varies in principle according to the property value. The only difference is that the Property Tax is intended to vary in accordance with the property's market value whereas the Compensation Fee varies in accordance with a proxy for the property's value. The revenues generated by both the Property Tax and Compensation Fee, are ultimately local government own resources.

6. Considerations for Tax Reform⁹

6.1 Property Transfer Tax

The legal provisions for the Property Transfer Tax are, in principle, well thought through. Nevertheless, a decrease of the five percent tax rate should be considered, taking into account the negative effect on fiscal revenues. One way to make up for the decline in revenues would be to reform the Property Tax. The assessment for the Property Transfer Tax is satisfactory and radical new solutions are not needed. Moreover, the assessment data should be used in the valuation process for the Property Tax. The number of staff at the local branches of the Tax Administration should be increased for assessment purposes and an exchange of information between well experienced and less experienced municipalities should be encouraged. In case of fiscal decentralisation, a countrywide, uniform rate for the Property Transfer Tax, as well as the procedure for assessing the tax base should be maintained.

The incentives for taxpayers to fulfil their tax duties are sufficient and no need exists for reinforcement. Any remaining tax evasion could be dealt with through measures creating additional incentives for registration, or certification of property transfers.

6.2 Inheritance and Gift Tax

A single rate for the Inheritance and Gift Tax should be introduced, regardless of the actual inheritance or succession order. Synchronising the rate with the Property Transfer Tax eliminates fictitious inheritances and gifts. These taxes have a small fiscal effect, and a significant increase in revenues is not to be expected.

6.3 Property Tax

The Property Tax should not affect the allocation of property, its effect should only be of a fiscal nature. Allocation policies should be embedded in urban management and planning. The current progressive tax rates should be replaced by one, proportional rate for all types of property. Whether this rate is to be determined by central or local governments should be part of a debate on fiscal decentralisation; both solutions are legitimate. If local governments determine the tax rates, the central government should set a range, within which local governments may set their own rate, or alternatively, the central government could set a maximum rate only, leaving local governments to determine their own rates not exceeding the legal maximum.

The single largest problem, however, is determining the tax base by assessing the property's value. If this problem cannot be resolved satisfactorily, replacing the Property Tax with another local tax or appropriate fiscal instrument that makes up for lost revenues should be considered. The only alternative would be a lump sum poll tax, collected from all citizens, which would avoid the problems inherent to a property tax, such as defining a tax base and assessing property values. Furthermore, a poll tax has no allocation effects, is easy to implement and difficult to evade. However, such taxes violate the principle of vertical justice (equity) and are therefore not recommendable. Furthermore, the political costs can be high, as illustrated by the fate of Great Britain's Poll Tax at the end of 1980s. In conclusion, there are enough reasons not to consider a poll tax as a realistic alternative for property tax.

It is not possible to levy separate taxes from urban land and buildings because the state, exempted from taxation, owns all urban land. The result is that only buildings are subjected to taxation, which is against the principle that property tax should be levied on the total value of a property and not only on part of it. For that reason, the owner of a building should also be considered as owner of the land. Even if it were possible to levy separate taxes for land and buildings it would be more efficient to levy one, undifferentiated, property

⁹ This chapter summarises the opinion of Mr Begović and does not necessarily reflect the editor's vision.

tax, based on the total value of the property. Assessment of the total value of the property would be easier, evidenced by countries increasingly switching to this assessment method. It also recognises the principle of allocation neutrality of property taxes. Indicating urban land as a separate taxable object is usually justified as a tool for allocation purposes on the urban land market. If the property tax system is thought to have no allocation effects, urban land should not be dealt with differently from other property.

Property taxes should be based on the capital value, i.e. the value of the property recorded on the date the capital transaction (transfer of absolute rights) takes place. The alternative, rental value, will cause problems, mainly regarding accurate information about market rents and this principle is being abandoned in contemporary tax laws.

The above mentioned considerations call for discarding the existing dual system, which recognises different tax bases for the Property Transfer Tax and for the Property Tax. It would result in increased transparency and efficacy in property taxation. Furthermore, this unification would open possibilities to significantly raise fiscal revenues, which could compensate for the existing systemic underestimation of the tax base for property tax.

Regarding the tax base, it is imperative to determine how to assess the capital market value of properties. It is possible to require the taxpayer to file a tax declaration with an assessed value. This would inevitably lead to a significant fall in fiscal revenues, because taxpayers will tend to underestimate the value of their properties. Moreover, taxpayers generally do not have the information and knowledge to adequately determine market values and the Tax Administration still needs to monitor and check the values. This eliminates any advantage of self-evaluation, making it undesirable. Assessment by the Tax Administration is left as the only realistic solution, raising essential questions on content and procedure of assessment and the incentives required for the Tax Administration's staff to perform their jobs properly.

6.3.1 Computer Assisted Mass Appraisal

The only acceptable method to assess the value of property is already implemented in a number of countries, a Computer Assisted Mass Appraisal model (CAMA). It makes use of as many available value data from other sources as possible, together with data on location, quality, etc. that typically characterise each property. The model uses different specific inputs for

each individual property, such as its price, if ever sold, its tax base from the Property Transfer Tax, its location and parameters for quality and for other characteristic elements. Based on these data and the use of statistical methods, the supposed market value of each individual property is calculated, regardless whether the property had ever been sold. The CAMA model does not require data about all sales transactions; they can be sampled at the municipality or local community level. Initial estimates for Belgrade indicate that the model would work satisfactorily if data from around six hundred sales was available. This example shows that the model could be used to efficiently establish market values as the tax base for the Property Tax.

The model is not only applicable to individual municipalities but also to Serbia as a whole. In this case, one parameter, for the specific municipality in which the property is located, must be added to the system formulas. This demonstrates that the CAMA model could be efficiently organised on the level of the central Tax Administration, which should receive all data regarding the Property Transfer Tax from its local branches. In addition, internal auditing measures for the assessment process need to be developed, to minimise appeals to the second instance authority, the central Tax Administration. Disagreement with its decisions involves filing an administrative procedure. Implementation of the CAMA model would not significantly raise the administrative burden for the Tax Administration. According to some estimates, a countrywide CAMA model needs up to three persons. The model's results depend on the quality of its inputs and it is necessary to establish sound procedures to gather and process all the needed information to keep the CAMA model updated. The assessment procedure and the information used in the evaluation process should be incorporated in a law and further regulations.

