



Tomasz Wołowiec

*Prof, Faculty of Administration and Social Sciences,
Head of Department of Finance and Accounting,
University of Economics and Innovation in Lublin
(Lublin, Poland)*

** Corresponding author: e-mail: wolowiectomek@gmail.com
ORCID: <https://orcid.org/0000-0002-7688-4231>*

THE CONCEPT OF REAL ESTATE TAXATION BASED ON THE AD VALOREM PRINCIPLE

KONCEPCJA OPODATKOWANIA NIERUCHOMOŚCI WEGŁUG FORMUŁY AD VALOREM

КОНЦЕПЦИЯ НАЛОГООБЛОЖЕНИЯ НЕДВИЖИМОСТИ НА ОСНОВЕ ПРИНЦИПА AD VALOREM

Abstract

A property tax (or millage tax) is a levy on property that the owner is required to pay. The tax is levied by the governing authority of the jurisdiction in which the property is located; it may be paid to a national government, a federated state, a county or geographical region, or a municipality. Multiple jurisdictions may tax the same property. This is in contrast to a rent and mortgage tax, which is based on a percentage of the rent or mortgage value. There are four broad types of property: land, improvements to land (immovable man-made objects, such as buildings), personal property (movable man-made objects), and intangible property. Real property (also called real estate or realty) means the combination of land and improvements. Under a property tax system, the government requires and/or performs an appraisal of the monetary value of each property, and tax is assessed in proportion to that value. Forms of property tax used vary among countries and jurisdictions. Real property is often taxed based on its classification. Classification is the grouping of properties based on similar use. Properties in different classes are taxed at different rates. Examples of different classes of property are residential, commercial, industrial and vacant real property. In Israel, for example, property tax rates are double for vacant apartments versus occupied apartments. A special assessment tax is sometimes confused with property tax. These are two distinct forms of taxation: one (ad valorem tax) relies upon the fair market value of the property being taxed for justification, and the other (special assessment) relies upon a special enhancement called a "benefit" for its justification.

Keywords: *taxation, ad valorem concept, real estate tax*

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Streszczenie

Podatek od nieruchomości (lub podatek od uprawy ziemi) to podatek od nieruchomości. Podatek jest pobierany przez organ, któremu podlega jurysdykcji, w której znajduje się nieruchomość; może zostać wyplacona na rzecz rządu krajowego, państwa federacyjnego, powiatu, regionu geograficznego lub gminy. Wiele jurysdykcji może opodatkować tę samą nieruchomość. Jest to odwrotnie niż w przypadku czynszu i podatku hipotecznego, który jest oparty na procencie od wartości czynszu lub kredytu hipotecznego. Istnieją cztery podstawowe typy nieruchomości: grunt, udoskonalenia gruntów (nieruchome obiekty stworzone przez człowieka, takie jak budynki), mienie osobiste (ruchome obiekty stworzone przez człowieka) i dobra niematerialne. Nieruchomości (zwane również nieruchomościami) oznaczają połączenie gruntów i udoskonalień. W ramach systemu podatku od nieruchomości, rząd wymaga i / lub dokonuje oceny wartości pieniężnej każdej nieruchomości, a podatek jest oceniany w stosunku do tej wartości. Formy podatku od nieruchomości wykorzystywane są różnie w różnych krajach i jurysdykcjach. Nieruchomości są często opodatkowane w oparciu o ich klasyfikację. Klasyfikacja to grupowanie własności opartych na podobnym zastosowaniu. Własności w różnych klasach są opodatkowane według różnych stawek. Przykłady różnych klas własności są mieszkalne, handlowe, przemysłowe i wolne od nieruchomości. Na przykład w Izraelu stawki podatku od nieruchomości są dwukrotnie niższe w przypadku mieszkań wakacyjnych niż mieszkań czynszowych. Specjalny podatek od oceny jest czasami mylony z podatkiem od nieruchomości. Są to dwie różne formy opodatkowania: pierwsza (podatek ad valorem) opiera się na wartości rynkowej nieruchomości, a druga (specjalna ocena) oparta na specjalnych zasadach „korzyści” określonych dla jej uzasadnienia.


Słowa kluczowe: opodatkowanie, koncepcja ad valorem, podatek od nieruchomości

Аннотация

Налог на недвижимость (или земельный налог) является налогом на недвижимость. Налог взимается органом, которому он подпадает под юрисдикцию, в которой находится имущество; он может быть выплачен национальному правительству, федеральному государству, округу, географическому региону или муниципалитету. Многие юрисдикции могут облагать налогом одно и то же имущество. В этом состоит отличие от арендной платы и ипотечного налога, которые основаны на проценте от стоимости аренды или ипотеки. Существует четыре основных типа недвижимости: земля, благоустройство территории (фиксированные объекты, созданные человеком, например, здания), личная собственность (движущиеся объекты, созданные человеком) и нематериальные товары. Недвижимая собственность (также называемая недвижимостью) - сочетание земли и ее благоустройства. В соответствии с системой налога на имущество правительство требует и / или проводит оценку стоимости каждого имущества. Формы налога на имущество отличаются в разных странах и юрисдикциях. Недвижимость часто облагается налогом на основании ее классификации. Классификация основывается на группировании свойств, основанных на аналогичном использовании. Недвижимость в разных группах облагается налогом по разным ставкам. Например, могут быть следующие классы собственности: жилые, коммерческая, промышленная и неиспользуемая недвижимость. В Израиле, например, ставки

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налога на недвижимость удваиваются для свободных квартир по сравнению с занятыми квартирами. Специальную налоговую оценку иногда путают с налогом на имущество. Эти две различные формы налогообложения: первая (адвалорной налог) опирается на справедливую рыночную стоимость имущества, облагаемую налогом, а другая (специальная оценка) опирается на «выгоде» для его обоснования.

Ключевые слова: налогообложение, адвалорная концепция, налог на недвижимость

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Statement of the problem in general outlook and its connection with important scientific and practical tasks.

It is an official description, list and register of real estate (land and real estate) made for tax purposes. Within this description the value of the property and the list of incomes generated by the property is assessed. In Poland, preparations for the introduction of the cadastre system have fiscal purposes. According to the assumptions, the currently valid principles of taxation concerning real estate tax, agricultural tax, forest tax and tax on inheritance and donations will be replaced by the new regulation. Instead of taxing according to the area of the property, the base for calculating tax will be the property value (Wołowiec T., Biliński J., 2002; Wołowiec T., 2002).

According to planes the cadastre system will not comprise only the fiscal cadastre. It will also include real estate cadastre and land and mortgage cadastre. Today the regulations governing the future cadastre system are the act on real estate management and implementation rules laid down in the regulation on common taxation of real estate. It is also planned to prepare a separate act on the cadastre system. The changes will be implemented gradually and the whole operation will be finished around 2010. The valid regulations stipulate that

the cadastral value be determined for real estate mentioned in the provisions of the real estate tax. In order to establish the cadastral value, the authorities running the cadastre will hold common taxation of property. The cadastral value of the property is established on the basis of assessing real estate representative for particular types of real estate in the area of a given commune. The value of representative real estate is determined using the transaction prices in the area of the commune. If there are not enough transactions – the area of an adjacent commune is taken into account. The activities of estimating representative property in order to define the cadastral value and to draw up taxation maps and tables is performed by real estate appraisers (Wołowiec T., 2003).

