

Preparing and Implementing
A Property Tax
Pilot Project
in Macedonia

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EXECUTIVE SUMMARY

- The Government of Macedonia plans to devolve the administration of property taxation to local governments for 2005 taxation
- Four pilot projects to improve property tax administration are proposed for the Public Revenue Office regions covering 25 municipalities, centred on the four cities of Veles, Gostivar, Sveti Nikole and Struga.
- The present administration of real and moveable property taxation by the national Public Revenue Office is a cause for concern because:
 1. Many properties are missing from the fiscal cadastre because it is not based on the land/legal cadastre;
 2. The inventory of real and personal property is based on taxpayer's voluntary self-assessments which are not routinely verified and updated from other sources;
 3. Real property valuation criteria were initially based on 1993/1994 market values and in most regions are not regularly updated to reflect the current real estate market;
 4. Locational zones that are the basis for application of the per square metre valuation rates are not regularly revised to reflect the current real estate market;
 5. Moveable property inventories in the fiscal cadastre, particularly for motor vehicles, are incomplete with highly variable coverage and tax yield amongst regions;
 6. Tax bills are routinely printed and delivered after the statutory deadline of March 31;
 7. The required quarterly notices reminding taxpayers of unpaid taxes are sent only once annually, usually at the beginning of the next year;
 8. Penalty interest is not uniformly applied to unpaid taxes;
 9. No collection and enforcement efforts are made by the Public Revenue Offices, which allocates its collection and enforcement resources to more remunerative efforts collecting income tax, excise taxes and VAT; and,
 10. Property taxation administrative practices and resources differ, in some aspects quite significantly, amongst the four proposed pilot project regions.
- Information on tax collection performance by region and/or municipality is incomplete or unavailable, which makes it difficult to allocate efficiently the limited collection and enforcement resources.
- This report makes 28 recommendations designed to improve property tax administration in the pilot regions in the following areas:
 1. Real property inventory updates from the land and real estate cadastres,
 2. Moveable property inventory updates from Interior Ministry records,
 3. Valuation commission membership, training, and updating of unit rates and locational zones,
 4. Tax bill printing, delivery and tracking taxpayers,
 5. A public information campaign, and
 6. Improved collection and enforcement options.
- Many of the recommendations have the potential for broader applicability; opportunities to improve the property tax administration in other regions, before 2005, should be considered.
- While the terms of municipal involvement in the administration of property taxation in the four pilot regions have not yet been established, the local municipal leadership can provide advice, direction, and in some cases, resources that can significantly improve the regional administration. **Simply stated, it can only get better.** The experience of the pilot projects should provide information and insights to both local governments and the national Ministry of Finance and the Public Revenue Office that will be valuable in the design of the devolution of property tax administration for 2005.

I. INTRODUCTION

The general objective of USAID's program of assistance to local public administration and reform of the policy framework in Macedonia is more responsive, self-financing, accountable, and effective local governments. A new Law on Local Self-Government was passed in January 2002. A new Law on Local Government Finance is expected to be enacted in the fall of 2003. This legislation is part of major intergovernmental reforms planned by the government. These initiatives included:

- Removing the cap on municipal tax revenues.
- Allowing municipalities to administer the property tax that is currently administered and collected by the national government and keep 100 percent of the yield of the property tax from taxpayers within the municipality
- Creating a new Municipal Equalization Fund with transparent, formula-based equalization policy.
- Devolving the responsibilities for urban planning to the local governments which allows them to approve plans and issue building permits locally.
- Developing goals and policies for local and economic development.
- Transferring certain communal service functions to local governments include naming of streets and approval of fees, and fire department units.

Broad property tax reform, including new legislation and possibly new valuation methods and a restructured administrative framework, is expected to occur within the context of the larger effort to implement changes to the intergovernmental finance system effective for the 2005 fiscal year.

This paper reviews the current property tax practices and makes recommendations for changes in current practices. This is in the context of a proposal to share responsibility between the central government and for four pilot municipalities for the management and administration of property taxation within the existing legislative framework. The Minister of Finance and ZELs propose to enter into an agreement respecting pilot property tax administration projects in four municipalities to demonstrate the capacity of local governments to manage and collect property taxes. We expect that the Ministry of Finance will also enter into agreements with the four pilot municipalities. The form, structure and terms of these agreements have not been determined at the time of writing.

II. ASSESSMENT OF THE CURRENT PROPERTY VALUATION AND TAXATION SYSTEM

Currently, property taxation in Macedonia comprises four different taxes related to property:

1. a tax on real property or real estate;
2. a tax on personal moveable property;
3. a transfer tax on the value of real estate transactions; and,
4. a value based inheritance and gift tax.

This commentary focuses primarily on the taxation of real property (immovables) and personal movable property, and more particularly from the perspective of the implementation of the property tax administration pilot project in the municipalities serviced by the regional Public Revenue Offices in Veles, Gostivar, Sveti Nikole and Struga.

The Object of Taxation: Under the Law on Property Taxes, the objects of real property taxation include all non-agrarian land and all buildings and structures. This initially appears to be very broad tax base with the exception of agricultural land. However the law also provides very broad exemptions from taxation that are not typically exempt in many other countries. The exemptions include all commercial and industrial property, except for portions of these properties that are used for administrative purposes, i.e. offices, and all vacant development land (construction) and other state owned land. Effectively this means that the only land subject to property taxation is privately owned land used for dwellings and vacant land that is not approved for construction. This is a narrow tax base compared to most other European countries.

The list of property exempted from taxation also includes more standard types of exemptions granted in many other jurisdictions to government property, state-owned land, property of churches, charities, cultural, sport and educational premises and property used for foreign diplomatic/consular purposes.

The breadth of the property tax exemptions in Macedonia significantly limits the potential yield from property taxation. The tax revenue lost to municipalities due to the exemption of businesses and vacant construction land is difficult to estimate without reliable information respecting the value of the full inventory of such property. However in other countries, these types of properties usually represent at least 40%, and often more, of the assessed value of all taxable property. In addition, the 50% residential deduction of assessed value is a tax preference that narrows the tax base further.

The exemption for vacant construction land is particularly unusual; it is not used in developed market economies because it rewards speculation in land. When construction land is sold by the state for private development purposes, the exemption may also serve to reward incomplete construction, because other provisions in the law limit tax liability until the building is approved for use, or actual use commences [Article 8(1)].

Some property tax theorists argue that only land should be taxed so as to discourage speculation and encourage owners to utilize the land resource so as to produce a return on their investment. Land values tend to reflect the "highest and best use" for the property, such that higher value buildings tend to be placed on higher value land. Vacant land nearby is valued at similar high values and tax burden on the vacant land creates pressure to develop the site. Australia uses a "land only" property tax system effectively.

The tax exemption for agricultural land in Article 6, paragraph 16 may be desirable as a public policy objective, but it severely limits the tax base for many rural municipalities. If the primary public policy objective is to provide a tax preference to subsistence farmers, that policy might be more directly targeted at the intended beneficiaries by a basic deduction or tax preference similar to the residential deduction.

The Subject of Taxation:

Article 3 of the law provides that the owner of the property, either a natural or legal person, is the subject of taxation. No express provision is made for the taxation of lessees of exempt property. The question of ownership of land is complicated by the Yugoslavian history of collective ownership of all land. Although the law now permits the private ownership of land and some individuals are acquiring title to the land associated with their private dwellings, there is some inconsistency in the regional Public Revenue Offices (PRO) respecting the taxable status of state-owned lands.

The Law on Property Taxes provides that non-agrarian land is taxable (Article 2, paragraph 1) and that the “taxpayer in certain cases may also be the person who usufructs the property.” (Article 3, paragraph 2) However, no definition of these “certain cases” is provided in the law and, with some exceptions, the administrative interpretation of this paragraph has been narrowly applied. Effectively, the real property tax is only applied directly to land that has been transferred into private ownership, according to land rates established by the local valuation commission. However, as shown in the discussion of the valuation process below, the real property tax is applied indirectly to all lands on which buildings, that are taxable real property, are situated.