The tax base needs regular adjustment to reflect changes in the property market. The most important are retail price index fluctuations, building depreciation rates and property market dynamics. The CAMA model enables continuous evaluation at relatively low costs. However, it requires frequent input of assessment data from the Property Transfer Tax. The difference between the new and the old value of the property can be defined and the model automatically adjusts the value of the tax base. The CAMA model should be applied to all taxpayers, including those that keep accounts. This would solve the problem that property book values are systematically lower than their market values. The system could be implemented in a phased way – first for

taxpayers who do not keep accounts, and after a review of the first experiences, for the rest. Further study of the CAMA model, including necessary adjustments, will reveal any need for a phased introduction.

Exemptions are not justified in the case of properties used for education, cultural, scientific, social welfare, health or sports related purposes, if privately organised, or for agricultural buildings. It is justifiable to remove this favouritism because of the allocation neutrality principle and taxpayer equity.

As in the existing law, a relief threshold must be established, below which no property tax is levied. Setting that threshold at a sufficiently high level protects the people that cannot afford to pay. Property market values may vary among different municipalities and for that reason the threshold should be different for each municipality. This is possible by defining the threshold as a certain percentage of the average value of the property within each municipality. Such a generally defined threshold facilitates centrally determined exemptions. It should only be applied to the taxpayers whose income does not exceed another threshold. In other words, taxpayers are only relieved from property taxes if both the value of their property and their income are below their respective thresholds.

6.3.2 Compensation for the Use of Urban Land Fee

The Compensation Fee is a typical local property tax, which should be abolished and incorporated into the Property Tax. The rates should be adequately raised to compensate for the loss of revenues. All tax collection will be centralised in the Tax Administration, which decreases collection costs. The Compensation Fee is paid monthly and the Property Tax quarterly; to evenly distribute the annual tax burden, the combined tax could be paid in six equal instalments. The advantages and disadvantages of this system should be compared to the existing system.

7. Fiscal Effects

The proposed reform of the Property Tax will increase revenues for two reasons: (1) a significantly increased tax base, through introduction of a real market value calculation, and (2) inclusion of the Compensation Fee into the Property Tax. It is estimated that this increase of revenues would more than offset a possible decrease in revenues from a Property Transfer Tax rate reduction. More detailed fiscal effects could be calculated when the parameters for the new system have been decided, such as rates, exemptions and reliefs.

8. Allocation of Fiscal Revenues

The total property taxes collected constitute local governments' own revenues. The revenue allocation to constituent municipalities should be pre-defined for city authorities. This paves the way to transfer responsibilities for tax policy formulation to local authorities. Since property taxes would become local communities' own revenues, a strong incentive exists to implement efficient local taxes, and to cooperate with the central tax administration on all aspects of efficient tax collection.

9. Tax Decentralisation

The laws and central government's regulations should clearly define the major parameters for property taxes and their implementation. These parameters include the method of tax base determination, rates for the Real Property Transfer Tax and Inheritance and Gift Tax, and the methods for calculating and collecting the taxes.

Local authorities, within specific limits set by the central government, should receive the discretion to determine a proportional property tax rate and a general tax relief threshold for households. This local discretion should be large enough to provide for local choices regarding the effective tax burden. This gives significance to the accountability of local elected officials to their constituencies. Local authorities would obviously prefer to have the lowest possible tax burden and the highest possible grants from central government. To reverse this trend, the formula for shared revenues could be adjusted by increasing the shared revenues relative to the amount of effectively collected taxes. This will be an incentive to increase the local tax burden and to effectively collect taxes. Local authorities should be allowed, at least initially, to readjust their tax rates annually. After some years, readjustment should be limited to a fixed period of two or three years. Local authorities should have an opportunity to alter tax rates every year and find the optimal local rate and tax burden through trial and error.

Levying and collecting the Property Tax should remain a task of the local branches of the Republic Tax Administration. However, communication between the local authorities and the Tax Administration's local branches should improve significantly. Because of the different level of capabilities, it is essential to facilitate the transfer of knowledge between the local branches of the Tax Administration.

Slovenia

1. Introduction

Property tax in Slovenia will be changed as part of an overall tax reform programme. Although it is a municipal tax, it should become uniform at the national level and based on market value. This made it necessary to upgrade existing property databases or develop new ones. Interfaces between a number of databases and procedures for data exchange should be established. Furthermore, a market value based appraisal system should be developed and implemented. All these activities require political, technical and social consensus, if the system is to function coherently and effectively. For all these reasons, the property tax system reform is complex and will be much slower than any other reform.

A *Property Registration Modernisation* project was initiated with the main objectives of simplification, reduction of backlogs, building necessary registers and databases, modernising legislation, developing mortgage banking and an appraisal and taxation system. The goal of the project was to ensure an appropriate basis for the development of a uniform, fair, transparent and rational system.

An important sub-project was a property appraisal and taxation system. The main objectives were developing and testing mass appraisal models and methods based on market value, supporting software, an appropriate organisational structure responsible for mass appraisal and a legal basis for the system's implementation. The overall project should be completed by the end of the year 2004. At the time of presentation of this paper the basis for the implementation of a property mass appraisal system had been developed, and a draft Property Tax Law and Property Mass Appraisal Law had been prepared. Political agreement existed that the Property Mass Appraisal Law should be adopted in 2004, thus allowing the Property Tax Law to be adopted in 2005 and implemented in 2006. This scheme anticipated the first mass appraisal to be carried out in 2005.