Cadastral values, determined in the process of common taxation of real estate, should reflect differences existing between particular properties and they should aim at getting as close to the market price as possible with the principles of mass valuation. The basis for determining the cadastral value of particular real estate are taxation maps and tables. The value is established for the whole property or its parts if they have

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been singled out as taxation objects in regulations on real estate tax. The cadastral value of a land property is the cadastral value of the land and of its elements. A taxation unit with reference to the land is a plot of land or its part with different allocation than the neighboring plots or the remaining part of the plot, determined in the local spatial development plan or another way of using a given part of the plot if the spatial development plan has not been prepared. A taxation unit with reference to the elements of the land is a building, a flat in a multi-flat building or another premise permanently fixed to the ground. The value of the property in the taxation process is established taking into account characteristic features of the property affecting its cadastral value. For this purpose two types of land are differentiated: developed property or property allocated for development, and property allocated for other than agriculture and forest purposes and agriculture and forest property (Wołowiec T., 2005). The characteristic features affecting the cadastral value of the first group include: location, purpose assigned in the local spatial development plan, and in case there is no plan – the way it is used, technical infrastructure, degree of development, soil class of the land if it was determined in the real estate cadastre. Characteristic features influencing the cadastral value of buildings also comprise: location, type of building, how it is used, what internal installations it has, technical data as defined in the provisions on the real estate cadastre, degree of wear and tear. On the other hand, the features of flats/premises affecting their cadastral value are: location in the building, type of flat, how it is used, what internal installations it has and its degree of wear and tear (Grycuk A., 2000). Advantages of the implementation of cadastral tax (ad valorem):

- consolidating (expanding) the income base for territorial self-government units;
- clarifying the issues of ownership of property (for example positive influence on safe of property trade);
- limiting the so-called grey zone of local taxes;
- an impulse to developing property not used yet (including communal property);
- is socially justified (owners of more expensive properties pay a proportionally higher tax);
- positive influence on wealth distribution in the society (more proportional distribution of tax burden);
- limiting speculative investment in real estate.

Disadvantages of the introduction of cadastral tax (ad valorem):

- it is expensive to introduce (for example the necessity of building an integrated system of information on properties);
- it requires completing and ordering data in the register of land and buildings and in the land and mortgage register;
- possible increase in costs of rental and use of the property;
- it may be seen as socially unfair (size of tax burden does not depend on the taxpayer's income);
- weakening the tendencies of some owners to renovate and modernize the property since its value may grow (and consequently, the amount of due tax);
- the risk of deepening disproportions between poor and rich communes (differences between the taxation base values).

The draft of the property tax reform according to the Ministry of Finance.

Taxation subject. Tax will cover property owners, or – in case of the perpetual usufruct of the property belonging to the Treasury – users holding the property.

Taxation object. All properties classified according to the civil code provisions: land, buildings and other structures erected on the ground and permanently fixed to it. For the purposes of cadastral tax, non-agricultural and non-forest properties will be differentiated depending on their purpose, into properties serving economic purposes, properties serving personal needs (residential or public) and properties for rent.

Taxation base. Taxation base is to constitute some percentage of the value of property determined in accordance with the provisions of the act on property cadastre. The above value is determined via **capital-based method** - according to its current value. In case of buildings for rent, it is postulated to determine the value based on rent value – that is according to the income of the property, that is real or hypothetical rent.

Tax rates. Tax rates will be differentiated depending on the type (purpose) of the property. The level of tax rates would be determined by the commune council, within limits determined by the act. The Ministry of Finance preliminary assumption is that the cadastral tax rates should be from 0.1% (residential buildings) to not more than 2% (buildings related to conducted business activity) of the property value per year. To compare – in western Europe property owners pay cadastral tax in the amount of between 0.5% and 1.8% of the property value annually.

Tax exemptions. The commune council would be entitled to use tax reliefs and exemptions, while maintaining the obligation to calculate tax for the purposes of the compensation subsidy system. There is also another group of exemptions from taxation,

lying in the competencies of the Polish Parliament, concerning investment reliefs or indefinite exemption of the property related to the defense. Properties owned by communes would remain exempted from taxation. Capital value of the property may be determined on the basis of the property market value, book value determined for depreciation purposes, and valuation assessment. The capital method is used in the USA, Germany, Japan, the Netherlands, Latin American countries and Turkey.

The reasons for reforming the property taxation system. Before analyzing the main reasons for reforming the property taxation system in Poland we need to establish the meaning in which the concept of “system” will be used in this publication. It is necessary due to the fact that we may have justified doubts whether there is any “system” of property taxation in Poland at all (Wołowiec T., 2005). This concept will mean a set of taxes valid at the same time in Poland, whose subject is related to holding a property. The keynote for this system – that is the factor combining these taxes into the whole is that the obligation to pay these taxes is connected with the fact possessing and using a property. Such understanding of the “system” does not determine whether it constitutes an orderly whole, is internally non-contradictory, has pre-determined goals, etc. These internal features of a rational system are not taken into account when determining what taxes are included in the system of property taxation; they will serve though as criteria for its evaluation (Etel L., 2004). The property taxation system, as understood above, is built of three taxes at present, namely: property, agricultural and forest taxes. Property tax is defined in the Act of 12th January on taxes and local fees, agricultural tax – in the act of 15th November 1984 on agriculture tax, while the forest tax – in

the act of 28th September 1991 on forests. The current property taxation system is made of three taxes of very similar objects, broadly understood as property. It is assumed that property tax has the widest object scope, as it places burden on land and buildings. The object of agricultural and forest taxes is only land. These performances, according to the rule differentiating their scope, included in Article 3 of the act on local taxes and fees, are supposed to complement each other so that land covered by agricultural or forest tax is not subject for property taxation, unless it is used for conducting other than agricultural or forest activities. These taxes, as emphasized in specialist literature, "are competitive to each other, since depending on the use of the property for agricultural, forest, residential or business purposes, it may be covered with one of these three taxes (Mastalski R., 1996)." In spite of the existence of the above rule separating these taxes, they overlap both as far as the subject and object of taxation are concerned. The co-existence of these three performances when taxing properties gives rise to numerous problems in both theory and practice. However, this is not the main reason for reforming the property taxation system. The most important reasons are listed below:

1. It is a typical historical system, shaped not on the basis of arbitrarily adopted assumptions but by continuous adjustment of its particular elements – taxes – to the changing social and economic situation. In fact, for the past few decades the same rules regulating the agricultural and forest tax have been used, subject only to modifications, and never thoroughly reformed. The property taxation, especially real estate taxation, is the final element of the tax system which has not been practically changed after 1989 (Wołowiec T., 2007).

2. This system is not adjusted to those operating in the European Union, dominated by systems based on taxable properties cadastre. The Polish system of registering and taxing properties has been severely criticized by EU experts, who emphasized the necessity of its reform. The creation of the cadastre and related property taxation system is one of the basic conditions of Poland's membership in the European Union, where such solutions are used in nearly all countries. The European Communities place special significance to the issue of cadastre, which is reflected in obliging those member states which have not had such system, to implement it. The work on the cadastre system was taken up practically in all Central European countries applying for EU membership. This is to harmonize their system of registering properties with the system used in the EU, which will undoubtedly facilitate and accelerate the process of their integration within the European Community (Wołowiec T., Soboń J., 2010).

3. It is an obsolete system, based on taxing the area of the property (buildings and land), only slightly reflecting value as the taxation base (buildings). The assets in these taxes are valued for the taxation purposes in square meters and hectares (conversion and physical), not in money. In the structural evolution of taxes comprising the property taxation system we can discern a visible trend consisting in moving away from the taxation of income (agricultural tax) and property value (property tax) and towards taxation of property area.

4. In fact there is no uniform and credible register allowing proper calculation of taxes imposed on the property. The area being the taxation base is supposed to be derived from the register of land and buildings. In reality, though, there is only the register of land, whereas the evidence of

buildings is still waiting to be created.¹⁹ Therefore the building taxation base is determined on the basis of physical measurements. Forests and forest ground are taxed on the basis of physical data resulting from the forest development plans or simplified forest development plans, whose credibility, due to the lack of updates is also far from perfect. Where no forest development plans are available, the area of the forest is determined on the basis of data from the register of land.