The Cadastres

Land/Legal Cadastre: There are two different real property based records or cadastres that are utilized for property taxation in Macedonia – a land cadastre (“old”) and a real estate cadastre (“new”). Both cadastres are under the jurisdiction of the State Authority on Geodetic Works. The old cadastre is being replaced gradually as the new cadastre is completed. Nation-wide completion is currently targeted for 2010. Earlier completion is possible if sufficient resources are made available.

The cadastre agency uses an administrative system of 34 regional offices on the same basis as the PRO. Only two regions are fully transferred to the new cadastre system. None of the four regions proposed for the property tax pilot project are fully completed. As a result, the property tax pilot projects will be working with the new and old cadastres in different portions of the pilot municipalities,

The old cadastre is a record of property ownership, land measurements and the ground floor area (footprint) of buildings. In some cases the old cadastre also contains the age of the building. The old cadastre dates from the 1940’s and earlier in some regions. The 1954 census was used to update the cadastre in some areas and aerial photography in the 1960’s was used for further updates. The ownership records in the old cadastre are not authoritative proof of ownership of property rights and ownership records are incomplete for many properties. This is due to poor record keeping for many years when land ownership was not an issue and to the reluctance of heirs to register inherited ownership of property. The issue of restitution of state lands to former owners also complicates determination of ownership rights in the old cadastre.

In addition, the old cadastre does not have any records for illegal buildings that were erected without building permits and without technical documentation, including approval to occupy the building. However, some owners submit the required documents and receive the required approvals. The buildings are then included in the old cadastre. Other owners submit the property tax self-assessment form, pay property taxes and then request registration of their illegal buildings in the old cadastre. Such requests are denied.

The new cadastre is based on a complete re-measurement of all real property, both land and buildings. The new cadastre includes information on the age of the buildings, the building material, number of floors, floor and size of dwelling units, number of rooms and the purpose of each room in each dwelling unit, and the size of the buildings. The new cadastre is an authoritative record of the

registration of rights to real property, including any encumbrances on the property, such as mortgages. Title documents can be issued based on the new cadastre.

The new cadastre also contains the same detailed information for illegal buildings, but the user/occupant cannot receive title documents for this property until the required permits and technical documentation are approved by the building permits officer of the Ministry of Transportation and Communications. [However, the cadastre agency will issue a document certifying that the owner of the land also owns an illegal building on the property. The illegal building will not be included on any title documents as long as it remains illegal.]

The Fiscal Cadastre: Assessment is a process of adding information to the land/legal cadastre about each property and taxpayer to produce a fiscal cadastre, also often called the valuation or assessment cadastre. Essentially the fiscal cadastre is a layer of special information added to the land/legal cadastre for property taxation purposes. The information added usually includes specific details about the property such as area and/or value, its use and information about the taxpayer including any eligibility for exemptions or tax preferences. This cadastre defines the tax base and is used to produce the list of property tax liabilities for tax billing.

As noted above, the fiscal cadastre is usually layered or built upon the land/legal cadastre. This is not the case in Macedonia. A separate database of approximately 450,000 property tax records was created on the basis of taxpayers' self-assessment forms and is maintained by the PRO for the purposes of real and moveable property taxation. Although, there is some data exchanged between the land/legal cadastre and the PRO, the fiscal cadastre cannot be described as a layer based upon the land/legal cadastre. This connection between the two cadastres will only be possible in regions where the new cadastre is completed, approved by Parliament and officially published, because then new cadastre is authoritative with respect to ownership and land and building measurements.

The fiscal cadastre maintained by the PROs serves as an assessment list of values and other pertinent property and taxpayer information, and is also used as a listing of tax liability, taxes paid and for arrears and penalty tracking. Most of the information contained in the fiscal cadastre reflects taxpayer reports because of the inability to regularly cross check much of the data with other government databases, such as the land/legal cadastre or the Ministry of the Interior.

The PRO does not have sufficient resources to do field inspections of properties to verify taxpayer supplied information or discover property omitted from the fiscal cadastre. Most observers agree that the fiscal cadastre is an incomplete and often inaccurate record of property and taxpayer information. The extent of these inadequacies will be determined to some extent by the pilot projects.

The Valuation Process

For all four forms of property taxation, the valuation process ostensibly arrives at a market value for each property. However, with a few exceptions for recently sold properties market values are not determined on an individual property basis. The valuation commissions established by each regional PRO only review the property prices reported by taxpayers for purposes of the property transfer tax and the gift and inheritance tax. That is, where real property is sold and the seller is liable to pay transfer tax; or where real property is transferred by gift or inheritance and the beneficiary is liable for taxation on the value of the property. [In both cases, the property tax must be paid before the new owner can register title and get a deed.]

We are advised that these reviews usually include field inspections and consideration of all the characteristics of the property that are deemed to influence value. In the regions reviewed for this paper, the criteria used by valuation commissions appears to vary; there is no evidence of a consistent methodology for valuation.

In addition, we do not have full information respecting how the valuation commissions determine the influence of specific characteristics on value. In some regions, municipal and revenue officials advised that reported prices are generally reliable, while in other areas taxpayers routinely understate values; estimated variance might be as high as 30% to 40%. In parts of Macedonia where real estate markets are informal, understating sale prices is more common and verification of prices in the market is difficult. Some valuation commissions rely on local construction costs for labour and materials to substantiate or correct reported sales prices. Under the circumstances, these review practices appear to be reasonable, but careful analysis of prior sales data should be an integral part of the review process, since sales verified for transfer tax purposes should also be used for determining the valuation rates for the real property tax. There does not appear to be a consistent approach for utilizing this sales data as valuation parameters for assessing property in the fiscal cadastre.

It should be noted however, that the valuation process set out in the self-assessment forms completed by taxpayers and in the audit and verification procedures used by regional PROs do not establish a separate and distinct market value for each individual property for purposes of the real property tax. The only exception in some regions is property that has sold recently, where the price established by the valuation commission is higher than the price established using the standard valuation criteria for the zone. In these cases the higher value is also used for the real property tax.

Instead, in some offices the criteria used by the Valuation Commissions are also used to establish values for real property tax. The estimate of value for each property is based on an average unit price per square meter that reflects the actual selling prices of other property of the same type in the zone. The types of property are limited to individual dwellings, apartments and offices. As a result, this estimate may be low for some properties and high for others, because it is an average for all properties of the same type in the zone. This approach to value ignores many of the building characteristics that influence buyers and sellers such as quality, condition, age, number of rooms, amenities, etc. The use of averages also ignores key land variables that are discussed later in this section.

However, in other offices, the criteria used by the Valuation Commissions are not used at all to verify taxpayer self-assessment forms, or only in exceptional cases. For example, we were advised that in one region, that the local revenue office staff only changed taxpayers' reports of value if the variance between the taxpayer's estimate of value was significant, say 30% or more. This tolerance for misstating values can lead to significant differences in tax burdens for similar properties that have approximately the same market value.

In a true market value assessment system, the assessing authority estimates a value for each property based on the property specific characteristics that would determine its selling price. This estimate is based on market-derived indicators or variables that have been shown to influence price; evidence respecting these characteristics for all property is required for a full-fledged market value assessment system.

If the new Law on Local Finance provides authority to municipal governments to vary tax rates for real property commencing in 2005, the introduction of mass appraisal methods to produce unique values for each property will become more important. Municipal discretion to set tax rates will be limited by the taxpayers' ability to pay. The valuation of all property in a zone at the same unit rate per square metre creates a problem for the exercise of the municipal discretion to set rates. If rates are established on some notion of ability to pay, then the rates will be geared to lower income taxpayers, who will tend to own property with assessed values that are higher than their actual market values. On the other hand, taxpayer's with more valuable real property and usually a greater ability to pay will not be taxed on the full market value of their properties, because their assessed value will be less than 100% of the full market value. The use of valuation method based on an average rate per square metre effectively limits the discretion of the municipality to increase the tax rate or risk the wrath of poor voters and create collection problems.

Land Values: To the extent that the assessed value is based on actual real estate market transaction prices for dwellings with a defined land base or “yard”, the land value is included in the assessed value. This occurs because buyers and sellers set prices on a combined basis for both the land and the building since the seller’s right to use the land is transferred to the purchaser of the building. The price will be determined by considerations related to both the land and the building. The principal land variables will be location and size. Market analysis will demonstrate that buyers and sellers follow this pricing behaviour consistently and without price distinction between privately owned land and state-owned land, as long as the buyer has a high level of confidence that the right to continued use of the state-owned land will not be arbitrarily ended.