2. Property Tax System Development

2.1 Existing situation

Two taxes are levied in relation to properties. The property tax is only levied on natural persons, whether owner or beneficiaries from buildings. In addition, a Compensation for the Use of Building Land Fee (CUBL) is levied on users of developed and undeveloped land, whether natural or legal persons. Both taxes are levied and collected by municipalities and belong to their own resources. Municipalities are relatively autonomous in the way they apply the law. Although they must consider certain criteria to establish the tax base, considerable room for discretion remains. The rates for property tax leave some room for local discretion but are progressive in relation to the property's value. The ranges for different types of properties are 0.1–1 percent for buildings, 0.2–1.5 percent for relaxation and/or recreation rooms and 0.15–1.25 percent for business premises. Municipalities may, based on a point system, set the rates for CUBL. In both cases, the tax base is determined without taking into account any market aspects. For this reason, the tax burden is unfairly distributed among municipalities and among taxable persons compared to a system based on the market value of properties.

The two systems have different types of exemptions and reliefs. The property tax has a strong spatial element, since it exempts apartments and individual houses, provided they are the permanent residence of the owner and their family and do not exceed 160 square metres. An additional ten percent reduction is given for each family member that exceeds the number of three. Buildings for agricultural purposes and business premises used by taxable persons for business activity are also exempt.

The CUBL system has its own set of exemptions; property used for public and general purposes, diplomatic missions and consular posts and buildings used by religious groups for their rites, to name a few. Further-

more, new or renovated apartments are exempted for a five year period. In addition, the law has a social element exempting low-income persons fully or partially.

2.2 Reasons for Change

The existing property tax system is not uniform at the national level, is inconsistent, untransparent, and has not been adapted to new ownership relations. Consequently, property of the same type is dealt with differently due to its ownership or economic status, while taxable persons may be treated unequally if not unfairly because of double taxation. One result is frequent appeals, particularly against municipal ordinances, the legal basis for the CUBL. No less than thirty percent of all appeals filed with the Tax Authority are against the CUBL.

3. New Law on Property Taxes

The existing two taxes, Property Tax and CUBL, will be replaced by one new uniform property tax system, which ensures a fair, transparent and rational taxation of property. This new system, as agreed between the coalition parties, should be based on the following principles:

1. All property shall be taxed, regardless of ownership;
2. In principle, the owner of the property is the taxable subject;
3. The proceeds remain municipal own source revenues;
4. The existing tax burden may not change significantly;
5. Properties will be assessed based on a uniform market value system;
6. Supportive of social policy through special rates and reliefs;
7. Tax liability shall be insured by means of mortgages against property.

The draft Property Tax Law has been prepared in accordance with the above principles and based on studies and foreign experiences. It covers all basic elements of taxation, such as definitions of taxable objects, taxable subjects, rates, exemptions and reliefs. The Property Mass Appraisal Law was drafted parallel to the Property Tax Law and deals with registration of taxable objects and tax base determination. All revenues remain mu-

nicipal own sources, except for a small part that goes to the state budget to cover the costs of the mass appraisal service and the maintenance of databases.

3.1 Taxable Objects

Taxable objects are land with associated parts, as defined in the Law of Property Code. Associated parts have been defined as buildings, implying that land with objects other than buildings is not subject to the Property Tax. The Property Tax Law defines as property any item that can be sold or purchased separately.

Slovenia has various databases instead of a uniform property register, which makes it difficult to identify property. This has been solved by a provision in the Property Mass Appraisal Law that property shall be identified based on the definition of Property from the Property Tax Law, by means of the connected databases and registers of property. A building becomes a taxable object upon issuance of an operating permit whereas illegal buildings are subject to registration and taxation. Undeveloped land shall be classified depending on its intended use, while all other taxable objects shall be classified according to their actual use. Tax liability is factually connected with the existence of property in the land and buildings registers, and the databases from the Property Mass Appraisal Service.

3.2 Taxable Subjects

Property tax is levied on owners, as entered in the land register. If the registration is disputed, the actual owner can be taxed against proof of ownership, such as legal transaction, inheritance, a decision issued by a government department, the law, etc.

The law makes no distinction between owners, regardless of their legal status. The law follows the basic principle that only the owner can manage the property. This principle is connected with the provision that tax liabilities are mortgaged against the property if the outstanding taxes exceed a certain predefined percentage of the tax base.

The taxable subject is determined on a certain date of the year. Any subsequent change in ownership has consequences only for the following year.

3.3 Tax Base

The tax base has been defined as the generalised market value of property and will be established by the Property Mass Appraisal Service in accordance with the rules laid down in a separate regulation. The market value, as a

reasonable approximation of the market price, is without doubt the most appropriate tax base.

3.4 Exemptions and Reliefs

The provisions on tax exemptions and reliefs are similar to those in developed countries. They should be economically reasonable, in line with the basic principles of spatial and property policies and they should be viable, i.e. databases and registers of property should suffice for their use. The law exempts property with a public function, property owned by foreign countries and used by diplomatic or international organisations, property with a special status like cultural monuments, property used for religious rites and for humanitarian, educational or medical activities. Further, municipalities may exempt new or renovated residential property for a period up to 5 years, provided this is in accordance with their spatial, economic and social policies, as well as property owned by socially endangered persons (under certain conditions).

A uniform relief based on affordability for socially deprived and elderly people is under consideration. If introduced, it will take the form of a mortgage or a land letter (with favourable interest rates), to be repaid when the owner's situation or the owner changes.

3.5 Tax Rates

A uniform tax rate for all property classes would be ideal. However, simulation of the new system's effects indicates that it would be impossible to meet the requirement that the tax burden on an individual taxable object remain universally unchanged. In addition, a comparison has shown that the current effective tax rates are very low.

The new law becomes effective not earlier than 2006, and the rates have not yet been set. However, the law will only provide basic rates and municipalities may multiply them by a prescribed factor, depending on the type of property. This system will ensure countrywide fairness in treatment of taxable persons and taxable objects and at the same time, give municipalities room for local fiscal policy.

3.6 Levying Authority

The national Tax Authority will become entirely responsible for the assessment and collection of property tax. However, it changes municipalities from a service provider to an autonomous body. It will obtain the data on taxable objects, tax base and taxable persons directly from the Property Mass Appraisal Service. Properties

entitled to exemption will be cleared from the databases. Other exemptions or reliefs will be taken into account based on information received from municipalities.