5. It is a system which does not bring any expected income for local budgets. This is mostly attributed to the fact that buildings, constructions and the so-called construction objects which are not permanently joined to the ground are covered by any register, and so tax bodies of communes find it extremely difficult to determine which of these objects have not been registered for taxation. Another reason for low fiscal productivity is due to the fact that there are very high and in many cases, unjustified differences in the level of particular taxes imposed on property. Preferential taxation of agricultural and forest property compared to other types of real estate, accounts for the escape of taxpayers from paying taxes on property and choosing to pay agricultural tax, which is very easy in the present system. For the area to be taxed with agricultural tax it only has to have at least 1 hectare and one does not even need to conduct agricultural activity. Also a large number of statutory exemptions (covering, for example, land classified as 5th and 6th class) translates into low incomes achieved by communes.

6. Taxes comprising this system, even though they are becoming performances similar in type due to the implemented changes, still demonstrate certain heterogeneity of their construction. Further changes to the agricultural tax and property tax have

transformed these performances from revenue (agricultural tax) and revenue-capital (property tax) into capital types of taxes, with some typical elements of revenue taxes. This dual nature of taxes accounts for ill-adjustment of their object (assets) to the taxation base, which directly does not reflect the value of the property.

7. The current system does not solve the problems of agriculture taxation, including taxation of agricultural real estate. At present taxes imposed on properties, especially agricultural tax, are the only performances burdening farm owners (not counting incomes from special sections of agricultural production). Since that professional group does not pay taxes on revenue or income obtained from conducting agricultural activity, attempts are made at making the agricultural tax a revenue-income-capital tax. This is obviously some fiction, negatively affecting the shape of agricultural tax, which is manifested, for example, in the concept of conversion hectare. Whether it is used to determine the revenue capacity, income capacity or the area of a farm, it is hard to say. Determining the principles of agriculture taxation, including classification of agricultural tax as a typical asset tax and covering revenues from agriculture with an income tax is one of the most important and most challenging problems to be solved in the near future.

8. It is a system without the “general part”, within which common institutions for all taxpayers would be regulated. In none of the constitutional acts are taxes treated as a whole; on the contrary – property tax is classified into the local taxes and fees, while agricultural and forest taxes are not. There is no uniform terminology used in legal acts regulating their structure, as a result of which problems arise concerning their object and subject scope.

9. In spite of appearances, the structure of these taxes may be shaped by communes

only to a small extent. For no apparent reason the scope of the power given to the council differs for particular taxes. The competencies granted to councils are not

adequate to the constitution-guaranteed right of territorial self-government units to determine the level of local taxes and fees.

Analysis of latest research where the solution of the problem was initiated.

The above drawbacks of the valid system of property taxation seem to call for the necessity of taking quick action aimed at reforming it. Some of them can only be removed by thoroughly reforming the property taxation system, aimed at introducing the cadastre system and the tax on property value based on it. The implementation of the fundamental reconstruction of the current system of registering and taxing properties requires quite a long period of time. This is mainly connected with the necessity of establishing the real estate cadastre and conducting common taxation in order to determine the cadastral value of properties. It is assumed that a fiscal cadastre may be introduced in a couple of years, at the earliest, and if it is going to be a multi-purpose cadastre, this period will be significantly prolonged (Wołowiec T., 2003).

However, many of the above-signaled drawbacks of the current property taxation system may be eliminated without the need to wait for the cadastre. Even now, within the first stage of the reform, actions can be taken aiming at improving the existing regulations, which should either strive at removing or modifying those provisions which generate problems at the stage of collecting taxed imposed on real estate and adjusting the existing norms to the assumptions of the designed cadastral tax. Among detailed actions that should be implemented in the first stage of the reform one could mention:

1. Standardizing the structure of three taxes imposed on the land, which especially concerns the statutory definition of the tax object, exemptions and reliefs, properties exempted from taxation, competencies of

self-government bodies in shaping some of their elements and the mode and terms of payment. Also terminology used in provisions of the acts regulating taxes should be standardized. Taking up these activities will make it easier in the future to impose one cadastral tax on all land property.


2. Eliminating significant differences in the amount of tax burden imposed on particular types of property. Activities here should be aimed at making tax burden real, especially in case of agriculture land and forests, by gradually increasing the amount of agriculture and forest tax (eliminating some exemptions and reliefs, increasing the tax rate). Also the differences in the amount of taxation within particular taxes should be decreased (for example between residential and other buildings, forests with forest development plans and those which are taxed on the basis of the register of land, etc.). Relative standardization of the level of particular taxes will eliminate the phenomenon of dodging property taxes and will alleviate the effects of covering agriculture and forest lands with cadastral tax (Wołowiec T., 2003).

3. Using the depreciation value as the taxation base not only to constructions, but to all objects subjected to statutory depreciation. In this way most buildings and constructions not fixed permanently to the ground and used for conducting economic activity would be taxed on principles characteristic for cadastral taxes.

4. Introducing a provision which would precisely differentiate the object scope of these three taxes. The best idea would be to write down in the act on agriculture and forest tax that the land covered with the

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provisions of this act includes the taxable land, the land exempted from these taxes and the land not covered by these taxes by the virtue of the above acts. This will help clearly isolate the object scope of these three performances and will limit the phenomenon of avoiding to pay property taxes (Wołowiec T., 2004).

5. Making entries in the land register real, establishing the register of buildings and clearly stating in the three acts regulating property taxation that the taxes are calculated on the basis of data arising from the above registers. This will standardize the principles of determining the area of the taxable property, facilitate calculation of taxes and contribute to revealing properties which have not been declared for taxation. Data included in these types of registers will undoubtedly be used when establishing the property cadastre.

6. Removing “dead” provisions from the acts, that is provisions which are no longer used or do not perform the assumed function (for example the right of the province governor to move communes to another tax region, preference treatment of land in case of only one group of the retired people – those who belong to a cooperative, etc.).

7. Increasing the rights of self-government bodies in shaping the structure of these taxes by, for example, adopting the principle that rates in agriculture, forest and property taxes may be decreased and differentiated by the commune council without any restrictions. Minimal rates should not be used, as – which is confirmed in practice – do not perform any function in the current system. The commune council should also be authorized to introduce not only exemptions but also reliefs in all three taxes. This competence of the council should be statutorily limited, due to Article 217 of the Constitution, only to object exemptions. Granting such rights to the com-

mune council is a manifestation of the implementation of the principle of increasing the local government rights and the constitution guaranteed right to determine the level of local taxes and fees. Accomplishing the first stage of the reform will make it more probable to achieve social acceptance for implementing fundamental changes in the system of property taxation. The evolutionary transformation of the tax “on the surface” into the tax “on the value” of the property will, as can be supposed, alleviate the taxpayers’ fears concerning possible effects of introducing the cadastral tax. Extending the circle of entities obliged to pay the tax on property value, within the existing regulations, will decrease the natural resistance of taxpayers against accepting new principles of property taxation. Such effect cannot be achieved by introducing, and omitting the transitory period, new, totally different regulations, addressed at a very wide circle of potential taxpayers used to the valid principles of paying tax on property.

The gradual implementation of the property taxation reform is also supported by the fact that in practice its success will significantly depend on the efficiency of the operations of self-government tax bodies. Employees of these bodies (especially treasurers) do not always have proper education allowing them to acquaint with new regulations concerning the process of property tax collection quickly and independently. We should bear in mind that in practice the first problems encountered with switching to the new principles of property taxation will be solved by these people. Their competencies will determine the efficiency of the implementation of new provisions. This favors the gradual adjustment of the valid regulations wherever possible, to the designed cadastral tax. It will enable us to ‘test’ in practice some of them in the system of property tax and will

allow the employees of tax calculation organs of local governments to acquaint with it. The accomplishment of the first stage of the reform will enable us to perfect the valid legal provisions and to eliminate those which generate problems. It is of particular importance in a situation when the structure of some elements of the new tax will be based, as it should be postulated, on provisions of law included in the current acts. The norms concerning such tax elements as its subject, object, exemptions or mode of payment, after introducing some corrections, may be moved to the cadastral tax. The introduction of these corrections and their practical verification on the basis of the 'old' tax will contribute to their problem-free operation in cadastral tax.