Irrespective of whether the land is state-owned or privately held, the land is not sold separately and its contribution to the total value cannot be easily determined. Accordingly, the land value is included in the rate per square metre determined for the dwelling. There is no indication that officials of the PRO or the valuation commissions make a downwards adjustment of the sale price, or the resulting rate per square metre for the building, so as to remove the land component on the grounds that the land is state-owned and not subject to taxation.

[As a result, under existing Macedonian law, it might be argued that if the land component is non-taxable, the determined value for the taxable real property – the building(s) - is overstated. In other words, the determined taxable value includes the land, regardless of whether the land is owned by the state or privately owned. Similarly, it could also be argued that the use of locational zones that reflect differences in building value are improper, because only the building is taxable and its value, when separated from the land, is the same regardless of location in the municipality.]

The same logic with respect to combined valuation of land and buildings applies to apartment buildings. Identical apartment units in different parts of a city often sell for different prices based on location. As with single family detached dwellings, the price difference might be attributable to proximity to the city centre, view, security or access to other amenities such as a river, lake or park; or alternatively, the presence of negative influences such as a source of air, noise or odor pollution. The cost of building or replacing either of the two apartment units is the same. The difference in price reflects location and therefore land value.

This occurs even though the apartment owners do not have any ownership interest, either collectively (an undivided interest) or individually (a divided or apportioned interest) in the land. The land includes both the land on which the apartment is situated and any surrounding yard areas that are associated with the apartment building and used by the apartment owners. In other words, there is an ownership interest in the location, which is for market purposes an implicit assumption of an ownership interest in land.

For these reasons, locational zones with different coefficients or rates that reflect land value differentials, are important elements of a valuation system that purports to arrive at an assessed value using uniform unit rates of building space for all buildings of the same type. The taxable value that is determined from market sales data by the assessing authority includes any difference in land value that might reflect the locational influence on sale price.

The delineation of the geographic area in which a locational coefficient is applied must be derived from real estate sales prices. Verification of reported sale prices is essential to ensure that only valid arms-length sales, that meet standard real estate market criteria, are used for establishing valuation rates. These criteria include exposure on the market for a reasonable length of time, no creative financing, such as a vendor take-back mortgage, knowledgeable buyer and seller and a sale based on exchange of money without other considerations. Sales that do not meet these validity criteria should be omitted from any analysis used to establish valuation rates.

However, it should be noted that a good design of locational zones does not resolve all problems. A sales comparison will also distinguish value differences between units in two apartment buildings that are located in the same neighbourhood. There might be significant differences in the size of the land

base, or amenities associated with the land around the apartment buildings – such as gardens or a swimming pool. These differences will not be reflected in the per metre rate for units in each apartment building because both properties will usually be in the same zone, because these are qualitative differences between properties that cannot be reflected in a flat rate system of valuation that relies on location zones.

Valuation Commissions

The Law on Property Taxes requires the establishment of a commission for determining market value for the purpose of the transfer tax and the gift and inheritance tax. The law does not specifically require the use of the Valuation Commissions for site inspections to verify self-assessment forms, but this is a desirable practice.

At the very least, the criteria used by the Valuation Commissions for validating real property sale prices should be used by regional office staff for checking and approving taxpayers' self-assessment reports. As noted above, the sales data collected by the Valuation Commissions is a valuable resource for the development of up-to-date rates per square metre and for redrawing locational zone boundaries to reflect changing real estate market conditions. This is done in some offices, but it should be standard practice.

In the past, Commission members were appointed on the basis of expertise and knowledge about real property valuation and the real estate market. In some regions, the accuracy and reliability of Valuation Commission decisions is such that the courts have relied upon their estimates of market value as expert evidence. However, we are advised that in 2002 the method of appointment for members of Valuation Commissions was changed.

Due to public expenditure restraints, the PRO issued a directive in April 2002, requiring that all future appointments of members to the Valuation Commissions be employees of the regional office. The directive allowed for one outside appointee to remain a member for one year, in the interest of continuity. Since the regional office staff has regular office duties, this change in appointment practice limits the time available for field inspections in some offices and thereby reduces the property transfer tax liability of sellers who successfully understate sale prices.

Gradska Renta

The Ministry of Local Self Government report entitled *Strategy For Reform Of The Local Self Government System In The Republic Of Macedonia* [November 1999] identifies a problem with the “undefined legal base for the collection of the City rent, that is, the sum citizens pay for use of urban land”. Regardless of whether municipalities have authority to levy and collect this rent charge, the “gradska renta” is a rent payment and not a property tax.

In other jurisdictions, users of property owned by the state pay rent and also pay property taxes as user/occupants. The rent is a payment for the right to use a capital asset, and thereby provide a return on the capital investment to the owner, while property taxes pay for municipal services. In the discussion of land values above, we concluded that state-owned land value appears to be included in the property valuation on which property tax liability is calculated. However, this conclusion should not be seen as a justification for eliminating any rent charges for the use of state-owned land.

Residential Deduction

Article 7 of the Law on Property Taxes grants a property tax reduction of 50% for residential property where the taxpayers live with members of their families. This is a regressive deduction, because it grants a uniformly larger tax preference to taxpayers with higher value real property and a corresponding greater ability to pay. If, as a matter of property tax policy, a basic residential deduction considered desirable, it would be more equitable to provide a standard deduction amount, rather than a percentage deduction, to all eligible residential property.

The existing method of verifying eligibility for the residential deduction is problematic. There is evidence that some taxpayers who own more than one residential property, claim to live in both dwellings and thereby receive the residential deduction twice. This double claim might be discovered and corrected by the regional PRO if the taxpayer owns two residences in the same region. However, where the taxpayer's second residential dwelling is located in another region, only the central PRO has access to the entire database and the capability of scanning for double claims for the residential deduction. We understand that this review has not been done to date.

The existence of dual residence claims creates an administrative problem as well. Since the residential address claimed by the taxpayer is used for mailing or delivering tax bills, some PROs send tax bills to residences in the region that are unoccupied for parts of the year and the tax bills are undelivered. As a result, additional effort is required to deliver the tax bill and collect the taxes.

Moveable Property

The legislation provides that motor vehicles with an engine size over 1.8 litres, buses, trucks; tractors, combines, vessels and planes are subjects of the moveable property tax if they are not used for business purposes. This is a personal property tax. Personal property taxes are generally more difficult to administer than real property taxes. The limited data available on personal property tax collections show a significant variance amongst the pilot municipalities in property tax billings for vehicles that are liable for property taxation.

This appears to be due in part to the inconsistent pattern of cooperation and information sharing between the regional PRO's and the local offices of the Interior Ministry. Information sharing by the Interior Ministry should help address this problem, not only for the regional PROs in the pilot project, but also for the entire country. We are advised that the Interior Ministry has one of the most sophisticated information technology systems in the central government. Accordingly, the Interior Ministry should be capable of providing lists of motor vehicles with engine displacement over 1.8 litre to the central PRO. The PRO must still determine whether the vehicles are used for personal or business purposes. At a minimum, this information could be used as part of a self-assessment verification of engine size.

The failure of taxpayers to file self-assessments for tractors and combines was also identified as an issue by some observers. However, no data is available respecting the number of tractors and combines that are owned and used only for personal purposes, rather than being exempt as business property. There is not information on the number and value of unreported tractors and combines that should be paying property tax. The question is simple: does the potential tax yield warrant pursuing these objects? Inquires could be made with the Ministry of Agriculture to determine whether such information is available from that ministry or elsewhere.

Tax Billing

The Law on Property Taxes (Article 32) requires that tax bills be prepared and sent to taxpayers by March 31 each year. All observers acknowledge that this deadline is routinely missed with corollary

effects on payment delays and cash flow for municipalities. The computerized calculation of the tax liability and printing of the tax bills should not be complex or time consuming because of the uniform tax rate, with only one variation for the residential deduction.