The Property Mass Appraisal Service is charged with handling appeals against appraisal and valuation, whereas the Tax Authority will deal with all other appeals.

4. Property Mass Appraisal System

4.1 Introduction

Property appraisal can only be done under free market conditions and is therefore mainly applied in developed economies. The appraisal theory explains methods, which ensure the most realistic estimate of supply and demand variables in the property market. The results of an appropriate method depend on sufficient and adequate information about the property market and about effected property transactions.

We can distinguish between individual and mass appraisal. Although both methods make use of the same information about properties and property markets, the individual approach analyzes the property and its location in detail. Mass appraisal, on the other hand, values several property items of the same type at the same time. This analysis looks only into the most important variables affecting the value of property and is mainly used when a great number of properties need to be appraised at the same time. Mass appraisal methods are therefore more general and use appraisal models based on empirical and statistical analysis. The American John A. Zangerle, developed the first theory of property mass appraisal in 1920. The advancement of computer applications brought mass appraisal within reach of every country wanting to apply the method.

Recently, Slovenia has introduced many international standards for property appraisal, however, only for individual appraisal. Mass appraisal on a market basis has not yet been developed. Liabilities for property taxes are still determined on administrative criteria as defined by each municipality. This causes economically unfair distribution of the tax burden. To ensure a uniform approach and introduce a market based valuation, Slovenia started to develop a property appraisal and taxation system. Although the Ministry of Finance is responsible for the development, it became clear that procedures for obtaining data could be simplified by establishing a separate Property Mass Appraisal Service within the Surveying and Mapping Authority.

4.2 Legal Framework for Mass Appraisal

When the legal framework for mass appraisal was designed, international experiences like objectivity, rational organisation, cost effectiveness and flexible legislation able to cope with changes in the system were considered. For Slovenia, a completely new system must be developed, many administrative and organisational problems solved, and users and operators trained.

The government decided that the Property Mass Appraisal Law should become effective in 2004, to enable implementation of the Property Tax Law in 2005. After discussion among ministries and professional organisations, the final draft went to parliament for adoption in July 2004. Further government decrees and regulations needed to be prepared. The Ministry of Finance will be responsible for implementation. The law provides the legal framework, but elements subject to frequent changes shall be regulated by government decrees, regulations and instructions. The law consists of nine chapters: (1) general provisions; (2) property mass appraisal; (3) administrative body responsible for property mass appraisal; (4) data required for property mass appraisal; (5) database on property mass appraisal; (6) database on property values; (7) penal provisions; (8) access to the system's database; and (9) transitional and final provisions. Appraisal models must be adapted to developments in the property market. For this reason, the law only defines appraisal models on the level of property groups, whereas further definition within each group will be regulated in government decrees. This allows for relatively simple and quick adaptation to changes in the property market. Government decrees shall cover: (1) subgroups of property of the same type; (2) appraisal models; (3) the method to calculate the value of property; (4) the methods to determine or change value zones and to calculate value indices; and (5) value indices for the different groups of property. Rules issued by the competent ministers will regulate the system's procedures, data and technical elements.

4.3 Organisation and Procedures

An independent Property Mass Appraisal Service shall be established within the Surveying and Mapping Authority. This new service, will consist of a central office and twelve regional offices. The central office will employ twelve experts in various fields and the regional offices will employ thirty experts, mainly in the field of residential and commercial property. The new service will be particularly engaged in information technology

solutions, testing appraisal models and building and maintaining the property databases.

The property mass appraisal system provides three types of appraisal: general, interim and indexation. General appraisal is comprised of appraisal model specification, calibration, and testing. Appraisal model specification is based on theory and on the situation in the property market. The most significant parameters affecting the value of property are selected by statistical methods, e.g. location, age, quality, etc. In the calibration phase, each parameter is statistically analysed and receives an appropriate weight, based on its effect on the value of property. Finally, the model is tested in practice on a sample basis. All three phases are carried out separately for each property class and must be repeated every four years. Interim appraisal should be carried out each year, except for property subject to general appraisal in the previous year, to take account of any changes in the property or property market. This will be done based on the models used for general appraisal. Value indexation should be carried out each year, except for property subject to general appraisal in the previous year, based on zone specific value price indices. Value zones are the geographical areas within which property of the same class has been affected by similar changes in the property market in the year before value indexation.

4.4 Mass Appraisal Models

Property mass appraisal is based on mathematical models which illustrate how the value of property of the same class is calculated. Each group, consisting of the same type of property, needs its own appraisal model. Different models exist and Slovenia has chosen value levels, value zones and value tables. Value levels represent classification of property of the same type according to the value. Value zones represent the geographical areas within which property of the same type has the same value. Value tables, which contain appraisal factors and coefficients, represent values of the different groups of property according to their features.

A value level has been determined for each of the different appraisal models and corresponds with the number of value tables. Each value table is based on a typical property, i.e. the average or the most frequently sold/purchased property within a group of property of the same type. For example, the typical apartment is 65 square metres, built between 1968–1980 and averagely maintained. Value zones, which have been determined separately for each of the different appraisal models,

come in a graphic form and cover the complete national territory.

Nine appraisal models have been specified, tested and calibrated for the following groups of property classes: (1) agricultural property, (2) forest land, (3) apartments, (4) individual houses, (5) garages, (6) commercial property – offices, (7) commercial property – retail, (8) industrial property, and (9) undeveloped building land.

4.5 Registers and Other Databases

The mass appraisal system depends on data from two separate cadastres, one on land and the other on buildings, both managed by the Surveying and Mapping Authority. The land cadastre contains identification data about land and the buildings cadastre about buildings and parts of buildings. Two separate cadastres were purposely developed because each of them provides a minimum number of data required by different users. Both cadastres contain technical data on property and some data on the use of land.