There is one more reason for the implementation of the reform, a reason we have already mentioned many times. The efficient operation of the new tax is determined by the creation of the cadastral system and conducting common taxation of properties. This tax, apart from other conditions, will function well if the cadastre performs its functions. This can only be checked empirically by observing how this institution functions for some time. If it turns out that it performs its functions, we can base the property taxation system on it. However, if for some reasons, the functioning of the cadastre does not go in line with the assumptions of its creators, we cannot relate a new property tax to it. Therefore it seems that it is not justifiable to introduce the cadastre and the cadastral tax simultaneously. In the first stage of the reform we should practically verify how the new solutions concerning property valuation and cadastre work and then – after successful verification – start the second stage consisting in implementing the cadastral tax.

Structure of the new property tax. The structure of the new property tax should be

based on the following assumptions (Wołowiec T., 2005):

1. Cadastral tax will replace the currently used three taxes: property, agriculture and forest ones. In this way all types of real estate being a property or belong to various types of entities will be taxed along the uniform regulations, which does not mean, though, that there would not be any specific principles of taxing particular types of property (for example agricultural land and forest). Imposing one tax on all kinds of real estate would help eliminate the above-signalized drawbacks of the existing regulations, such as: avoiding taxes on real estate, considerable difficulties with proper classification of the property as subject to a given tax and determining which entity has tax obligation. When determining the object of the new tax, we should preserve the current regulation stating that a taxpayer is an owner of the property and only in case of properties belonging to the Treasury and self-government units, the taxpayer is an entity holding the property. This principle should be reinforced by adopting a solution that in case there are both the owner and the owner-like possessor, it is the owner (with exceptions of the state and commune properties) who will be the taxpayer. It should be postulated that the lawmaker, when defining the taxpayer, should leave the term "owner" and adopt the term "holder" of property. The latter is a broader term, covering not only the owner, as understood in Article 336 of the Civil Code, but also the dependent holder, trustee and manager of the property. In this way clear criteria for determining the person obliged to pay taxes on state and commune property would be created; it would be the holder of the property, regardless of their legal title and other related circumstances. A similar principle would be applied to defining the taxpayer for the properties whose legal status has not been regulated yet, which unfortunately are

quite common in Poland. In this case the taxpayer is the holder of the property whose legal status is not regulated.

2. The object of the cadastral tax should be the real estate not only as understood in the Civil Code, but also other types of building objects and constructions, which are not these types of property (temporary buildings, sheds, fences, swimming pools, greenhouses, etc). The provisions regulating the cadastral tax should relate to the Construction Law, which comprises precise definitions of a building, a structure and an object.

The tax object should also be agricultural and forest real estate, which is connected with the already mentioned postulate of eliminating the agricultural and forest tax. An optimal solution would obviously be to cover from the very beginning all land with the new property tax. However, due to significant specificity of agricultural and forest land taxation, a transition period seems to be necessary. In this period we should maintain the existing tax burden placed on these types of land. However, during this time, the agricultural and forest tax level should be gradually increased to the assumed level of the cadastral tax. The burden should be increased by eliminating some reliefs and exemptions (such as exempting class VI land from tax, "soldier" reliefs) and granting commune councils the right to increase the rates for these taxes. It also seems that we should consider what was already practiced in 1984, namely gradual increases of the statutory rates of agricultural and forest land tax to dampen the effects of switching to the general taxation principles.


3. The taxation base in the new tax should be the value of property resulting from the real estate cadastre. The real estate cadastre should be of fiscal nature and should be run by self-government cadastre bodies at the district level. The cadastral value should be

determined via common appraisal of real estate, which would help to avoid costly individual appraisals performed by appraisers. The principles of determining the cadastral value being the taxation base for the designed tax have already been defined in the act on the real estate management. Section IV of this act concerns property valuation, including determination of cadastral value. The real estate cadastral value, according to Article 150 part 4 of the Act, is determined for real estate listed in the provisions of the property tax. It is determined via common appraisal of real estate by bodies running the real estate cadastre. The cadastral value of the property is determined on the basis of appraising properties which are representative for particular types of real estate in a given commune. Technical activities related to assessing the value of representative real estate and then drawing up appraisal maps and tables are performed by real estate appraisers. Appraisal maps are used to mark single values of the land located in the zone characterized by similar factors determining the market value of the land. Relating this value to the land area we obtain the cadastral value. Similar principles are applied to the value of land elements. In order to determine the cadastral values of land elements (buildings, structures, constructions which do not constitute a separate ownership title) are determined via their respective area values and presented in appraisal tables. The cadastral value of the object constituting an element of the land is determined as the product of its area indicated in the property cadastre and the unit value indicated in appraisal tables. The same method is applied to determine the cadastral value of premises and buildings constituting an object of ownership separate from the land.

Appraisal maps and tables are drawn up by the body running the cadastre, obliged to

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provide access to them. Everyone whose legal interest is affected by appraisal maps and tables may raise objections to them. Having considered objections, the commune council passes a resolution on validating appraisal maps and tables. Those dissatisfied with the way their objection was dealt with are entitled to appeal to the Supreme Administrative Court.

The cadastral value of a particular property is determined by the body running the cadastre and on the basis of this decision the value is entered into the property cadastre. This value becomes official data once it is entered into the register. Values of properties entered into the cadastre may be updated officially or at the taxpayer's request, following the individual assessment of the property. The law does not specify when such first valuation of property should be conducted (this is to be determined separately). The Council of Ministers was obliged to issue a regulation on detailed principles and mode of conducting the valuation and its control, however the relevant regulation has not been adopted yet.

It seems that the regulation of the principles of determining the cadastral value in the 'non-tax' act of law is a rational solution for two reasons. Firstly, the principles of determining this value constitute an integral part of the system of property valuation, which is regulated in a complex way in the act on property management. Isolating the mode of determining the cadastral value from general principles of property valuation would require regulation of the same issues (for example ways of determining the property value, principles of real estate surveyors work, etc.) in an identical way in two different acts of law. Secondly, the complexity of the issue would justify excluding the principles of determining cadastral value from the act on property tax. Regulating it in the prepared


act would considerably increase its volume, which would negatively influence its transparency and clarity.

4. Maximum percentage rates of the tax should be determined in the act, whereas the commune council would be given an opportunity to differentiate them. In order to determine the maximum rate for a given category of property it is necessary to perform some simulations which would allow us to decrease the risk of sudden growth in tax burden imposed on the property. New tax rates should be shaped so as to make the amount of cadastral tax similar to the amounts currently paid. The commune councils should, within these limits, determine rates for a given tax year, adopting a relevant resolution. It seems that it is hard to justify, as confirmed in the practice of determining the lowest rate that communes have competencies to introduce rates exceeding maximum rates, though this competence should be limited by law, for example to 10% of the maximum rate. This competence would work as some kind of 'safety fuse' in the first period of implementing this law, when we can expect to see the phenomenon of ill-adjustment of the statutory rate – uniform for the whole country – to the specificity of a given commune.

5. The proposal of the act on cadastral tax the catalogue of reliefs and exemptions existing in the current taxes should be limited. It is not advisable to incorporate all reliefs and exemptions into the new act, as they have been shaped in various periods of time and do not constitute an orderly and well thought out system aimed at accomplishing some clearly defined goals. First of all, it is hard to indicate the criteria which determined why a given type of property is exempted from tax. The subject literature demonstrates that it is completely unclear why, for example, we should exempt from tax structures used for the public

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railway transport, airports, sea ports or structures for generating electricity or energy, in a situation when their use is associated with conducting business activity in which you can take into account costs related to taxation of such property. The lack of clear criteria for exemption is also manifested, inter alia, by the fact that power lines are exempted from taxes, whereas telecommunication network, though its significance and functions performed for the economy are very similar, are not. It seems that when determining the content of the catalogue of properties exempted from the new tax, one should first set some goals to be achieved via such exemptions and reliefs, and eliminate those which are not useful. This would undoubtedly eliminate most of the exemptions and reliefs included in the draft of the act. Especially excessive statutory exemptions should be reduced. The tax exemptions concerning the objects should be exclusively introduced by the commune council. We should consider the introduction of 'investment' reliefs, stimulating to build and develop some structures used for conducting business activity concerning social and housing infrastructure and residential constructions.