However, the deadline for taxpayers to file an amendment to their property self-assessment is January 31st each year. The processing of these changes takes some time for verification and data entry. In some cases, field inspection by the valuation commission or regional office staff might be necessary. No information is currently available respecting the number or percentage of amendments reported by taxpayers each year. However, if the volume is even 5% of properties, two months appears to be inadequate time to do a thorough job of processing changes considering the limited staff resources available for property tax in most regional offices. Under the current legislative framework, this billing timetable might be somewhat unrealistic.

If the self-assessment process is retained in the future legislation framework, reporting and billing dates should be reviewed. One option used in some jurisdictions is an interim tax bill for one half of the amount of last year's taxes. This interim tax bill is usually mailed in late January and addresses the municipal cash flow problem for municipalities, where final tax bills are typically issued in the second or even third quarter of the fiscal year.

Usually tax bills are delivered by mail or "fast mail". A signed acknowledgement of receipt of the tax bill is required from the taxpayer as proof of delivery and receipt. In several cities this method of delivery appears to work well. While in other municipalities concerns were expressed about the number of tax bills returned to the PRO as undeliverable, tax bills left with persons other than the taxpayer or pinned to notice boards in apartment buildings and missing receipts of delivery. A suggested alternative to using the postal system is personal hand delivery by staff of the PRO or the municipality. These different levels of satisfaction with the postal delivery appear to be related to different practices and successful delivery rates by the postal service in different municipalities.

However, the cost/benefit of personal delivery by staff is difficult to understand, unless it is only used for tax bills returned because the postal service is unable to deliver them to the taxpayer and obtain a receipt. One option is to consider standardizing terms of delivery with the post office so that all tax bills are returned, if no receipt is obtained from the taxpayer. Staff of the PRO and/or municipality would then personally deliver the tax bills that could not be delivered by the postal service.

Collection and Enforcement

Article 39 requires taxpayers to pay their property taxes quarterly in four equal installments in the middle of each quarter; this installment payment schedule effectively requires the first payment in mid-February with a second payment due in mid-May. The first payment date (mid-February) is unrealistic because even if tax bills are delivered on time, taxpayers cannot meet the deadline. However, this anomaly is addressed by the wording of the tax bill that requires three payments in the middle of each of the three quarters after March 31st.

We are advised that approximately 70% of taxpayers who pay their property taxes make their payment in one installment rather than taking advantage of the quarterly payment system. This is an interesting phenomenon that indicates that the tax burden is viewed as relatively low and that quarterly payments are a nuisance for these taxpayers, rather than an opportunity to budget payments. Nonetheless, if the new Local Finance Law gives municipalities the discretion to set higher tax rates, the installment payment system should be retained, perhaps with modifications respecting timing of payments.

There is some uncertainty respecting the charging of penalty interest. The law requires that penalty interest be charged on tax arrears. The annualized interest rate was over 36%, but was reduced to about 18% on April 12, 2003. The law appears to require that interest is added, effective March 31st in each

year, even when the tax bills are delivered late. However, we are advised that no interest penalties are added to tax bills within the current year.

The annual tax bills are also an opportunity to remind taxpayers of any arrears in taxes outstanding for prior years. We are advised that standard practice is to send a separate reminder to taxpayers respecting unpaid taxes at the end of each quarter. The reminder notices include any applicable interest penalty. However resource limitations in the PROs have limited the sending of reminders; as a result, these notices are usually sent only once annually and usually early in the next year. Also, the relatively low amount of the average quarterly tax payment raises cost/benefit questions for more frequent reminder notices. Nonetheless, experience elsewhere demonstrates that the single most effective tool for tax collection is simply asking taxpayers to pay by sending reminder notices.

Municipal officials consider lack of enforced collection of property taxes a serious issue. Article 27 of the Law on Property Taxes adopts the enforcement provisions of the Personal Income Tax Law. These provisions give broad powers of enforced collection to tax collectors. These powers include a wage garnishee, a bank account garnishee, inventory of personal moveable and real property and seizure of this property. However, court approval of enforced collection action is required.

The cost of initiating court action and pursuing collection on the basis of the court order usually is greater than the outstanding tax amount. We were advised that these powers are not used to collect property tax arrears, because there is no cost/benefit. The PRO devotes its collection enforcement energies to activities that are likely to produce the greatest return on their investment of scarce resources – specifically enforced payment of VAT and income tax

Experience elsewhere demonstrates that less intrusive and less aggressive collection methods can also yield good results at less cost. Some of these methods are used in Macedonia. For example, a property purchaser cannot register ownership of a newly acquired property with the State Authority on Geodetic Works without producing proof that the transfer taxes on the sale price of the real property are paid. Similarly, in at least one region, the Ministry of the Interior cooperates with the revenue office to ensure that all taxable motor vehicles pay the moveable property tax. However, other regional offices complain that they are unable to get any information from the Interior Ministry.

We were advised that in the past the PRO also required proof that real property taxes were paid before ownership was transferred; however, this practice ceased when legal advice suggested that no legislative authority existed to require payment of any unpaid real property tax when the transfer tax was paid. The advent of the new cadastre with the capacity to register encumbrances such as mortgages and liens provides an opportunity to lawfully register liens for unpaid taxes.

Public Perceptions of Property Taxation

Several observers suggested that the general public does not understand the property tax. Some see it as a voluntary tax and others think all the revenue goes to the central government. There does not seem to be an appreciation of the connection between property taxation and the level of municipal services that the local government can provide.

Specific Observations on the Pilot Municipalities

1. Veles

Land/legal Cadastre: The regional cadastre office maintains records for 84 areas, of which 28 areas or approximately 70% of the population are now on the new cadastre. The old cadastre covers only some small settlements and mountain villages. For properties in the new cadastre the property identification number can be matched to the taxpayers identification number. The regional cadastre

office provides annual updates to the regional PRO office respecting new owners by property transfers and subdivision of land. Local officials estimate that 95% of illegal buildings are in the new cadastre and can be identified for property taxation purposes, if the databases can be linked in some manner. This is a major issue since local officials estimate that there are approximately 2,000 to 2,500 illegal buildings in the Veles region.

Fiscal Cadastre: The condition of the fiscal cadastre for the Veles region is a cause for concern. The original self-assessments filed for 1994 taxation are still relied upon for real property taxation, without amendment unless the taxpayer requests a change. Although the new land/legal cadastre has accurate building area data, it has not been made available to the regional PRO because of cost.

In any event, the local PRO staff would be unable to compare the data electronically because of the limited information technology equipment in their offices. All electronic data processing of property and taxpayer identification numbers, address changes and valuation information is done manually in Veles and then transferred to the central PRO for data entry with resulting time delays and clerical errors. As a result, no updates have been processed for 2003 assessment and tax billing.

The valuation commission reviews values of properties that are sold or transferred for gift and inheritance purposes. The commission uses the market value data it collects to revise the valuation criteria used for evaluating future sales and other transfers. However, the information gathered by the commission is not used for establishing valuation rates per square metre or for revising boundaries for the locational zones for the real property tax. Nor is it used to change the assessment on sold properties. As a result these properties have two values in the PRO property tax system; the first value is the value reported by the owner in 1994, and the second value is the more recent market value sale as verified by the commission.

PRO Resources: Approximately three staff work on property taxation; one on real and moveable property tax; one on transfer and gift/inheritance tax and one for accounting. Of the four pilot municipalities, Veles has the largest number of taxpayers and the lowest staff/taxpayer ratio. The person responsible for the real and moveable property tax has only recently acquired a computer and the regional office recently gained electronic access to the central PRO DANIS system and database. All the property tax records for the Veles region are kept on a single floppy disk.

Tax Billing & Collection: The Veles PRO does not have the capacity to print its own tax bills. In past years, the Veles PRO tax bills have been printed in Skopje, but this year will be printed elsewhere. Arrangements for printing the 2003 tax bills had not been finalized by mid-April. Rates of tax collection for real and personal property taxes were 64% in 1999 and 83% in 2000. Collection rates for transfer tax and gift/inheritance taxes were 100% in both years.