Apart from the land and the building cadastre, a third registration system exists, the land register. It is under the authority of the Supreme Court and contains property related rights. In order to exchange data between the Surveying and Mapping Authority and the Supreme Court, an interface between the three registration systems will be developed. To that end, the land register will be computerised and the systems will be connected online in the year 2005. Other data required for the purposes of mass appraisal, which are the responsibility of municipalities, will initially be obtained directly from municipalities and later from the legal regimes register, which is the responsibility of the Ministry of the Environment, Spatial Planning and Energy.

A technical register of buildings, containing data such as quality of maintenance, year of renovation, etc., will be developed on the basis of questionnaires filled in by the owners of buildings. However, it will be difficult to maintain such a register systematically. A database on the property market, containing data on prices and rents obtained from property agencies, the Tax Administration and notaries and municipalities will be developed. Its primary use will be the development and monitoring of appraisal models, as well as ensuring transparency in the property market. Under certain conditions, it will be accessible to third parties. Finally, a database on property mass appraisal, for general property appraisal, will be set up. It will contain appraisal data such as value levels, value tables, value zones and indices for different property classes.

5. Conclusion

The introduction of a property mass appraisal system to use market value as the base for property tax requires a long term and systematic approach. The biggest costs are associated with the collection and systematic maintenance of property data. It is advisable to develop the system in such a way that it can serve other purposes besides taxation.

Due to the new parliamentary elections in Slovenia in autumn 2004, the political decision was taken to postpone the tax law discussion and to introduce the new property tax no sooner than 2006. However, the draft law on Property Mass Appraisal has political support and is expected to come into force in mid 2004¹⁰. This enables the establishment of a well functioning property mass appraisal service and ensures a successful change to the new property tax system in the year 2006.

¹⁰ Parliament finally approved the law on Property Mass Appraisal on 31st May 2006.

Conclusions

1. General

Although the forum in Skopje was named Reforming Property Taxation in Southeast Europe, some of the author's papers have a broader scope. Besides true property taxes, the contributors from Croatia and Serbia discussed a number of pseudo property taxes - taxes, levied not because of the property itself but because of the occurrence of a specific event mentioned in the law. The property itself only serves as a measure to determine the amount of tax that should be levied. True property taxes, however, are levied because of the mere existence of the property. The frequency of collection of the two groups of taxes, also reflects their different nature. Pseudo taxes are only collected when the specific event, such as transfer, gift or inheritance, occurs whereas true property taxes are collected on an annual, recurrent basis, without the need for any specific event.

From a managerial point of view, pseudo property taxes are easier to administer for the simple reason that the number of taxpayers is just a fraction of that for true property taxes. Because of the large numbers and the annual recurrent procedure, true property taxes require relatively large databases of both taxable objects and subjects. Moreover, those databases should be kept up to date to correctly produce and distribute the yearly tax bills. The same arguments apply to the collection procedures for outstanding taxes. The collection rate for true property taxes can be disappointingly low, because of the lack of progress reports, which show whether actual collection is satisfactory and indicate any need for follow-up procedures to improve collection.

Both Croatia and Serbia levy the same pseudo property taxes: property transfer, inheritance and gift taxes¹¹.

¹¹ The Macedonian paper only mentions the same three taxes, which will be devolved under the new law, to the municipalities, however, it does not give any further details.

The tax base for the Property Transfer Tax in Croatia is much broader than in Serbia because it encompasses any transfer of property, inclusive of gifts and inheritances. Therefore, the tax base for the Inheritance and Gift Tax is accordingly smaller and actually restricted to movable properties and financial assets. Those differences, however, are not important because the rates for both taxes are the same, five percent. Serbia applies the same rate of five percent for each of those taxes, with the exception of the first 200,000 dinars (approx. € 28,500) for second order successions, which are levied at three percent. In either country, central government revenue offices levy and collect the taxes. The differences come with the destination of the proceeds. In Croatia, the central government withholds forty percent of the Property Transfer Tax and transfers the remaining sixty percent to local governments, whereas the counties receive the full proceeds of the Gift and Inheritance Taxes. Serbia transfers all revenues from both the Transfer and the Gift and Inheritance taxes to the local governments in which area the taxes are collected.

For property taxes, Macedonia and Montenegro levy one single tax, which in principle includes all properties, buildings and land. Both Serbia and Slovenia still levy a Property Tax and a so-called Compensation for the Use of Urban Land Fee. All republics of the former Yugoslavia introduced this levy in the 1970s because of the then existing social ownership of urban properties. Actually, it was a kind of substitute for an ideologically impossible property tax. That rationale disappeared and therefore the Compensation Fee could easily be included in the system of property taxes. Slovenia indeed will replace the two existing taxation systems, the Property Tax and the Compensation Fee, with a single property tax system.

Rather different is the situation in Croatia, which levies four separate property taxes, each in relation to a specific class of properties: vacation houses, idle agricultural land, vacant business properties and undeveloped building land. All four are quite similar and based on

the surface of the property, expressed in square meter or in hectares. Each tax has a different rate range, within which local governments may determine their own rates. Besides those four property taxes, local governments levy a communal fee from owners of residential and business space, garages and (undeveloped) building land. This communal fee is similar to the Compensation for the Use of Urban Land Fee in Serbia and Slovenia. However, its proceeds are special purpose revenues, and therefore not taxes but fees. Nevertheless, they all have features of a true property tax.

2. Level of Decentralisation

The European Charter on Local Self Government mentions that local governments should receive sufficient own source revenues to discharge their functions. Although a wide variety of local government's own revenues exist in Europe, property taxes are undoubtedly the most proliferate and typically seen as local government taxes. All (candidate) European Union member states from central and Eastern Europe went through a decentralisation process, which devolved authority from central to local government. Part of this process was the invariable decentralisation of property taxes to local governments.

Slovenia is already a member of the European Union and all other four republics have expressed their desire to join, therefore it is worthwhile to examine to what extent those five republics are converging to European Union practices. All five introduced one or more property taxes and the proceeds are local government own revenues. However, the mere fact that property taxes exist and that local governments receive their proceeds are by no means indications of decentralisation. Better measures are the level of discretion local governments have to determine the rates and to collect these taxes. Determining the rate gives local councils the power to set their own budgetary priorities and to decide between higher or lower taxes against more or less services for their citizens. Furthermore, it stimulates them to become accountable to the citizens for their policy choices.