6. The cadastral tax should be paid on the current principles. Legal entities and organizational units without legal capacity would calculate and pay in installments the due tax to the budget of the commune in which the property is located. Individuals would pay the tax on the basis of a decision issued by the self-government tax body, which should be the body running the property cadastre. We can also consider the possibility of administering this tax by a tax body to all taxpayers in form of a decision.

It is justified by the fact that in the first period of the new tax taxpayers will experience difficulties with calculating it on their own. However, the implementation of this proposal, especially in large municipal communes, would considerably increase the obligations of tax bodies, as they would have to prepare, issue and serve a large number of valuation decisions. This would negatively affect the costs of this performance. Besides, legal entities and organizational units which do not have legal capacity are obliged by the valid law to declare and calculate taxes whose construction is more complicated than the construction of the cadastral tax and somehow manage to it, therefore we can assume that they would also manage to calculate the cadastral tax. Resigning from self-calculation of the cadastral tax by this category of taxpayers in the initial stage of the tax implementation does not solve the problem, but only postpones it. This may lead to a situation when legal entities and other organizational units will 'forget' the necessity of self-declaring and self-calculating property tax. Therefore it seems that the cadastral tax should be paid on the current principles. The implementation of the above-presented postulates concerning the structure of the future cadastral tax is not enough for creating a rational system of property taxation in Poland. Simultaneously, work should be done on establishing a modern fiscal cadastre of properties, as its proper operation guarantees the success of the reform. This issue, however, exceeds the scope of this publication, whose main aim was to present the basic assumptions of the reform of the property taxation system.

Aims of paper. Methods.

The main goal is to present and evaluate legal regulations concerning systems and

models of real estate taxation in the European Union countries. The analysis of

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legal regulations includes both the point of view of the taxpayers and public administration bodies (tax authorities). Additional goal comprise identifying disadvantages and advantages of the surface model as well as *ad valorem* model, together with legal assessment of the concept of transformation of real estate tax based on the so-called zoning of tax rates.

Scope of research. The evaluation of legal regulations and solutions concerning systems of real estate taxation in the European Union countries was limited to the real estate tax and reflects the search for legal governance in real estate taxation from the point of view of taxpayers (individuals and entrepreneurs) and public administration units (mostly local self-governments). The evaluation of current and projected solutions and amendments to legal regulations includes both short-term and long-term perspective. **Subject of research** are legal regulations concerning systems and models of real estate taxation in the European Union countries, includes both the point of view of the taxpayers and public administration bodies (tax authorities). Subject of research comprise also identifying disadvantages and advantages of the surface model as well as *ad valorem* model, together with legal assessment of the concept of transformation of real estate tax based on the so-called zoning of tax rates. **Object of research** comprise the legal models of real estate taxation in EU countries taking account a presentation the ways of reforming Polish real estate taxation system. **Research methodology.** Induction is the main research method used in the paper. It consists in drawing general conclusions or determining some regularities on the basis of an analysis of empirically observed phe-

nomena or processes. It is a type of reasoning on the basis of details on general properties of a phenomenon or an object. The application of this method requires accepting an assumption that only facts may constitute the basis of scientific reasoning. These facts are real situations (social, legal or organizational ones). Induction methods comprise various types of analyses, expert's opinions, statistical data and scientific documents used in social research. Moreover, in the paper I used two general research methods, namely **analytical and synthetic methods**, characterized by special approach to examining the reality. The analysis shows reality as a set of single, particular features and events. Following this research method consists in taking the object of the analysis apart and examining each part separately, or in discovering the elements of that object. A drawback of the analytical method is excessive exposure of details, sometimes leading to losing sight of the whole object of research. This prevents us from fully and objectively learning about the reality, which admittedly is a set of independent elements, but also a set of parts closely linked together to form the limited whole. **The synthetic method** treats reality as a set of features, its implementation consists in seeking common features of various phenomena and events and then combining them into a uniform entity. Therefore the synthetic method examines and determines the whole object of research. **Using complex (hybrid)** research approach we also used the so-called **triangulation of data sources**, that is comparing the information on real estate taxation from various periods and legal systems, and **theoretical triangulation** – consisting in analyzing the obtained data from the point of view of various theoretical legal concepts.

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Exposition of main material of research with complete substantiation of obtained scientific results. Discussion.

The system of financing local government in Poland requires changes which would strengthen the share of own income in self-government budgets and increase the autonomy of financial policies implemented by local authorities. Among the hotly debated proposals in Poland of strengthening the tax potential of local budgets one can differentiate:

- Discussions concerning changes in the property tax
- Concepts aiming at transforming shares in PIT into a local income tax
- A concept of local sales value tax, recently formulated by W. Misiąg.

All these three directions deserve detailed analysis, however, our report concentrates most of all on the first of the above-listed options. There is no coincidence in the fact that property tax is the main source of income for self-governments in many countries. This is due to its features which make it a nearly ideal local tax:

- The tax base is relatively (at least compared to most other taxes) equally spread in the area;
- Allocating the income to a particular local authority is unequivocal (this feature differentiates property tax from PIT, where we also encounter problems while trying to determine the actual number of residents. There is also a problem of how to treat people with several places of residence. The problem of territorial equivocalness is even more acute in other taxes – for example CIT, or – in an even more dramatic form – in case of VAT);
- Allocating to a particular local authority prevents manipulations of possible taxpayers (for example in case of PIT we cannot exclude the

possibility of fictitious migrations motivated only by the need for tax savings).

The concepts of changes to the property tax in Poland date back to as early as the first half of the 1990s, though none of them has ever been implemented. This report presents the concept which, in our opinion, meets several important criteria:

- It increases potential incomes of many local authorities;
- It is more fair than the currently used system;
- It is relatively simple and easy to implement.

The main subject of this report is to present the details of this proposal, together with the simulation of its financial implications for various categories of self-government. In addition, we briefly relate to a few issues connected with the main topic, namely:

- The issue of combining changes to property tax and accompanying changes to other segments of the system of financing self-governments, especially the way of calculating the general subsidy;
- The issue of connecting property tax to other burdens of similar nature – forest and agriculture taxes and perpetual usufruct fees;
- Discussion on the scope of tax power of local authorities.

I present a thesis of positive effects which would be brought by the strengthening of local authorities incomes by local taxes. We may list several arguments, both political and economic ones, for such construction of the income system:

The system in which the major part of local budget comes from own resources devel-

ops responsibility of local governments towards their inhabitants. The shape of the commune budget largely depends on decisions concerning local taxes and fees. This helps strengthen political responsibility of councilors and executive authorities towards their voters as well as supports the interest of inhabitants in local public issues. In other words, such a system of incomes supports the development of local democracy.

Such a system also helps rationalize expenditure and search sources of possible economies. Local government politicians find it more difficult to increase expenditure if it is to be financed by increasing taxes imposed on their own voters (who may not be happy with such a solution) than in a situation when we receive the money from the central government.

The fiscal policy may be adjusted to local preferences. In one place, inhabitants may expect a higher level and better availability of services, even at the cost of higher local taxes, whereas in another place they will prefer poorer availability or higher payment for services only to keep local taxes as low as possible. If a significant part of income came from donations and subsidies, the implementation of such a policy, taking into account local preferences, would be impossible, as only own incomes can be shaped at the level of local government units.

A solution in which the majority of local authorities income is own income lowers the pressure on the amount of total public expenditure, especially on the size of expenditure from state budget. This is the consequence of the above-mentioned fact that in a situation of the dominant own income, attention is paid to seeking savings rather than on negotiating resources (transfers) with higher level authorities. Rattso (Rattso J., 2002) notices that in a situation where the dominant part of local authorities

income comes from transfers, that is a situation in which the local community does not bear the direct burden of financing tasks, inhabitants are inclined to expect excessive supply of local services. On the other hand, local authorities – passing these expectations further – require bigger transfers, which are financed from taxes imposed on taxpayers in the whole country. Such system leads to increased pressure on higher public expenditure.