2. Gostivar

Land/legal Cadastre: The region has 87 cadastre areas. The last full mapping of the region for the old cadastre was done in 1961. However, this mapping was updated in 1979 for Gostivar and 15 villages. The development of the new cadastre is proceeding slowly; this is due in part to the crisis in 2001 that caused a delay in starting work on the new cadastre in 54 villages. Only three cadastrals in small villages are fully completed and registered on the new cadastre. The City of Gostivar is about 60% complete (4 of 7 cadastre zones) in terms of inspection, measurement and determination of ownership, but has not been officially registered. Some delays in completion of the new cadastre in Gostivar are attributable to a lack of staff, particularly lawyers to review ownership documents.

Fiscal Cadastre: There is recognition that the fiscal cadastre is incomplete, especially in the new municipalities, where there has been a lot of new construction. Information on land and buildings in the fiscal cadastre is currently based exclusively on taxpayers' self-assessments. Land is not assessed or taxed unless the taxpayer reports it; no verification of land ownership is made by cross checking with the land/legal cadastre.

Motor vehicle ownership reports by taxpayers are very low and the regional office has been unable to get information from the Interior Ministry respecting vehicle registrations. Illegal construction is a serious omission and the old cadastre does not contain this information. It will only be possible to capture illegal construction in the areas covered by the new cadastre, both registered and unregistered.

The valuation Commission uses a relatively sophisticated set of valuation criteria, including ranges of value, for estimating market value for transfer tax and gift and inheritance tax. However, these criteria are not used for verifying taxpayers' self-assessments. The dominance of an informal real estate market and serious concerns about the accuracy of reported sales information, limits the information available to the commission to establish criteria that are demonstrably market based.

PRO Resources: Approximately 7 staff (measured on a full time equivalent basis) are dedicated to the four property tax functions. All staff have computers and connection to the central PRO DANIS system and database. Some staff have developed skills in using Windows software. The regional office has the capacity to print its tax bills.

Tax Billing & Collection: Tax bills are printed at the regional PRO and delivered by the postal service. Collection rates for property tax were 63.24% in 1999 and 70.34% in 2000. Only 3,000 MKD was collected in both years in moveable property tax.

3. Sveti Nikole

Land/legal Cadastre: The region has 45 cadastre areas of which 27 are registered in the new cadastre. Of the four pilot municipalities, Sveti Nikole appears to be the most advanced towards full completion of the new cadastre. The city of Sveti Nikole itself is entirely on the new cadastre. For some of the areas that are still under the old cadastre, much of the building information is inadequate and in "poor shape". These are used for verification of land areas only. Although there are some illegal buildings that have not been approved for use, most of these buildings pay the real property tax because they have been identified in the new cadastre.

Fiscal Cadastre: The regional PRO estimates that the fiscal cadastre is approximately 90% accurate. Local officials believe the property records are reasonably up-to-date and accurate, however the valuation commission has not been functioning recently. Taxpayer self-assessments are sometimes checked against the valuation commission criteria, but the percentage checked annually is unknown. However, the valuation commission's criteria have not changed since 1995. Although, local officials suggest that this is because there has been no real estate market fluctuation in this eight-year period, the commission should still perform annual sales analysis to ensure that rates for different types of properties have not changed and that existing zone boundaries are still justified.

The Sveti Nikole valuation commission uses a uniform straight-line depreciation of 1% per year for all buildings to a maximum of 30%. There is no information that the market indicates this form of depreciation. We are also unclear whether depreciation is reduced for renovated buildings to reflect a decrease in effective age.

The Sveti Nikole PRO is the only regional office that routinely includes state-owned land in the taxpayer's property record and the property assessment, regardless of whether the taxpayer reports the land in the self-assessment. The values for land (yard areas) are based on locational zones with values per square metre of land determined by the Building Permits Officer unit of the Ministry of Transportation and Communications. This officer is a member of the Valuation Commission. Unreported motor vehicles are not a problem in Sveti Nikole because of an excellent working relationship with the local office of the Interior Ministry that supplies information to the PRO about vehicles that are liable to the moveable property tax.

PRO Resources: Three staff work on property taxation related duties; one maintains property records and prepares tax bills for all four property taxes; one for collection and enforcement and one for accounting. All staff have access to computers and to the central PRO Danis system and database.

Tax Billing & Collection: The Sveti Nikole PRO prepares and mails its tax bills and achieved a 91% collection rate in both 2001 and 2002. Collection rates for gift and inheritance tax were 100% in both years; the transfer tax collection rate was 86% in 2001 and 100% in 2002.

4. Struga

Land/legal Cadastre: The region has 50 cadastre areas. The last full mapping of the region for the old cadastre was done in the 1960's including full aerial photography. The new cadastre covers 14 out of the 50 cadastre areas, all of which are outside the City of Struga. The City of Struga is about 60% complete; however it is not being prepared by geographic zones but rather by property number, such that the completed properties are dispersed throughout the city.

Any comparison with PRO data cannot be done by zones, but must be matched to property identification numbers or taxpayer numbers, if the latter are recorded in the cadastre. The portions of Struga that are completed on the new cadastre are completed with respect to inspection, measurement and determination of ownership, but none of the city been officially registered in the new cadastre. The new cadastre for the City of Struga is expected to be completed in 2003.

Fiscal Cadastre: Local officials believe the property records are reasonably up-to-date and accurate. Struga is one of the few regions where self-assessments are regularly verified against the valuation commission criteria. However, valuations may be less reliable since a broad tolerance is allowed between the taxpayer's reported value and the value indicated by the unit rate per square metre in the various locational zones. The Valuation Commission uses ranges of value within each zone. This introduces an element of subjectivity, which might be otherwise desirable but not in the absence of information on building age, quality or condition.

The region also has a problem with illegal buildings that are not in the fiscal cadastre, but there is no estimate of the number. For the portion of Struga that is completed and the 14 new cadastre areas, the illegal buildings can be identified in the new land/legal cadastre for inclusion in the fiscal cadastre. Identification of moveable property (primarily motor vehicles) is not a problem in Struga because of an excellent working relationship with the local office of the Interior Ministry.

PRO Resources: Approximately 5 staff (measured on a full time equivalent basis) are dedicated to the four property tax functions. All staff have computers and connection to the central PRO DANIS system and database, however the computers are old dumb terminals and of limited utility for the proposed pilot project.

Tax Billing & Collection: The Struga PRO no longer prints its tax bills. This loss of local control prevents checking of bills and addresses before mailing. Last year the bills were centrally printed and mailed. Serious addressing problems occurred. Before 2002 tax bills were hand delivered by PRO staff with a low rate of undeliverable bills. In 2002 the tax bills were mailed using "fast post" and delivered by the postal service. The number of undelivered bills increased dramatically. Struga has a problem with taxpayer addresses for taxpayers who claim to reside in vacation dwellings in the municipality, but have a permanent residence elsewhere. The PRO receives returns of undeliverable tax bills for these properties.

Collection rates in the Struga regional PRO for real and personal property tax were 65% in 1999 and 79% in 2000. Collection rates for transfer tax and gift and inheritance tax were 100% in both years. The Struga PRO has an excellent working arrangement with the Interior Ministry to facilitate information exchange and property tax collection for taxable motor vehicles.

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III. THE DESIRED STATE OF REAL PROPERTY TAXATION IN MACEDONIA

“The art of taxation is to pluck the goose so as to obtain the most feathers with the least amount of hissing.”

Jean Baptiste Colbert - Comptroller General of Finance to Louis XIV of France - 1665 to 1669

The Long Term

A tax on property in one form or another exists in about 130 countries. In most countries property tax is a major source of local government revenue. The basis for taxation varies from market value, rental value, various forms of unit rates on land and/or buildings and combinations of these. *Ad valorem* or market value assessment is a common element of many hybrid systems, as well as pure market value assessment and taxation systems.

Taxes can influence how taxpayers behave. Ideally, according to market theory, taxes should be “neutral”. That is, they should not distort how taxpayers behave. When taxes are neutral, market-pricing mechanisms produce the most efficient allocation of resources. Broad based proportional taxes tend to be neutral taxes.

Property taxation is usually broad based (few exemptions) and proportional to the owner’s wealth in real property. It therefore tends to be neutral. Tax neutrality suggests that a tax should not cause people to change their economic behavior, but governments often ignore this principle so as to exert influence on economic activity, sometimes with unpredicted consequences. One of the most important aspects of a good property tax system is a broad tax base with minimal exemptions. This ensures that all the owners and tenants of real property share in the cost of supporting the municipal services they receive. The tax is applied to some of the increases in value that are partially created by public expenditures on investments in infrastructure.

