

## **The Impact of the Method of Taxation of Immovable Property on the Improvement of the Public Services Quality**

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**Abstract:** Albania as a country that is already in the market economy, feels the need to raise the level of income, to stabilize the economic problems of equilibrium and balance of payments, leading ultimately to the growth of the country's economic development. Tax on real estate assets, especially the one on residential buildings, is politically sensitive depending on the size and value with which they grow. The transition from the tax base in the area of the Real Estate to the market value of immovable property requires time and proper preparation for this qualitative change to the law of taxation of real estate. **The purpose** of this article is: Determining the efficiency of the method of taxation of the Immovable Property in improving the qualitative service of public services. The composition of tax revenue according to the type of tax in the OECD countries, revenues from taxation of real estate averaged about 5% of tax revenues.<sup>2</sup> Thus, there is room for governments to increase their support on the recurring taxes on real estate. The diversity of methods used for measuring the tax base of real estate is great. What is important and should be understood by policy-makers is the fact that management of the system of taxation of real estate today and in the future should be better evaluated than to date by expanding further basis of taxation of real estate, including in them property which has been neglected so far.

**Keywords:** tax; tax system; the tax base; real estate; income; public services; market value

### **1. Home Real Estate Tax**

Home Property Tax is the amount that will ultimately be used to distribute the tax burden on individuals, households and businesses. Accurate assessment of the tax base is the key to real estate taxation.

In some countries, mainly in developing countries and undeveloped ones, the tax base of real estate is the area of the building in m<sup>2</sup> or area of land in ha, in most cases the tax base of real estate value is the value in the market of the real estate according to the local tax administration. Some states like France, Ireland and the

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<sup>2</sup> Economic Papers 463 Oktober 2012.

United Kingdom determine the tax base on the rental value of real property. Another example is Cyprus, where in 2009, the tax base of real property refers to the value of certain property in 1980. The levels of wealth tax charge move within the segment 0.1% to 3% of the property value and are generally determined from local authorities.<sup>1</sup>

In Albania, the tax base is the area of construction buildings per square meter of the building or part of it, above and below ground level and on every floor. The tax base on agricultural land is the area of agricultural land, in hectares, owned by the taxpayer. The tax liability is calculated by multiplying the tax level with the taxed base. Income derived from taxes on buildings belonging to the municipality or municipal 100%, where this tax is implemented. All taxpayers pay the tax on buildings and agricultural land tax and land tax under Annex 1 of Law no. 142/2015 dated 17.12.2015 “On some amendments to Law no. 9632 dated 30.10.2006 “, “On local tax system” changed.

Albania as a country in transition has not seen political consensus and cooperation of institutions responsible for solving the problem of property in connection with their formalization and increase revenue from the tax to be applied on them.

Taxes related to a particular property should be commensurate with public services that are obtained by those who own the property. An alternative viewpoint is that those more valuable properties tend to be controlled by people with higher income and greater capacity to pay taxes.

Success of property taxation in developing countries and countries in transition, lies on the structure that has been made to it suit the circumstances of the country and then having a plan for the development of a proper tax on property values. The transition from the tax base in the area of Real Estate in the market value of immovable property requires time and proper preparation for this qualitative change to the law of taxation of real estate.

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<sup>1</sup> Un habitat. Property tax regimes in Europe page 7.

## 2. The Opportunity for More Revenues

The composition of tax revenue by type of tax in the OECD countries, revenue from taxation of real estate averaged about 5% of tax revenues.<sup>1</sup> Thus, there is room for governments to increase their support of recurring taxes on real estate.

According to the Fiscal Indicators of the Consolidated Budget for 2015 and the plan for the years 2016 to 2017, tax revenue relative to GDP is 25.3% for 2015 and planned for 2016 are 25.6%. Local tax revenues are 0.9% of GDP, just as planned as for 2016. Tax on buildings occupies 0.3% of GDP, and the same is the plan for 2016.<sup>2</sup> Tax on immovable property (buildings) occupies 1.8% of tax revenues<sup>3</sup>

As appears from the information provided, compared with the OECD countries, the proportion occupied by the income from this tax against revenue tax is very low.

Albania's GDP per capita expressed in Purchasing Power Standard Management is almost a third of the average GDP per capita of EU countries.<sup>4</sup>

According to INSTAT monthly income by family type are:<sup>5</sup>

| Type of family            | ALL income |
|---------------------------|------------|
| The only person           | 14 859     |
| Couple without children   | 14 075     |
| Couple with 1 child       | 14 084     |
| Couple with 2 children    | 10 084     |
| Couple with 3 children    | 6 463      |
| parental family           | 11 535     |
| Monthly income per capita | 10 884     |

Pursuant to Instruction no. 4 KM. dated 09.30.2015 “On approval of the average cost of housing construction by the National Housing” from Table 2 of this Instruction “monetary values for the sale of flats in the free market for 2015” for three cities, as capital Tirana and two cities taken in Gjirokastra and Saranda analysis (the latter two cities as cultural tourism, historic and seaside) we come up with the following information:

<sup>1</sup> Property taxation and enhanced tax administration in challenging times Property Edited by Christian Gayer and Gilles Mourre f.30a.