The postulated income structure also strengthens the position of local authorities in the country. Self-government becomes a partner contributing to the financing of public tasks, rather than a client asking from “crumbles” from the government table.

With a high share of own income in local authorities budgets, local authorities become more interested in promoting local economic development (though this interest has also other reasons). Self-government politicians and managers will try to support development of economy just to increase budget incomes from their taxes. However, we cannot pretend that basing self-government budgets on own incomes will only bring positive results. There is also a negative consequence – a growing role of own incomes in local budgets will inevitably lead to growing differences between poor and rich regions.

Besides, using the criteria discussed here, the worst type of income is the self-government share in state taxes. It has the above-mentioned drawback (leads to growing disproportion of incomes achieved by self-governments in poor and rich regions), and does not have most of the benefits associated with own incomes. Since the decisions taken by local authorities do not influence the rates of these taxes or granted reliefs and exemptions, it is hard to expect that the existence of this share could contribute to better adjustment of fiscal policy to local

preferences or that it could limit the general amount of public expenditure.

Local taxes in European countries. Most European countries have more than one local tax. There are two dominant models:

- The model in which the most important local tax is property tax. Here we have the United Kingdom (we will discuss this case in greater detail), France, Poland and nearly all Central and Eastern European countries which joined the European Union in 2004;
- The model in which the most important local tax is local income tax. This group is dominated by all Scandinavian countries (Denmark, Sweden, Norway, Finland), though Croatia and Belgium also seem to follow in this direction, since the growing part of their incomes is from the self-government addition to income tax (Alibegović, D. 2002; Bajo A. Jakir-Bajo I., 2008).

The object of my special interest are those countries which base on property tax. Special attention should be paid to those of them which abandoned the tax related directly to the value of each taxed property. The United Kingdom is an interesting case. Traditionally property tax was one of local taxes and was collected on both residential and business buildings. Until the mid-1980s, local authorities had unlimited rights to determine the amount of this tax. Then the right was limited indirectly by the possibility of imposing the expenditure limits on local authorities by the government. In 1990 Margaret Thatcher decided that the property tax should be replaced with the poll tax. This moment also created an opportunity to deprive self-governments of the tax imposed on property used in business activity (the incomes from this tax still go to local authorities, but they are allocated on the basis of the algorithm defined by the government). In 2010 they

jointly brought 13% of local government incomes.

The poll tax was perceived by the large part of the society as unfair and caused massive protests. It was one of the main causes of the resignation of Thatcher's government at the beginning of 1991. Her successor – John Major – decided to implement another reform – introducing the local government tax (*council tax*), which is similar to the property tax, though it contains elements of the poll tax as well. Properties are divided – according to their value – into 8 classes (*bands*), marked with letters A to H, where A stands for the cheapest properties, while H – the most expensive ones. The council passes a resolution on the amount of tax for band "D". The tax for each property is calculated by multiplying the base amount by a relevant coefficient related to the value of the property. The tax also depends on the number of people residing in the property. For example single persons pay 25% less. The tax is paid on the property which is the only or the basic place of residence. In case of rented houses, it is the tenant, not the landlord, who is the taxpayer. An interesting source of inspiration is provided by the Czech Republic and Slovakia, where the tax depends – with some exceptions that are negligible for our considerations – on the type of use and size (area) of the property. A certain substitute of the value is found in determining the maximum tax rate differentiated according to the location of the property. In both countries a uniform maximum tax rate on square meter is differentiated depending on location (Local Government Finance, 2010).

Property tax in Poland – the current state. The aim of my analysis is not to describe the commonly known details concerning the structure of the existing tax. I will concentrate on a few features which

are of fundamental significance for the proposals presented in the further sections.

1. Property tax still remains the most effective source of own income for commune self-governments.
2. The local tax base, and consequently, the share of property tax in budget income of communes, differs.
3. With a few exceptions (concerning constructions), tax is calculated not on the value but on the area of the property, with maximum rates applied, since local authorities cannot exceed them.
4. Apart from the tax policy run by local authorities, the size of collected revenues is influenced by numerous statutory provisions, which determine, for example, exemption of some categories of properties from tax. Also of significance are those seemingly small amendments to the law not related directly to local authorities finance and implemented without the awareness of their far-reaching consequences. For instance a change to the definition of a building and a construction object in the Act on Construction Law, implemented in 2003, narrowed down the

concept of the building, eliminating 'by the way' all property taxation on construction objects not permanently fixed to the ground (for example garages), if they are not connected with conducting business activity. The adopted structure of maximum rates accounts for the fact that the property tax is mostly the tax paid on conducted business activity and only to some small degree it is paid by owners of residential or recreation properties (Przekopiak J., 2011).

5. As we can see from the above-quoted data, a significant number of communes resign from applying maximum rates by granting reliefs, exemptions, redemptions and also lowering rates on some categories of property. A detailed analysis of the tax policy in this scope is beyond the scope of this report, however, it is worth indicating several features to which we will refer in the proposals presented in the further sections here. Firstly, lowering property taxes concerns mostly smaller communes – especially rural ones – whereas in large cities this phenomenon is rather rare.

Conclusions.

All governments had to deal with various aspects of property tax policy design – determining what is included in the tax base, assessing properties, setting tax rates, and administering the property tax system – although the focus was different in different places. This conclusions presents each of these elements of property tax reform in a little more detail. Bahl (Bahl R., 2009; Bahl R. & Wallace S., 2008) sets out several logical steps in preparing a property tax reform: (1) do a detailed diagnostic of the current system to understand what is working and what is not as well as to determine

clearly the objectives of the reform -- revenue mobilization, fiscal decentralization, land use control, etc.; (2) develop an appropriate tax policy design with respect to choice of tax base, rate structure, exemption policies, etc.; (3) design the administrative reforms needed to implement the tax designed such as coverage, valuation, record keeping and collection; and (4) monitor carefully the success of the reform with such quantitative indicators as collection rate, revenue collections, assessed to market value ratios, etc. This advice seems sound but it is unclear that any country has actually done all this and, as the cases in

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Section 2 above suggest, politics seems to have dominated most country discussions of property tax reform and largely determined the outcomes.

The first key design question is what should be taxed. Some properties are exempt in most jurisdictions. For example, property owned and occupied by government is generally exempt from property taxes. Other property types that are often exempt include colleges and universities, churches and cemeteries, public hospitals, charitable institutions, public roads, parks, schools, libraries, foreign embassies, and property owned by international organizations. In some countries, agricultural land and principal residences are also tax exempt.

Exemptions have been criticized on a number of grounds. First, since governments use municipal services like others who occupy space, they should be taxed. Second, since taxed properties face higher costs than exempt properties, economic competition among businesses and between businesses and government is distorted (Kitchen H.M. & Vaillancourt F., 2009). Third, differential tax treatment also affects location decisions, choices about what activities to undertake, and other economic decisions. Fourth, exemptions narrow the tax base and either increase taxes on the remaining taxpayers or reduce the level of local services. Finally, since the proportion of tax-exempt properties varies by municipality, disproportionate tax burdens are created across communities. This result is especially troublesome when higher-level governments determine what is exempt from local taxation. Of course, local governments themselves are often tempted to provide tax incentives to attract businesses to their jurisdiction. The usual argument is that property tax incentives will result in job creation, investment in the local area and increased local output (Brunori D.,

2003). Governments often engage in such tax competition to attract and keep taxpayers who are believed to contribute more in local revenues than they consume in government services.