One can argue whether the authority to collect property taxes is essential for decentralisation, as no policy decisions are involved and the proceeds go directly to local government. This would indeed be true if the procedures to levy and collect taxes were effective and efficient, and local governments could trust that the central government's revenue agency would collect, for example, at least ninety-five percent of the collectable

taxes. Unfortunately, this condition does not yet exist in the Balkans for a number of reasons. Most importantly the registers and databases needed to prepare and send tax bills, are generally neither complete nor correct. Second, the proceeds of property taxes are relatively small compared to other taxes and therefore, central tax agencies do not put much effort into their collection. Under these circumstances, decentralisation makes sense because it at least gives local governments an opportunity to optimise the proceeds from property taxes by making efforts to improve databases and collection procedures.

Three republics decided rather recently to introduce new property tax laws. Since 2003, Montenegro entitles municipalities to levy and collect property taxes and local councils may set the rates within a range from 0.08 – 0.8 percent of the property's value. The same applies in Macedonia. Since 2006, local councils may collect and set rates between 0.1 and 0.2 percent of the property's value. Slovenia moves partly in the opposite direction. Their new property tax law, passed by Parliament on 31 May 2006, still leaves local governments some discretion to determine the rates, however, the national Tax Authority takes over the collection from local governments.

In Serbia, the situation is mixed. The true property tax was completely centralised until recently. The rates, although progressive, were uniform throughout the country with no local government discretion. As recently as July 2006, however, the Serbian Parliament passed legislation that devolved the discretion to set property tax rates to local councils. The collecting authority is the central government's tax administration. On the other hand, local governments fully administer, levy and collect the Compensation Fee, which in essence is a property tax. The local councils even determine, by local ordinances its criteria, measures and rates.

Croatia is rather comparable to Macedonia and Montenegro. The local council, within a range given by law, determines the rates of each of the four property taxes and they themselves collect all monies. The same applies to the Communal Fee, which as already said, has all features of a property tax.

3. Basic Features of Property Taxes

On the surface, levying of property taxes is a rather simple and straightforward activity. The variables that really matter are limited: taxable object, taxable subject, tax base, tax rate, exemptions and reliefs. Nevertheless, when it comes to implementation the results can be

unsatisfactory and disappointing. The single biggest problem is properly determining the tax base. Further, there is a lack of complete and correct databases of taxable objects.

3.1 Taxable Objects and Subjects

The taxable objects for property taxes are buildings and land, and in some cases only buildings or only land. Furthermore, exemptions exist for specific categories of properties. The legal frameworks in each of the five republics may be different, if one considers the Serbian Compensation for Urban Land and the Croatian Communal Fee as property taxes; they all levy and collect property taxes on buildings and land.

Each republic applies a range of exemptions, which are much the same as in other countries, although some specific local exemptions exist. Most notably, Slovenia exempts buildings for agricultural purposes and business premises used by taxable persons for their business activity. Similar exemptions exist in Macedonia for industrial premises and in Serbia for agricultural buildings. The common feature is that they all considerably diminish the tax base of local governments. Typical for Slovenia is that municipalities may exempt, under certain conditions, new or renovated residential property for a period of five years.

Serbia and Montenegro exempt owners, whose tax base does not exceed a certain threshold. Serbia has set the threshold at approximately € 3,600 and Montenegro at € 5,000, provided the property has no commercial function. Macedonia exempts buildings in mountainous rural settlements, determined by the government. These three exemptions have much in common with reliefs for low-income people who can hardly afford to pay taxes.

The taxable subject for property taxes can be either the owner or the user of the taxable object. All five republics under review have in principle chosen the owner although some exceptions exist. Macedonia and Montenegro for instance, levy the tax from the user when the owner is unknown or unavailable whereas Macedonia also levies from the user in case of state owned property.

3.2 Tax Base

Generally, there are two methods to determine the tax base for property taxes. The first method is to assess the property market value and the second method is to calculate a proxy for the market value. The proxy method uses the property's surface, expressed in price per square

meter, adjusted for a number of factors - area, destination and depreciation, to mimic market value. Until recently, all five republics used valuation methodologies that belonged to the proxy family, although most called them market value.

In the recently introduced new property tax laws, Macedonia, Montenegro and Slovenia chose market value as tax base. In reality, however, only the recently adopted legislation in Slovenia introduces a system to establish real market values. Although Montenegro introduced valuation by assessors, the methodology introduced in 2003 was just a continuation of the proxy valuation under the old law. The Macedonian law reads that the tax base is the market value of the property, however, the valuation methodology introduced under that law is again just a continuation of the old proxy system.

In conclusion, although three republics in recent years passed new laws calling for market value as the tax base, only Slovenia is preparing for its introduction. All other republics have their own, different methodologies, which provide proxies for market value. Those methodologies have many flaws and their results are generally far below a property's true market value. Average prices per square meter are not correctly calculated and the adjusting elements for area, purpose and depreciation do not adequately indicate differences in value, as illustrated in the next two examples from Serbia and Croatia. The methodology in Serbia provides square meter prices and location and quality coefficients that are too low, and excessively high depreciation. The result is a substantial underestimation of the tax base for those taxpayers that do not keep accounts. For those who do keep accounts, the tax base is the value of the property according to their balance sheets. However, book values are often well below market values. In both cases, the result is a substantially eroded tax base. Great disparities in taxation exist in Croatia between individuals and legal entities, and between rich and poor taxpayers. This inequity also exists within property classes. A luxury apartment has the same taxable value as an identical apartment in an old socialist apartment block in the same location.

When it comes to providing solutions, the opinions among the authors do not differ much. Most outspoken is the author of the Serbian paper who says that the only acceptable method to assess the value of property is, as already implemented in a number of countries, the Computer Assisted Mass Appraisal model. The Slovenian author actually agrees by saying that liabilities for property tax are still determined on administrative criteria, which causes economically unfair distribution

of the tax burden, whereas the market value is without doubt the most appropriate tax base. For that reason, Slovenia had decided to develop and introduce a property appraisal and taxation system. The Croatian author, on the other hand, is of the opinion that a recalibration of the existing coefficients for location and destination to market value would be sufficient to appropriately mimic a market value based tax. Though this system still follows the same formula, the coefficients more accurately reflect the average value of the property in each zone and use category. Another reason to start with this interim step towards a true value based tax is the property market in Croatia. Although it is developing rapidly, it still lacks the maturity conducive to introducing a value based property tax.