<sup>2</sup> MF Treguesit Fiskale të Buxhetit të Konsoliduar 2015 dhe parashikimi 2016-2017.

<sup>3</sup> Author's calculations.

<sup>4</sup> INSTAT Shqipëria në Shifra 2015 f. 29.

<sup>5</sup> INSTAT Anketa e buxhetit të familjes 2006 – 2007.

|             |                          |
|-------------|--------------------------|
| Tirana      | 89125 All/m <sup>2</sup> |
| Gjirokastra | 47860 All/m <sup>2</sup> |
| Saranda     | 53300 All/m <sup>2</sup> |

Despite the changes in the law approved recently for the way the taxation of real estate constitutes a novelty, yet the level of taxation of real estate is *very low*. If for any reason we compare the level of tax on buildings per m2 for buildings constructed after 1993 from about 30 Leke/m2 for Tirana municipality and ALL 10/m2 for municipalities of Gjirokastra and Saranda, so for a residential building with an area of 100 m2 the sum of 3,000 Leke is paid per year with the current law on the territory of the municipality of Tirana and 1200 leke per year for municipalities of Gjirokastra and Saranda, with fees based on the free market price of buildings in 2015. So for each of the cities above the tariff tax of 0.1% (the lowest level) of the market value of real property that is applied in most European countries we would have this amount of taxes:

Tirana  $89\,125 \text{ Lekë/m}^2 \times 100 \text{ m}^2 \times 0.1\% = 8\,912 \text{ Lekë}$

Gjirokastra  $47\,860 \text{ Lekë/m}^2 \times 100 \text{ m}^2 \times 0.1\% = 4\,786 \text{ Lekë}$

Saranda  $53\,300 \text{ Lekë/m}^2 \times 100 \text{ m}^2 \times 0.1\% = 5\,330 \text{ Lekë}$

As it appears from the calculations in case the tax base is applied in the market value of real estate in Tirana then it results in an increase in fees with approximately 190%, Gjirokastra 298% and Saranda 344%, considering the lower level of fee tax applied in EU countries.<sup>1</sup>

In the region this fee is about 1% of the value of the building and in EU countries amounts to 3%, therefore it is necessary to improve management of the tax system to tax on real estate and the tax base market value should be applied <sup>2</sup>.

Under these circumstances I think that the application of the instant tax base market value would be impossible for the reasons mentioned and above it is the low level per capita income, not registration of real estate and lack of the fiscal cadaster. Passing gradually towards this base would be the best option, including the value of the tax elements of quality of construction and location for residential buildings and elements of agricultural potential assets of agricultural land and the potential for improvement on assets building sites. By increasing income levels, with the completion of cadastral tax and revaluation of properties, increasing the quality and

<sup>1</sup> Author's calculations.

<sup>2</sup> Guide to local revenues in 2014.

quantity of services provided by the units of local government and awareness of the taxpayers make it suitable for applying the tax on market value of the real estate property.

Discussing raising taxes in general, it has been argued that people should see an improvement in the quality of services provided by the government to be sure that the money they pay through taxes is used properly. High corruption in the public sector discourages people from paying their taxes. An important conclusion is that, especially in the current circumstances, efforts to increase tax revenue must be carefully balanced against the long-term erosion of voluntary compliance and trust.

But why are tax collection rates so low in developing countries and countries in transition? The most obvious reason is that people tend to avoid payment of any tax if law enforcement is weak and if possible penalties for failure to implement the law are trivial. We also know that people resist paying taxes when the costs of compliance are high.

There are many other reasons, such as the compliance to pay voluntarily may be low because the taxpayer believes that the tax is unfair, or just because he does not understand how it is calculated. Often we hear the complaint, “Why pay a local tax for services that are not delivered in the right way”?

In general, provision of equipment and urban services results in increased market value of properties, so with benefits to their owners. This argument may be a strong argument in favor of the acceptance of the tax among taxpayers since income taxation on property may be related to these public investments to maintain and to provide urban infrastructure.

The transition from the current system of taxation base on the surface, in the manner *of taxation of the value of real estate* as a modern way of managing the taxation of real estate, also based on the experience of the EU countries where we aspire to be the next member soon is a target of the Albanian Government.

This objective should be done in several steps:

- (i) consolidation of the current system through the collection of dues from all subjects.
- (ii) Enhancing inter-institutional cooperation through formalization of real estate and the creation of a fiscal record of real estate tax and a cadaster record for agricultural land.

(iii) Use of this tax for infrastructure and other public services by increasing transparency and its impact on awareness of the taxpayers as it will improve the services for them.

### 3. Tax Lessening on the Taxation of Immovable Property

The diversity of methods used for measuring the tax base of real estate is great. Whichever method is adopted to measure this basis, the tax base is fragile and is often eroded by numerous exemptions and discounts.