Once the tax base is decided upon, the second key question is how to determine it in practice. Two distinct assessment methodologies are commonly used for valuing property: area-based assessment and value-based assessment, with the latter being divided into capital and rental value approaches. A few countries (e.g. Ireland) use some variant of self-assessment. The conventional consensus is that capital (or market) value taxation is best, for several reasons. The benefits from services are more closely reflected in property values than in the size of the property. For example, properties close to transit systems or parks enjoy higher property values. Market value also has the advantage of capturing the value added by neighbourhood amenities that have often been created by government expenditures and policies. Finally, any assessment system that fails to take account of changes in relative values over time will result in inequities. Nevertheless, some countries use area-based systems of taxation because they lack the necessary information, expertise, and resources to determine market values (e.g. Greece) or sometimes, as in the case of Poland, because they consider the market-value approach politically unacceptable. Germany, where property tax reform has been discussed for more than 35 years but never implemented, is currently considering three different reform proposals – market value, area-based, and a combination of the two whereby land would be based on market value and buildings would be area-based (Färber G. Salm M. Hengstwerth S., 2013).

Some countries use variants of self-assessment, under which property owners place an assessed value on their own property. In

the case of Ireland, for example, taxpayers are required to determine the value of their property and choose the correct value band. Self-assessment is an appealing procedure to countries with little administrative capacity. It does not appear to require expert assessment staff, and it seems to be easy to implement. In general, however, self-assessment seems likely to lead to inaccurate estimates of property values, with a tendency toward under-estimation. Since lower-valued properties are generally less under-estimated than higher-valued properties, this approach tends to produce regressive results with taxes being relatively higher on low-valued properties. To minimize the obvious problems of under-statement associated with self-assessment, governments must be prepared to obtain (often costly) expert assessments of individual properties in cases where it believes self-assessment is inaccurate. Three major issues arise with respect to tax rates. Who sets them? Are they differentiated, and, if so, how? And can taxpayers understand how the rate is applied to particular properties?

Sometimes rates are set by the central government. Sometimes there is some local discretion, within centrally-set limits. Sometimes there is complete local discretion. Even where rates are locally determined, they are often limited by the central government. For a local government to make efficient fiscal decisions, it must weigh the benefits (at the margin) of proposed services against the costs of providing them. If local governments do not finance services themselves, the connection between expenditures and revenues is lost and the choice of services will not be based on an accurate perception of their cost (Bird R. M. Slack E., 2013). Setting local tax rates places accountability for tax decisions at the local level, and increased ac-

countability may lead to better local services and perhaps even to a sounder development path over time (Hoffman B. D. Clark C. G., 2005; Sokoloff K.L. Zolt E. M., 2006). Local determination of tax rates is particularly important in countries in which a senior level of government determines the tax base. Local tax rates may have to be set within limits, however, to avoid distortions. A minimum tax rate may be needed to avoid distorting tax competition. Richer local governments may choose to lower tax rates to attract business. With their larger tax bases, they can provide equivalent services at lower rates than poorer competing regions.

Even when the resulting location shifts are not allocatively distorting they are generally politically unwelcome. A maximum rate may also be needed to prevent distorting tax exporting, whereby local governments levy higher tax rates on industries in the belief that the ultimate tax burden will be borne by non-residents. Such tax exporting severs the connection between payers and beneficiaries and renders decentralized decision-making about taxing and spending inefficient. Political leaders prefer providing services to their constituents without placing the burden of payment on them. When they do so, however, there may be increased demand for more services from those who do not have to pay for them. Variable tax rates (or other differentiation of property taxes among property classes) may be justified on a number of grounds. For example, the benefits from local public services are different for different property classes. In particular, a case can be made on these grounds for taxing non-residential properties less than residential properties. Since business capital tends to be more mobile than residential capital, efficiency arguments also lead to the conclusion that business property


should be taxed more lightly than residential property. In reality, however, lower rates are most often applied to residential properties, presumably for political reasons. There is little economic rationale for higher taxation of non-residential property. Differentially higher taxation distorts land use decisions and favors residential use over commercial and industrial use (Maurer R. Paugam A., 2000). Special taxation of one factor of production (real property) may also distort productive efficiency by inducing a different choice of factor mix in producing goods and services. However, politics often produces such discrimination: homeowners are much more likely to vote in local elections than tenants and, while the incidence of nonresidential taxes is seldom clear, non-resident owners and consumers who may bear some of the burden of such taxes have no vote (although political contributions and connections may give them some voice in the local political process). Farm properties are favoured in the property tax system in many countries as part of a more general policy of protecting farmland. Favourable treatment of agricultural land is usually designed to preserve it from conversion to urban use. It may be, however, that basing the property tax on value in current use is not sufficient to preserve farmland because, given the generally low effective tax rates on land, the resulting tax differential is unlikely to be large enough to compensate for the much higher prices that would be paid if the land were converted to urban use. Favorable treatment of rural land can increase speculation at the urban fringe and increase urban land prices.

Property tax rates may be visible, but can taxpayers understand how the tax rate has been applied to their property? When central governments set local property tax rates, local accountability is clearly reduced. Under this system, however, it is

simple to understand why one's tax burden increases since the only possible reason is that the assessed value of one's property has increased. One need not accept this result as either correct – it is, after all, a presumptive assessment, no matter how carefully it may be done – or fair, since it is by no means evident that increases in assessed values correlate tightly with any accepted fairness principle (Sheffrin S. M., 2008). Nonetheless, one can understand what is going on. However, when property tax rates are determined annually by local governments, although in principle the system is more conducive to local accountability to residents, it is much less clear to any taxpayer why his tax bill changes in any year. Suppose, for example, that local government budgets must be balanced, as is usually the case. The additional amount that any locality must raise from property taxation in a particular period is determined not only by changes in local expenditures but also by changes in transfers from other levels of governments and other revenues: it is the residual resulting from this calculation that must be financed by property taxes. The change in that residual divided by the assessment base yields the average property tax rate increase that must be imposed. However, the base itself changes with a market-value assessment system, with some values changing very differently from others. The tax imposed on any particular property in any year thus depends not only on the overall change in the tax demand and in the assessment base but also on the extent to which the change in the valuation of that property is greater or smaller than the average change in assessed values. It is hard to believe that many people can actually figure all this out. This system may be more accountable than one in which tax rates are determined centrally but it is certainly far from transparent.

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No form of taxation is more dependent on administration than the property tax. How well property taxes are administered affects not only their revenue but also their equity and efficiency. Poor tax administration is an impediment to implementing the property tax. Sometimes, local authorities simply do not have the capacity to administer the tax. Many administrative functions are performed manually rather than being computerized. Sometimes, the revenue base does not include all taxable properties, collection rates are low, and enforcement is almost non-existent. Even countries with relatively good property tax administration often have problems updating values on a regular basis. Recognizing the difficulty of local administration, many countries involve higher-level governments in some aspects of property tax administration, notably assessment. Even then, however, the results may leave much to be desired, since higher-level administrations often have little incentive to respond to the needs of local governments for up-to-date and accurate tax base information. Three key steps are involved in the process of taxing real property: (1) identification of the properties being taxed, (2) preparation of a tax roll (which contains a description of the property and the amount of assessment) and responding to assessment appeals, and (3) issuing tax bills, collecting taxes, and dealing with arrears. The first step in levying a property tax is to identify the property and to determine the owner (or other person responsible for tax liability). A cadastre is an inventory of all properties with a unique property identification number for each parcel to allow for the tracking of all parcels and linking of assessment, billing, and property transfer records. A good property identification system also requires that information on properties within the jurisdiction is updated and

made consistent. Fair and productive property taxes require a good initial assessment as well as periodic revaluation to reflect changes in value. Indexing (e.g. by the rate of inflation) is not as good as reassessment because property values change at different rates in different neighbourhoods and for different property characteristics. Nonetheless, where financial resources are insufficient to do regular reassessments, indexing (over a three to five year period) that reflects relative price changes among locations and property markets may both ameliorate taxpayers' discomfort with large assessment changes and improve information about market trends for assessment administrators.

