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IMMOVABLE PROPERTY VALUATION GUIDELINES FOR THE INLAND REVENUE DEPARTMENT

I was instructed by the Commissioner of Inland Revenue to undertake above commission, and following meetings with Commissioner Mr C Conti, Assistant commissioner Mr. F. Cachia and in-house Perit C Thake, the following was undertaken.

Introduction

The first part of this report refers to Property Taxation on the International Scene with reference to the situation in the UK, advanced European Countries, the new democracies of Central & Eastern Europe, Hong Kong & Singapore both having scarce land resources and high population densities.

The second part of the report delves locally and reports a how a database of market value rates for the Maltese localities will enhance property valuation procedures with the Department leading to less litigations as the system will be viewed as fair, hence improving efficiency. It is further considered that the land Registry Plan layout contains important information which is a good aid for valuers to assess all factors relative to the Valuation.

Historic Origin of Property Tax

The Elizabethan Act of 1601 for the Relief of the Poor is citied as the beginning of taxation of landed property.

In pre-Modern Sweden a variety of land-based taxes existed. “Grandranta” was used by kings to finance their war expeditions, levied according to the produce of the land.

In France property taxation was introduced in 1790 during the French Revolution with the purpose of redistributing wealth with the tax base being the rental value of land, whilst in the mid-nineteenth century, a building tax based on rental value appeared.

Systems in Advanced European Economies

Property taxes are levied on:

1. The annual rental value of the property
2. The capital value of the land & improvements
3. The unimproved site value of the land

1-2 The annual value may be seen as an attempt to tax the current yearly income from properties, whereas the capital and site value forms can be viewed as partial wealth taxes. Composite systems, comprising both capital and annual value are also used. Each country evolves it own system through its cultural values, historical background and political considerations.

Property taxes were originally based on the annual rental value, however with the increase in home-ownership over the years, the basis of the tax was changed to Capital Value, for the prime reason that there was insufficient open market rental transactions upon which to determine assessments – so important when assessments have to be defended. An insufficient transaction base would present difficulties because of the inability objectively to defend assessments before an appeal tribunal. Comparable transactions are therefore critical to ensuring that **horizontal equity** arguments are achieved. **Vertical equity**, on the other hand relates to the principle that those with more "wealth" pay more than those with less "wealth". There can be problems associated with capital value transactions, such as under reporting of values, problems in identifying the legal boundaries of what has been sold and the lack of a land registry.

On the other hand, if the primary mode of transactions for commercial property is by rental, it seems appropriate to base taxes on this basis. In the UK, residential property is taxed on the capital value, whilst the prevailing form for commercial property is by the rental value. Other countries with this dual system include Mexico, Thailand and Turkey.

It can be argued that capital assessment is potentially more difficult requiring more technical expertise than a similar annual value system. A capital value approach requires more frequent revaluations and more regular re-inspections of the properties because capital value have a greater volatility than rental values, with horizontal equity in the rental market maintained for a longer period before revaluations are required.

Thus initiating a mass appraisal system would reduce the administrative work load. Value maps are powerful decision tools that illustrate the geography of property values over space and time in a way that most property professionals find intuitive, mainly in map form.

When the current use of the property diverges from its highest and best use, then the capital value would be largely unrelated to the existing income being generated. When property is put to its highest and best use, the potential future gains are taxable. The tax system has to decide whether to go for a tax on income or tax on wealth.

On the other hand in the UK the tax due is not worked out on a point value but on banded values (Band A< GBP 40,000, Band B GBP 40,000 – 52,000). Here the volume of appeal challenges was reduced because banding affords a less precise area of valuation dispute. A further advantage of the banded system is that the period between expensive disruptive revaluations is extended. When a property falls borderline between bands, the benefit of doubt by the valuer is given to the taxpayer by allocating to the lower rather than the higher band.

Revaluations are supposedly to be undertaken on a 5-yearly cycle, but due to the banding system adopted there is presently no intention of revaluing domestic tax base, although a high volatility rate to the property market causes for horizontal equity to be difficult to maintain. Appeals against assessment are possible in very limited circumstances within 6 months. Stamp duty in the UK works out at 0% for properties less than £175,000 and then based on a progressive rate varying from 1% up to 4% with the higher rate applicable to properties over the £500,000 mark.

Revaluations in Sweden are undertaken on a 6-yearly cycle. If the property is physically changed by a minimum of 20,000 Sw Kr, then the property becomes subject to the special annual reassessment. Further to Sweden, the property is not assessed on its full market value, but on 75% of its market value. Appeals may be undertaken up to 5 years of valuation, unlike most countries, which improves justice.

In France the revaluation cycle on a rental value is on 6 yearly basis, with adjustments occurring every 3 years, this has, however, never occurred in practice. An appeal must be submitted within 2 months.

3 Site value taxation can be viewed as being of most relevance within developing countries. Within this context it is used in Kenya, Tanzania, Papua and New Guinea, Denmark, Jamaica, parts of Australia, New Zealand, Estonia and South Africa. An advantage of this method is that assessment can be done more cheaply and uniformly if improvements are not included. Land generally fits more conveniently into a general pattern of values which would assist the mass appraisal process. To arrive at a fair land value, the residual valuation approach is required to isolate both land and building values, defeating the scope of simplicity.

On the other hand, 2 identical plots of land might have the same site value assessment, but in terms of their existing development, they might be producing significantly different levels of revenue/profits to the owners. This makes site value tax insensitive to horizontal equity.

The New Democracies of Central & Eastern Europe

The majority of the new emerging democracies are in the process of introducing ad valorem-based property valuations. There is a clear need for the new democracies to introduce a land information system (LIS), which would integrate an efficient land market system, land registration and a land transfer system.

However, prior to the dawn of the Communist era, most countries had a form of Cadastral system in place during the last couple of centuries. From 1256 Poland had a cadastre of "Grounds" only

A cadastre is a complete & up-to-date official register or inventory of land parcels in any state of jurisdiction containing information about the parcels regarding ownership, valuation, location area, land use and usually buildings or structures thereon. However, under communism all real property rights were nationalized with the consequence that property markets ceased to exist. Bearing this background in mind, attempting to establish ad valorem taxes raises some significant difficulties due to a lack of qualified personnel.

The property markets in these Countries in Transition exhibit the characteristics of instability, inadequate transaction verification, under-reporting and possibly also inflated prices due to the preferential tax treatment of businesses.

Considering the above, Estonia moved to establish a tax on land only. This decision was based on practical considerations, since it was considered almost impossible to collate the information required to value improvements.

Furthermore, due to lack of valuers, self-assessment is predominantly used and although this reduces administrative costs, it creates questions regarding accuracy, compliance and fairness. If the assessment is based on a floor area system not taking account of market value approaches due to a lack of transaction data tax equity is impaired.