The Slovenian, Macedonian and Montenegrin laws explicitly name market value as the tax base, the Serbian author calls it the only acceptable method and even the Croatian author sees the recalibration of coefficients as an interim step towards a true value based property tax. Given this, it is somewhat odd that the only republic that actually moves in that direction is Slovenia. It recently adopted the legal framework for a property mass appraisal system and for the establishment of an appropriate organisational structure. Although Macedonia and Montenegro introduced laws that call for market values, they just continue with the proxy systems from the old laws.

Market value is undoubtedly the superior measure for property taxes but its introduction requires a well established professional organisation. In this respect, it is worthwhile to refer to the Slovenian approach to see how much systematic effort is needed to successfully introduce a market value based property tax. If we consider the relatively poor performance in property registration, as later shown in paragraph 5, it is at least questionable whether the other four countries are ready for the introduction of market value. Moreover, as rightly mentioned by the Croatian author, it is doubtful whether the property markets in the countries are sufficiently mature to allow for successful implementation.

3.3 Rates and Reliefs

Except for Serbia, local authorities have, within legal limits, certain discretion to set their own rates. However, in July 2006, the Serbian parliament passed legislation that will devolve discretion over setting rates to the local authorities. Serbia is also different from the others because it has a progressive rate system consisting of four brackets. The rate in the highest bracket is

five times that in the lowest. Slovenia applies different rates for different property classes. However, this system will shortly be replaced by one uniform rate for all properties. Municipalities may only multiply this rate by legally prescribed factors. It is worthwhile to mention that Macedonian municipal councils may increase the rates for unused agricultural land by a factor of three to five.

Although the rates among the five republics differ considerably, it would not make sense to see them as a reliable measure for the level of tax burden, because the tax base in each country does not reflect true market values. For that reason, the effective tax rate may be quite different from the nominal one as set by a law or a municipal ordinance.

It is interesting to note the common historic roots reflected in similar reliefs for families. Macedonia reduces the taxes by fifty percent for residential buildings, occupied by the taxpayer and his/her family. Slovenia, under the old law, exempts the permanent residence of the owner and their family, up to 160 square metres. Additionally, each family receives a ten percent reduction for each family member more than three. Montenegro reduces the tax for the owner of a building or apartment that serves as their main residence by twenty percent, and by another ten percent for each family member of the household, to a maximum of fifty percent. Taxpayers in Serbia who live in their own apartment, receive a discount of forty percent, to be increased by ten percent for every household member, up to a maximum of seventy percent. These reliefs are undoubtedly targeted at low income citizens who can ill afford to pay taxes. The unwanted result, however, is that all families, poor and rich, are entitled to it, causing substantial fiscal losses. Therefore, it would be advisable to redesign these reliefs so that only low income families would benefit. Although the Slovenian exemption is restricted to residences up to 160 square meters, undoubtedly excluding many affluent families, the best solution as proposed by the Serbian author, would be to grant reliefs only if both the value of the property as well as the taxpayer's income, are below certain thresholds.

4. Remarkable Legal Provisions

Although many differences exist among the property taxation systems in the five republics, all are just relative deviations from a general framework, typical of property taxes all over the world. Two exceptions, however, are worth mentioning. Slovenia introduces with its new

law the principle that tax liabilities will be insured by means of a mortgage against the property. However, if the tax administration functions effectively and applies all legal instruments at its disposal, there should be no need for such instrument. Furthermore, they are considering introducing a uniform relief for socially deprived and elderly people. These reliefs too will be mortgaged against the property and must be repaid when the owner's financial position changes or when the property change hands. The result will be that effectively no relief will exist. Taxpayers will undoubtedly consider this provision very unfair.

The Macedonian law has provisions to fine not only the taxpayer, but also a whole range of officials, involved in levying and collecting taxes. This includes persons working for state agencies, the court, the municipal tax administration and the mayor. Interestingly, the law does say that all fines are municipal revenues but the authority to assess fines, initiate legal procedures or provide the possibility for appeal does not exist.

5. Property Registration

One of the biggest problems in all five republics is the piecemeal and inadequate registration of properties, evidenced by a short description of the situation in each country.

Slovenia does not have a uniform register of property, but various databases, which causes a problem in the identification of property. Under the new property tax law, connected property databases and registers should solve this problem.

Local government databases in Croatia are generally incomplete and not regularly updated. Ministries, which might collect relevant information, do not provide information to local governments. The Ministry of Justice, for example, maintains the official registry for property rights, but does not share the information with local governments, which are often unaware when properties are extended or have changed hands. The results are extensions not recorded in the municipal registers and wrongly addressed bills.

In Macedonia, the records of the old cadastre are not reliable evidence of ownership; many are incomplete due to poor recording over the course of many years. Illegal buildings are not recorded, unless the owner submits the necessary documents to obtain the required licenses. Municipalities encounter problems receiving data from the State Geodetic Office. Although municipalities did receive databases from the Public Revenue Offices

during the transition, they do not yet have adequate software and still cannot produce the tax bills for 2006. Furthermore, the data received from the Public Revenue Office is incomplete and incorrect and municipalities face a huge effort to update it.

The database from the Department of Public Revenue in Montenegro was not adequate and the municipalities tried to update them. It was estimated that in some municipalities, up to forty-five percent of taxpayers were not registered. All changes regarding ownership of property need to be reported to the court but no provision exists that would oblige courts to inform municipalities on changes of ownership. The cooperation with the DRE during the transition was not fruitful. They provided the municipalities with databases, however, in a format without any instructions and impossible to use. No municipality was able to use the data.