A tax on immovable property is a very suitable source of revenue for local governments. The immovability of the tax base makes clear which municipality is entitled to the tax revenue. If the property is the security for the tax, it cannot be evaded. A dedicated source of revenue promotes local autonomy. The visibility of property taxes focuses attention on the overall quality of governance and promotes accountability.

Property taxes can be one of the simplest forms of taxation to calculate and collect. The tax base is easily identified. The tax is difficult to avoid. However, before any taxes are calculated, the assessed value of all real property must be determined. This can be a somewhat more complex task than the taxation component, depending on the type of property. Of course, re-assessments should be frequent to provide a buoyant base, particularly during periods of economic growth or inflation, and to maintain relative equity amongst properties. Information collected in the course of creating and administering property assessments becomes part of a valuable database of information that has numerous government and private uses. If up-to-date and publicly available, this information can play a key role in the development of orderly real property markets. However, the more exemptions from assessment or taxation that are allowed, or the more tax burden is mitigated by special preferences, the more administratively complex the system becomes.

Most assessment and property tax professionals support separation of the valuation and taxation functions. This ensures that the valuation process is independent of the municipality’s revenue requirements and the tax rate setting, billing, collection and enforcement processes. . The valuation process must also be perceived as neutral and independent by taxpayers. Taxpayers will more likely consider the assessment process as fair and equitable if they understand that values are determined independently of municipal revenue requirements. Although, the municipal council might have authority to set the tax rate, the council should have no authority to determine or influence values for individual properties. Where the assessment function is part of the municipal administration, it is

usually protected from political and administrative interference by some measure of statutory independence.

In considering the type of assessing authority most appropriate for Macedonia, two other important issues are economies of scale and retention of valuation expertise. Although residential property is relatively easier to value, modern computer assisted mass appraisal techniques for residential property will require highly skilled staff. If the property tax base is broadened to include business properties and all land, there will be a need for assessors skilled in the income and cost approaches to value. (See the discussion of approaches to value later in this section.) For these reasons, consideration should be given to a national assessing authority, which would be capable of performing all the necessary valuation functions independently, thoroughly and accurately. This agency could be funded and governed jointly by local governments and the national government since both levels of government have an interest in its product – for property taxation, to help foster and develop a viable and stable real property market, for economic analysis, for measures of wealth for equalization payments and possibly for some types of categorical and/or block funding.

To the extent that wealth in real property is a measure of ability to pay property taxes, it is important that the assessed value accurately reflect the market value of property. For example, if as in Macedonia, all property is valued at the same rate per square metre without regard to specific characteristics that influence value, pressure exists to maintain the valuation parameters at the lower end of any range of unit value to avoid over taxing persons with the least ability to pay. Where municipal councils have discretion over tax rates, this same pressure operates to keep tax rates low.

However in other countries, it has been found that property value can be a good measure of a taxpayer's wealth or ability to pay. Accordingly, the greater the real property wealth, the larger the tax bill. Some legislation provides a preference or deduction for lower value owner-occupied residential property to ensure that owners of such property are not unduly burdened by the property tax.

There are some prerequisites for a good market value property tax system that are currently not fully available in Macedonia:

1. a complete and accurate real estate cadastre that identifies all land and the ownership interests in the land;
2. a thorough analysis of taxation policy options that is based on aggregate information respecting the value of all real property assets and a clear legislative framework that reflects the policy choices;
3. individual property assessments based on market value; with a transparent and easily accessible complaint and appeal system, and,
4. an efficient and unified tax billing, collection and enforcement system.

1. The Real Estate Cadastre

The real estate cadastre should be comprehensive and complete so that the property tax administration is assured that all properties liable to assessment and taxation are found in the cadastre and are accurately described. The cadastre must also be able to identify all owners so that the subject of taxation is known to the assessing authority and the tax collector. The property assessment system should be based on the real estate cadastre so that all property is assessed.

2. The Policy Options

If all property is not valued, informed policy analysis and tax policy decisions cannot be made about tax rates, property classification, exemptions, preferences and tax mitigation measures. Alternatively, policy makers should at least have reasonably accurate information about the total value of all properties of different types and uses. As noted earlier, the existing real property tax legislation in Macedonia exempts a significant portion of the potential tax base and provides a generous percentage-based residential preference that is inherently regressive. What are the costs of these exemptions and preferences? Are the original reasons for introducing these benefits still valid? Are there other options

for ensuring that the exempt property receives the intended benefit by the national government without compromising the real property tax base?

These questions have greater significance if the proposed new Law on Local Finance gives municipal governments the authority to vary tax rates and removes municipal budget capping. With the introduction of variable tax rates and the estimated property tax yield serving as the balancing revenue item in uncapped municipal budgets, levels of property taxation will be “budget” driven, rather than simply derived from rates. In this legislative environment, the property tax will be fundamentally unlike income tax, VAT, or other forms of taxation; it will be a sharing of the municipal revenue requirement based on wealth in real property. To ensure the sharing is fair, each taxpayer’s wealth in real property must be accurately measured or assessed. Any under-valuation, exemption or tax preference simply shifts the tax burden, based on fixed municipal revenue requirements, onto other taxpayers in the municipality.

Consideration of policy options for property tax reform must also be seen in the broader context of the pending reforms of local government finance. What is the role envisaged for property taxation in the complete local government revenue equation in the longer term? Which of the four property taxes? What proportion of total municipal revenue is property tax projected to be in perhaps ten years? What is a realistic percentage of municipal revenue that should be derived from property taxation in Macedonia? Should this total amount include transfer taxes, or do these taxes exacerbate regional differences?

3. The Assessment of Property

The assessment of property should be based on an estimate of the market value of each property as of a uniform date. The current Law on Property Taxation requires that the real property taxation shall be based on the market value of the property; however this is not the practice. Instead, each property is valued at a uniform flat rate per square metre, by general property type, without regard to recent sales that might indicate a higher or lower value for similar real property in the local neighbourhood. However, the determination of market value should require a property specific approach. For each different type of property, the most appropriate approach to determining value should be determined. Assessment professionals use three different approaches to value:

1. the direct sales (or market) comparison approach is a valuation based upon the principle of substitution. Values are estimated using direct comparisons with recent sales of similar properties.
2. the income approach is an analysis of the present value of future benefits i.e., income. It is often calculated by capitalizing the net income produced by a property. The income received and the capitalization rate employed are established through a comparison with other market opportunities.
3. the cost approach is based upon a logical assumption; i.e., that people would pay no more for an object than the cost of substituting an equally desirable or functional alternative.

For properties for which there is an active real estate market - usually residential properties, the direct sales comparison approach has been shown to be a very accurate indicator of value. This methodology can be computerized and assessed values determined and updated annually with a minimum of effort and cost. New developments in computer assisted mass appraisal in the past 25 years have rendered obsolete the use of single property appraisal for almost all residential property. However, this approach to value requires some detailed information about every property so that its characteristics can be compared with similar properties that sold recently. The required physical characteristics are those that have been shown to be determinative of price through market sales analysis. In other countries, variables such as quality, condition, age, building size, number of stories, number and types of rooms, other amenities, lot size, location, view and security are independent variables that usually influence prospective purchasers.

For commercial and other properties that are purchased to generate an income stream from rentals, usually a capitalized income approach is most appropriate for assessing. For these properties it is

possible to analyze the income and establish a current value of that income stream. By determining the net income attributable to the real estate, an income analysis makes it possible to draw conclusions about the value of the property. The basis for producing a current value in an income approach is the same for all investment opportunities, and is addressed by answering the question: What is the present value of the expected future return?

For industrial property the cost approach is usually the only option because the sales market for industrial properties is limited and most are owner-occupied, rather than tenanted. The premise behind value considered in a cost approach is addressed in the following question: What would a prospective purchaser pay to replace the existing property? Therefore the approach starts with an analysis of what would be replaced, that is, an analysis of the remaining utility of the existing property. The cost of replacing the property is then determined through a two-step process. First, establishing the cost as new; and second, depreciating this cost to reflect the utility remaining in the existing property. Establishing the remaining utility considers such factors as depreciation, obsolescence, the functionality of the property, and its remaining economic life.