On average in the EU, property taxes generate 3.6% of the total income tax (2010). Property taxes are the highest in the United Kingdom (11.9% of total taxes), France (8.1%), Belgium (7.1%), Spain (6.7%) and Ireland (5.6%). They are the lowest in Estonia (1.0%), Austria (1.2%) and the Czech Republic (1.3%).<sup>1</sup>

Immovable assets and individuals benefiting from the lessening in taxation of real estate can be divided into four classes:

**Firstly** it is those properties that are free from taxation by virtue of international conventions (e.g. foreign embassies) or specific use asset such as schools and churches.

**Secondly** they are the exemptions granted to protect families with low incomes. The poor tend to live in areas that do not get good service and thus have lower property values.

Here there are often two motives for giving the Immovable Property Tax mitigation for families with low incomes:

Even if taxed, revenue collected from the poor cannot exceed the cost of collecting the tax;

In countries where significant proportions of the population live in extreme poverty may seem unfair and not reasonable to add to their burden through the tax system. On the other hand, utilities and urban infrastructure is often the key to improving the living conditions of the poor. In this situation the creation of a culture in which most of the population is actively engaged in local governance can be facilitated if all families are likely to contribute through the tax system. Even modest tax payments

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<sup>1</sup> Tax policy european perspective by Martin Hutsebaut.

tend to encourage a sense of ownership and a desire to get the best value from local government.

In Albania considering the law nr.9632, dated 30.10.2006 “On the system of local taxes, amended” the municipal council decided to relieve or leaving out from the obligation to pay taxes for: a) people who have incomes below the subsistence minimum according to the criteria laid down at national level; b) the taxpayer, whose property is damaged by the action of major forces. In this case, relief or exemption is temporary and duration determined by the municipal council or municipal council in relation to the damage caused to the value of 75 percent.

Exempt from tax on buildings: a) the properties of the state and local governments, which are used for non-profit purposes; b) residential buildings, used by the tenant rent non-liberalized; c) buildings used by religious communities. d) assets owned by the state, approved by the Council of Ministers, under the management of state-owned public companies. (Amended by Law no. 106/2013, dated 28.03.2013.) Exempt from the tax agricultural land, planted with orchards and vineyards for the first five years from the time of planting

A slightly different approach than the discount system that is often used to provide tax relief for groups such as pensioners, veterans and invalids is to create an application and approval process before the tax bill is determined or taxes are collected.

**Thirdly**, there are exceptions of “social engineering” and they are given for political reasons. Chief among these exceptions is the owner occupier, which is used in almost all countries.

**Fourth** is the exemption from taxation of real estate properties owned by the government and occupied by nonprofit enterprises. This exclusion deprives local governments from the right to charge for some of the land use within their boundaries, and this imposes a cost to income, while services provided by these properties are significant and are not compensated by the user. (Bahl, Linn, & Wetzel, 2013, p. 100) Three steps can be taken to define a “best practice” in developing countries and transition economies in connection with the exclusion policy:

First, periodic review of institutional policies of exclusion of property tax in order to determine whether these exemptions continue to serve their purpose target or set any

new treatment preferential and introduce toward closing preferential existing treatment or at least for a period of time to review them.

Second, adopt the practice of evaluating all real estate including what is exempt, on an annual basis.

Thirdly, based on this assessment, the tax expenditure budget is to be determined, a free tax set instead of property to government properties and for most that do not use the property for profit. Such a practice is followed in many countries, including, for example, India and Kenya. In Mumbai, the country payment is set at 80 percent of the tax that would be paid if the property would be privately owned.<sup>1</sup>

## **4. Conclusions and Recommendations**

### **4.1. Conclusions**

Albania as a country that is already in the market economy, feels the need to raise the level of income, to stabilize the economic problems of equilibrium and balance of payments, leading ultimately to the growth of the country's economic development.

The management of the system of taxation of real estate today and in the future should be evaluated better than to date, by expanding further basis of taxation of real estate, including the real estate which has been neglected so far.

Success of property taxation in developing countries and countries in transition lies on the tax structure that is made to suit the circumstances of the country and then having a plan for the development of a proper tax on property values.

With increasing income levels, with the completion of tax cadaster and revaluation of properties, increasing the quality and quantity of services provided by the units of local government and awareness of the taxpayers makes it suitable for passing the tax on market value of the real estate.

### **4.2. Recommendations**

The consolidation of the current system of taxation of real estate is a complex process that must be done in several steps, where we would highlight:

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<sup>1</sup> Tata Institute and the University of Mumbai, 2001.



Increase in the efforts and performance of public administration of local government in terms of tax collection of the real estate predicting a new report for the collection of this tax.

Increase in cooperation to formalize institutional real estate and creating a register of real estate tax and a land register for agricultural land.

Establishment of a national specialized unit that will help formalize the immovable properties, which would carry out the assessment and updating of immovable asset values and transfer this information to the fiscal register.

Use of this tax for infrastructure and public services by increasing transparency and its impact on the entities taxed awareness that this tax is going to improve the public services offered by the central and local governments.

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