Tax evasion in Serbia is significant and has three causes: (1) the self-assessment system in which the taxpayer voluntarily files their tax returns; (2) large numbers of unregistered properties because the cadastres are not up to date; and (3) unregistered illegal buildings.

There is no doubt that the challenge, whether for central or local governments, is not only to establish an adequate fiscal cadastre but also to keep it up to date. Otherwise, many citizens will receive tax bills that are too low, or worse, no bills at all. The result is not only a considerable loss of fiscal revenues but also citizens who lose confidence in the fairness of the system. To establish and maintain adequate fiscal databases, institutional arrangements are needed to formalise data exchange between all the government organisations that deal with property data. The effectiveness of property taxation and citizens' confidence in the fairness of the system depends to a large degree on the quality of such databases.

6. Management of Tax Collection

From experiences in other countries, it is known that the collection rate of taxes may drop, sometimes considerably, after these activities are devolved from central to local government. This decrease in revenues appears despite ample (donor) support in the decentralisation process. The main reasons for this phenomenon is that the support primarily focuses on central government and less on local government, with a strong emphasis on legal aspects and not on management issues. In other words, local authorities receive laws, regulations and instructions on their new responsibilities but little support on how they should implement and execute them. Gener-

ally, the weak spot is the limited ability and experience of local authorities to properly organise and manage a tax collection process. The initial problems they face are many times aggravated by the fact that the databases they inherit from the central government's tax administration, are generally incorrect and incomplete and need to be updated. This paragraph outlines the basic aspects of an adequate organisation.

A tax collection organisation should have at least the following five major features:

- An organisational setup which provides sufficient separation between: (1) data collection and registration of taxpayers, (2) collection of taxes and fees, and (3) financial registration in the accounting system.
- A database, which is able to compile an annual register/list of all taxpayers and the amounts to be paid by them for every single tax and fee.
- A complaints procedure.
- Well described procedures and job descriptions (who does what and when).
- Skilled and trained staff.

6.1 Functional Separation

Two ways exist to reach the desired separation of functions. The most common and logical solution is to place all activities related to tax collection in three separate sections under the supervision of the Head of the Finance Department.

- Registration and Inspection Section,
- Collection Section within the Cashier's Office of the Finance Department,
- Accounting Section of the Finance Department.

Bringing together all three activities under the supervision of one person, the Head of the Finance Department, creates the most conducive organisational structure for good overall management, coordination, control and reporting related to tax collection in all its distinctive aspects. As much as possible, it uses existing equipment, systems and procedures.

Sometimes the existing staffing situation of the finance and tax departments is not conducive to implementing such a drastic change in the organisation at once. In such cases it is recommended to make only the minimum changes needed to comply with the basic separation principles as mentioned before. This implies

a physical and organisational split of the tax department into two sections, one for registration and inspection and one for tax collection, both under the supervision of the Head of the Tax Department. The accounting section remains in this option under the Head of the Finance Department. The main tasks of each section, whether or not under the overall supervision of the Head of the Finance Department, should be as follows.

6.1.1 Tax Registration and Inspection (Tax Office)

- to gather and register data on tax subjects and tax objects (who should pay for what);
- to inspect and check the quality of the database and make improvements;
- to gather and register all changes in taxable subjects and taxable objects;
- to prepare, produce and despatch tax bills;
- to prepare and produce lists of all taxes to be collected, signed by the Head and the Mayor;
- to register, investigate and settle taxpayer complaints.

6.1.2 Tax Collection (Cashier's Office)

- to receive from the Tax Section the official lists of amounts to be collected;
- to collect taxes and issue receipts for the amounts received;
- to register all amounts received, whether on paper or in a computerised tax system;
- to provide a daily report to the accounting section;
- to prepare and despatch reminders.

6.1.3 Accounting Section (Finance Department)

- to register in the accounting system the taxes that should be collected (tax capacity);
- to register in the accounting systems the amounts collected for every tax and fee;
- to financially control the Tax Section and the Cashier's Office;
- to monitor actual collection against budget and tax capacity;
- to prepare periodical progress reports to the Mayor and/or Council;

6.2 Establishing a Database

Establishing a comprehensive database will be the most critical and time consuming part of the reform. It is critical for two reasons: the proposed database will be the heart of the tax system and is crucial to introducing the desired separation of functions. It is time consuming because a computerised registration system must be introduced, a great number of data must be gathered for every individual taxpayer and finally, all data must be entered into the registration system.

The following activities have to be carried out:

- define what information is needed for every single tax and fee;
- decide how to collect that information to be sure that all taxpayers are registered and the information about the taxable objects is up to date and reliable;
- design collection forms and a collection scheme;
- design a registration system that serves the three basic functions of the taxes that should be collected (registration, collection and accounting);
- enter all data into the computerised registration system;
- test the system and train the people that will use it.

6.3 Complaint Procedure

A complaints procedure can serve several goals. The most important is to demonstrate that a municipality cares for its citizens by offering them an opportunity to express their opinion and/or grievances. The number and kind of complaints can provide useful information

about the efficiency and/or effectiveness of the staff involved in tax collection and can serve as guidance for improvements. An additional advantage will be that the integrity of the registration system gradually improves and the possibility to commit fraud diminishes.

A standard complaints form should be introduced, which consists of three parts: the first to be filled out by the taxpayer, describing the complaint; the second to be filled out by the inspector who investigates the complaint, giving advice to the Head of the Tax Department; the third to be filled out by the Head of the Tax Department, giving the final decision on the complaint. After completion of the procedure one copy of the form must be sent to the complainant, one to the collection section, one to the accounting section and one should remain at the registration section to update the database and finally to file.

A reporting format and procedure must be introduced, which gives information on the number of complaints received/dealt with/outstanding, the number of complaints honoured/rejected and the amounts involved in honoured complaints.

6.4 Tax Collection Scheme

Based on the above mentioned principles and activities, a tax collection scheme can be designed which gives an analytical overview of all document flows, information and monies between the municipal units, the taxpayers and the bank. This relational scheme can be helpful in designing a proper organisational structure as well as job descriptions. It also can be useful to get a better understanding of the tax collection process as a whole.