These approaches to value require detailed information appropriate for each method about each individual property and skilled assessors who uniformly apply valuation principles and manuals. These resources do not presently exist in Macedonia and will not be developed without a significant expenditure of time and money. Nonetheless in the long term, a market value assessment and taxation system is a desirable goal because it is likely to yield the most revenues for local government. At the same time, a market value system used as measure of individual wealth in real property demonstrates a correlation to individual taxpayer's ability to pay that is not available in flat rate property valuation systems.

The existing appeal procedures under the Public Revenue Law are seldom utilized for real property taxation matters, because most assessments are based on the taxpayer's self-assessments and even where the PRO changes that assessment, the tax liability is relatively small. However, if a market value based assessment system is introduced, a transparent assessment listing and a readily accessible complaint and appeal mechanism will become essential elements of the assessment system. Access to a form of quasi-judicial administrative justice is more efficient than burdening the court system with assessment complaints and a properly run tribunal system will reduce complaints over time and increase confidence in the property tax. Since most people have a reasonably good sense of the value of their own property, transparency helps ensure the accuracy of assessments since obviously inequitable assessments will be appealed successfully. Transparency of tax liability also helps to ensure that like properties are taxed alike and helps to build public support for the real property tax system because taxpayers are assured and come to believe that the tax is fairly determined. In any new property tax system, legislative provision should be made for an open and relatively simple adjudicative process that is accessible to lay people without the need for counsel or expert appraisers – except for more complex properties.

4. Tax Billing and Collection

Computers obviously simplify all aspects of tax administration including tax calculation, printing tax bills, sending late payment notices, calculating penalty interest, the production of exception reports and analysis for enforced collection and key management information for future planning. Installment payment amounts and timing can be set out on tax bills easily and varied to suit local circumstances where necessary. For example, in some countries predominately agricultural municipalities choose property tax payment dates that coincide, in whole or part with the annual autumn harvest. While this can negatively affect municipal cash flow, it tends to reduce interest penalties, late payment notices and enforced collection for taxpayers who have insufficient funds till their farm produce is sold.

Interim billing early in the fiscal year can be used to ensure cash flow for municipalities where final tax rates are not determined, where updating the fiscal cadastre regularly delays the issuing of tax bills or where full payment or installment dates are allowed later in the fiscal year.

As noted earlier, the simplest method repeatedly shown to improve tax collection is to ask taxpayers to pay their taxes. However, this should always be combined with strict enforcement measures for non-payment, that are taken consistently after a uniform and reasonable time. The funds expended on enforcement must be tailored to the amount of the outstanding taxes, but occasionally the cost/benefit of enforcement is in the message sent to other taxpayers, not simply the taxes collected from the reluctant taxpayer.

Some Suggestions for Interim Measures to Improve the Existing Nation-Wide Property Tax System

The proposed property tax pilot projects will be an opportunity to demonstrate the efficacy of some operational and administrative changes that could serve as the basis for an interim system that should be an improvement on the existing Macedonian real property tax system. The recommendations later in this report contain some elements of an interim system that could be implemented nation-wide starting in 2005. Of course, which pilot project recommendations that are adopted more broadly will depend on the success of these various measures in the pilot municipalities. In addition, this review of the current property tax system identified some matters that might best be addressed on a broader basis than the pilot projects. However, some administrative changes can only be made on a nation-wide basis and other aspects will require consideration of legislative amendments.

Without significantly changing the existing tax base or exemptions, the following suggestions could be considered:

1. Users and occupants of state-owned exempt property could be made subjects of taxation. The land and/or building should be valued on the same basis and at the same level of value as other similar privately owned property. The exemption for state-owned property would continue, except when occupied or used by a taxable person.
2. The “gradska rent” legislation should be reviewed with a view to ensuring that occupants of state-owned land pay an economic rent based on the capital value of the land occupied, as well as property taxes based on the value of the land.
3. The recommendations respecting the comparison of the PRO property listing with the new cadastre could be implemented nation-wide for 2004 taxation if shown to work successfully in the pilot project. All buildings – legal and illegal – and all privately owned taxable property discovered in the new cadastre could be added to the real property inventory and assessed.
4. The national PRO should develop national standards for valuation commissions for the valuation of non-agrarian land and buildings.
5. The national PRO should provide training on real estate market analysis techniques and valuation methods and ensure consistent application through regular audits.
6. The national PRO should require valuation commissions to review existing locational zones and unit values per square metre annually based on current real estate market analysis, with a view to refining the locational zones and rates so as to reflect all statistically significant variances in market prices. (This could be seen as the precursor of a mass valuation system.)

7. a) The national PRO should develop computerized methods for regional PROs to verify that individual self-assessments for real property taxation accurately reflect the most recent valuation rates established by the local valuation commissions; and,

b) The national PRO should require regional PROs to change the assessments for all properties where the assessment is higher or lower than the value indicated by the application of the market derived locational zones and square metre rates.
8. Consideration should be given to amending the Law on Property Taxes so as to change the 50% owner-occupied residential deduction to a deduction based on a fixed amount of assessment so as to target the tax relief to those least able to pay. Provide local governments with the authority to vary the amount of the deduction, within certain parameters, to reflect differences in real estate values across the country.
9. The national PRO should eliminate dual application of the residential deduction by identifying all such occurrences in its database and cross referencing PRO taxpayer identification numbers and permanent residence information maintained by the Interior Ministry.
10. The national PRO should initiate combined tax billing/reminder notices that show both current year taxes and prior year(s) unpaid taxes and penalty interest.
11. The legislative provisions on full payment and installment payments of property taxes and the timing for the charging of penalty interest should be clarified. [For 2005 and beyond, new provisions respecting timing of tax payments and installments and the introduction of local discretion in setting payment dates and terms should be considered. When municipalities individually retain all of the revenue raised from the property tax in their territory, the authority to control tax revenue timing and thereby influence their own cash flow is a logical step to more local fiscal autonomy.]
12. The national PRO should explore with the State Authority on Geodetic Works the opportunity provided by the new cadastre to register unpaid taxes as a lien against the title of the property.

These suggestions only begin to provide a roadmap for devolution of the PRO property tax function to local governments in 2005 and the governance framework for that devolved responsibility, if the property tax administration remains regionally based rather than municipally based. Both the operation of the pilot projects and the governments pending reform of territorial division will offer some further insights on options to address these matters. As these contingent matters unfold, it will be possible to develop an overall strategy for the orderly devolution of the property tax administration to local governments. An evaluation of the results of some of the nation-wide administrative changes suggested above will also inform the devolution strategy. The principal parties should begin working on this strategy as soon as possible to ensure a smooth transition through January 1, 2005.

V. RECOMMENDATIONS FOR PILOT PROJECTS

General

1. The proposed property tax pilot projects should commence immediately and operate for the balance of 2003 and all of the 2004 fiscal year.
2. The agreements between the national governments and the pilot project municipalities must bind the national government ministries and agencies to provide all information required to implement these recommendations.
3. The property tax pilot projects should be conducted on a uniform basis to the maximum extent possible to ensure comparability of the results.
4. The pilot projects should be conducted in all municipalities within each of the four regions served by the local Public Revenue Office (PRO)
5. The mayor of the central city in each PRO region should be assigned leadership responsibility for the pilot project in the region under terms of an agreement with the Minister of Finance.
6. The mayor of the central city in each PRO region should establish a regional steering committee for the pilot project composed of the mayors (or their designates) of each of the municipalities in the region. The steering committee should meet at least once before the pilot project commences and then meet monthly for the duration of the pilot project to review progress and exchange information.

Real Property

7. The PRO property tax records should be further updated by comparing the PRO property records with the database of the State Authority on Geodetic Works. Properties should be matched on a common identifier and then for each of the recommended comparison parameters below, exception lists should be created where differences exist. This comparison and preparation of the exception lists should be done in a spreadsheet application, such as Excel, using batch downloads of manageable size for staff. Downloads from the cadastre and PRO databases for specific geographic areas, or by some other matching basis should be done for the following:
 - i) Data from old cadastre to be used to update PRO property records for 2004 if warranted.
 - Investigate variance where land and/or building measurement is larger than PRO data; confirm measurements by field inspection.
 - Investigate variance where non-agrarian land is in old cadastre, but not in PRO records.
 - Investigate variance in taxpayer name or address, by checking with Interior Ministry.
 - ii) Data from new cadastre
 - Update PRO property record for 2004 from new cadastre where land and/or building measurement is different (larger or smaller) from PRO data;
 - Update PRO property record for 2003 for new buildings constructed on construction (vacant) land;
 - Update PRO property record for 2003 for land shown in the cadastre that is not agrarian land or construction land.
 - Investigate variance in taxpayer name or address, and change based on new cadastre where warranted. (This is especially important for updating incomplete records of property transfers for deceased taxpayers.)
8. The PRO should issues tax bills for 2003 where no tax bill was previously issued for 2003 in the following circumstances:

- i) for a new building where the new cadastre confirms existence of the building;
 - ii) for land where the new cadastre confirms the taxpayer owns the land;
 - iii) for a new building, if the taxpayer was billed for land only, and a building is confirmed to exist on the property;
 - iv) for land, if the taxpayer was billed for a building only, and the new cadastre confirms the taxpayer owns the land.
9. The PRO should issues tax bills for prior years where no tax bill was previously issued for those years in the following circumstances:
- i) where the new cadastre shows a new building constructed prior to 2003 - issue tax bills effective from year of construction, for up to 5 prior years;
 - ii) where the new cadastre land confirms ownership of land by a taxpayer, after enactment of the law respecting transformation of state property, issue tax bills from the date of ownership;
10. The entitlement of taxpayers to the residential deduction should be verified by implementing the following steps:
- i) the central PRO database should be scanned for double claims of permanent residence by taxpayers with property in each pilot municipality and any other municipality;
 - ii) a spreadsheet showing all dual residence claims should be provided to the PRO in each pilot area;
 - iii) in each pilot area, the PRO dual claims of permanent residence should be compared with Interior Ministry records of permanent residence to determine the correct permanent residence of the taxpayer;
 - iv) the residential deduction should be removed for 2004 taxation in the regional PRO database for the taxpayer's non-permanent address;
 - v) the taxpayer's address for this property should be changed to the taxpayer's permanent address; and
 - vi) the regional PRO should re-mail any 2003 tax bills that were returned as undeliverable to the taxpayer's revised permanent address.

Moveable Property

11. New Registrations: When a previously unregistered motor vehicle with an engine size greater than 1.8 litres is registered in the name of a taxpayer, the Interior Ministry should provide the regional PRO with information sufficient to identify the vehicle and the taxpayer's name, address and identification number. The PRO should immediately send the taxpayer a self-assessment form, or alternatively, a letter asking the purchase price of the vehicle and whether the vehicle is intended to be used for personal or business purposes.
12. Re-Registrations:
- i) When motor vehicles liable for property taxation are re-registered annually, the Interior Ministry should require proof of payment of the most recent moveable property tax bill as a condition for re-registration; or alternatively,
 - ii) On a monthly basis the Interior Ministry should provide to the regional PRO a listing of all motor vehicles liable for property taxation that were registered in the preceding month, including information sufficient to identify the vehicle and the taxpayer's name, address and identification number. The regional PRO should verify that the motor vehicle is included in the property record for the owner/taxpayer.
13. The PRO should issue a 2003 tax bill for moveable property where no tax bill was previously issued for 2003 to the taxpayer, or if the taxpayer was billed for a building and/or land only, and it is discovered that the taxpayer also owns taxable moveable property.

Valuation Commissions

14. The membership of the valuation commissions should be expanded to include a municipal representative for the pilot period to build municipal confidence in the work and decisions of the commissions and to ensure that municipal concerns are addressed.
15. Consideration should be given to the appointment of an official of the Building Permits Office of the Ministry of Transportation and Communications to the valuation commissions.
16. To ensure consistent practices, valuation commission members should be provided with training in property inspection techniques, field data collection, sales validation, real estate market analysis, and methods for establishing valuation parameters and locational zone boundaries from real estate markets and construction costs.
17. Valuation commissions should analyse real estate market sales data to establish average values for zones for the purpose of checking and/or updating taxpayers' self-assessment reports. Zone boundaries should take into account geographic variations in market prices to the maximum extent possible. The zones should be as small as market analysis and statistical tests indicate. The zone boundaries should not necessarily be the same for different types of property, unless justified by market evidence.
18. The valuation commissions, that are not already doing so, should establish ranges for value per square metre within locational zones for the purpose of verifying sale prices for property transfer tax and the gift and inheritance tax. Specific parameters such as quality, condition, age, view and any other relevant parameters as indicated by market sales analysis should guide the selection of levels of value per square meter within the ranges. These parameters will serve as a basis for eventual development of refined locational zones for mass valuation.

Tax Bill Printing and Delivery

19. Tax bills for the pilot municipalities, based on the most current 2003 PRO records, should be issued as soon as possible, and no later than June 1, 2003.
20. The pilot municipalities PROs should have the capability of printing their own tax bills, or at least reviewing the printed bills before mailing to catch obvious errors.
21. The annual tax bills should show any property tax arrears and penalty interest for prior years. [If possible for 2003 taxation and definitely for 2004 taxation.]
22. For tax bills returned as undeliverable, PRO and/or municipal staff should
 - check against dual residence list; if dual, find permanent address and re-mail
 - attempt re-delivery with PRO or municipal field staff
 - retain for database comparisons and development of exception lists on taxpayer name or address; if changed re-mail nor hand deliver if local address

Public Information Campaign

23. A public information campaign should be designed to enhance public understanding of several key messages:
 - i) how property tax revenue is spent by City;
 - ii) the benefits received from property taxes;
 - iii) how the property tax is levied & collected;
 - iv) the duty to pay property taxes.

Collection and Enforcement Practices

24. A first reminder notice should be mailed to all taxpayers who do not pay their property taxes within 15 days of receipt of the tax bill. This reminder should refer to the three installments option for tax payments and specify the dates on which the installments are due. The notice should also include any property tax arrears and penalty interest for prior years.
25. A second reminder notice should be sent no later than immediately after the final payment deadline in mid-November to taxpayers with unpaid current year tax liabilities. These notices should include amounts of penalty interest for the current year and any property tax arrears and penalty interest for prior years.
26. Staff of the PRO or the municipality should request payments from taxpayers who are in arrears for prior years. This should be done initially by phone, with follow-up visits to the taxpayer.
27. The Government of Macedonia should consider the possibility of denial of services for unpaid taxes; i.e. only services related directly to the real or moveable property - such as building permits or property transfers for real property tax or motor vehicle re-registration for moveable property tax.

Appendix A

Persons Interviewed

Mayors:

Ace Kocevski, Mayor of Veles
Xhemail Rexhepi, Mayor of Gostivar
Jordan Gjorchev, Mayor of Sv. Nikole
Romeo Dereban , Mayor of Struga

Ministry of Finance:

Trajko Spasovski, Dept. Of Budgets and Funds
Vukica Saveska, Dept. Of Budgets and Funds
Vera Kazankova, Dept. Of Tax Policy and Administration
Marija Kostovska, Dept. of Budgets and Funds

ZELS:

Branko Trajchevski

Public Revenue Office:

Zoran Vaskovski, General Manager
Micho Miloshevski, Deputy Manager of the sector for operational policy and education
Vesna Levkovska, Manager of the operational and IT centre
Biljana Stojanoska, Operational and IT sector
Irena Pockova, Sv. Nikole
Goce Jovanoski, Veles
Marina Lazarova, Property Tax Officer, Veles
Olivera Josifoska, Gostivar
Stanislav Tasevski, Struga

State Authority for Geodesic Works:

Zoran Angelov, Deputy Director
Klime Ilkovski, IT sector

Ratka Goneva , Veles
Abdilbari Halili, Struga
Kire Aleksov, Sv. Nikole
Farmakoski Zlatko, Struga

Ministry of Transportation and Communication

Blagoj Brnalic , Sv. Nikole
Jonche Dinkov, Veles

AFO

Zoran Jankuloski, Executive Director
Maksim Acevski , Member of the Board

Appendix B (*insert tax collection table*)