Many countries have no provision for regular revaluations of the tax base or have postponed revaluations. As a result, assessed values bear little relationship to market value or annual rental value. Austria, for example, applies cadastral values from 1973 and the United Kingdom from 1991 for residential properties. Belgium uses values from 1975 and Germany from 1964 although both index the values with inflation or a corrective factor. Regular updates occur, however, in the Netherlands (annually), Denmark (biannually) and Sweden every third year (Johannesson-Linden A. Gayer Ch., 2012). No matter how well designed and implemented it may be, any property tax system may make mistakes. An essential component of a good system is thus an error-correction mechanism, and one critical element of such a mechanism is to allow taxpayers to appeal their assessment if they think it is wrong. An appeal system is both desirable and necessary: in reality, however, its outcome may sometimes be to reduce equity, simply because appeals are invariably most utilized by better-off taxpayers who both have more to gain and can better afford to pursue

legal redress. Administration of the property tax can be sufficiently costly to be an obstacle to reform (Brys B., 2011). Property assessment can be particularly expensive. Frequent valuations maintain the legitimacy of the tax and reduce the risk of sudden, dramatic shifts in tax burdens from large increases in assessed values. For these reasons, the valuation cycle needs to be fairly short. Revaluation is one of the most difficult aspects of property tax reform in terms of resources and administration. The costs associated with regular reassessments include computer software and support, training and availability of in house staff, and training and availability of local contract appraisers (Mc Cluskey W.J. Franzsen R., 2013). To administer a property tax at the same level of fairness as most other major taxes can be costly. In a number of developing countries, property tax reforms have failed at least in part because the cost associated with administrative improvements was too high relative to the potential yield from the improved property tax.

Much of the popular resistance to the property tax appears to be based on its visibility. Unlike the income tax, the property tax is not withheld at source. Unlike the sales tax, it is not paid in small amounts with each daily purchase. Instead, the property tax generally has to be paid directly by taxpayers in periodic lump sum payments (except in cases where the mortgage institution includes property taxes in monthly mortgage payments). Property tax liabilities are usually sufficiently large that taxpayers have to save in advance or increase their debt to pay the taxes. The result is that the payment of property taxes is more salient than other taxes (Cabral M. Hoxby C., 2012). Moreover, the property tax finances services which are also very visible, such as roads, garbage collection, and neighbourhood parks. Studies show that residents are more

willing to pay for local services when they rate their government and service provision highly. If services are not considered adequate, however, they are more likely to complain about their property taxes.

An important aspect of the property tax is that it does not reflect a real cash flow but rather an imputed one that may not necessarily reflect the owner's current situation. The imperfect association between homeowner incomes and property tax liabilities may create problems for some taxpayers such as seniors with little income. It is thus not surprising that the most vocal opponents to property taxes and tax increases are often seniors, many of whom may be asset rich but cash poor.⁴⁶ In part, they may simply have more time to voice their opposition. Whatever the reason, older homeowners are a strong political force in opposing the tax and are often rewarded by receiving special tax treatment.

Some of the resistance to property tax reform is based on the belief that the tax is regressive. Who pays the property tax, and is it an equitable tax? There are as many answers to these questions as there are views about the property tax. Those who view taxes on residential real property as essentially taxes on housing services tend to think that property taxes are inherently regressive, since housing usually constitutes a relatively larger share of consumption for poorer people. Those who view property taxes as essentially a tax on capital tend to think that such taxes are inherently progressive, since income from capital constitutes a relatively higher share of income for richer people. Those who view the portion of the tax that falls on land as being paid out of economic rent consider it to be inherently equitable to tax 'unearned increments' that often arise from public actions. Those who view property tax as essentially a benefit tax see no more sense in asking if the 'price' of local public services

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(the property tax) is regressive than in asking if the price charged for anything else is regressive: voluntary exchange (imposing property taxes as generalized user charges for services) does not, in their view, raise any question of incidence. Although hardly conclusive, the empirical evidence on capitalization on the one hand and 'tax exporting' on the other, at least in the United States and Canada, suggests that there may be something in all of these views. Since almost all quantitative studies purporting to show property tax regressivity reflect the assumption used in allocating property tax revenues across income classes, in the end belief concerning the equity or inequity of the property tax depend less on the (unclear) evidence than on what one thinks of the property tax in the first place. Property taxes may be levied at a flat or graduated rate. In many countries, some graduation is introduced by exempting low-value properties.

Property tax revenues are relatively inelastic because unless the base or rate is changed revenues do not change. Unlike income or sales taxes, property taxes do not automatically increase with growth. Even if the potential tax base does increase with growth, as with a market-value based tax, property values generally respond more slowly to changes in economic activity than do incomes or sales. This inelasticity is exacerbated because few of the countries that use market value assessment update property values for taxation purposes on an annual basis. In those countries where property taxes are based on the area of the property, the tax responds even more slowly to annual changes in income. In order to maintain property tax revenues in real terms (let alone increase them), it is thus usually necessary to increase the rate of the tax. One result of inelasticity is more accountability because local authorities

must increase tax rates and persuade taxpayers that they are justified in doing so. But this good feature is seldom considered desirable by those held accountable. As times change, perspectives may change. When the economic tide is rising, local governments deplore the inelasticity of the property tax both because it means their revenues do not expand automatically with growth and because they have to face the voters with higher rates simply in order to maintain revenues in real terms. On the other hand, the stability of property tax revenues may be considered a good feature by local governments in times of recession since it provides them with a more stable fiscal base for financing local services than they would otherwise have. At the same time, however, local taxpayers may again be very unhappy because their property taxes do not go down as quickly as their incomes and probably not as quickly as the value of their properties. In the last few years, for example, although property prices have fallen sharply in some OECD countries, property taxes did not fall as quickly and to the same extent.

The reasons for undertaking property tax reform vary over time and across countries. Good reasons for reform include increasing local revenues (and perhaps reducing transfers to local governments), improving local fiscal performance, removing inequities in the tax system so that there is similar treatment of similar properties, reducing administrative and compliance costs by simplifying the tax system, and improving efficiency by reducing the impact of taxes on households and business decisions. The economic approach to property tax reform emphasizes efficiency. In reality, however "tax policy is the product of political decision making, with economic analysis playing only a minor supporting role" (Holcombe R. G., 2003). As a rule, politicians

are less concerned with economic efficiency than with equity and public acceptability – concerns that often lead to such structural elements as exemptions, procedural elements such as less frequent assessments, and an array of supposedly transitional limits and constraints on the tax. A well-designed reform is more likely to succeed; but it is not necessarily more likely to be accepted. Tax reform is always as much or more a political exercise as it is a technical one. Someone always loses from tax reform and losers are vocal in their opposition. Nonetheless, reform requires not only sufficient and sustained political will and support to ensure that it is implemented but sufficient political acceptance to ensure that it is sustainable and sustained. For such support to be generated, taxpayers (and local governments) must also accept the reform. Both are more likely to buy into reform if they have been consulted and feel that their issues have been properly heard. Consultation raises awareness of the reform and stakeholders who have participated in the consultation process are less likely to oppose it. Of course, consultation also runs the risk of consolidating opposition to reform: it is not always easy to lead people to the light, especially if they have little trust in their leaders. As discussed earlier, it is not surprising that property taxes – and especially increases in property taxes – may be perceived to be unfair and arbitrary. Taxpayers' perceptions of how fair the property tax is and how fairly it is implemented affect the extent to which local governments can raise the tax. There is some – though hardly overwhelming -- evidence that people treat local taxes as essentially prices for local services, an outcome which is on the whole to be welcomed. More and better 'taxpayer education' has often been put forward as a way to increase public understanding and ac-

ceptance of rising property tax bills. However, the inherent arbitrariness of even the best assessment procedures when combined with the complex institutional process that lies behind the 'local tax demand' almost guarantees that many taxpayers will not understand - or trust - the basis on which property values are assessed or how the tax bills they receive are related to those assessments. A proper communications strategy engaging businesses, unions, special interest groups, academics, and the broader public may help to overcome some of the obstacles to property tax reform. But communication has to be in a form that taxpayers understand. All too often, there is a striking divergence between the popular (and media) 'frames' for property tax policy and those of the experts, who "speak an obscure and unrecognizable language to each other" and "have forgotten how to communicate and 'frame' the property and land tax issue sensibly". One way to overcome both the apparent distrust of what politicians say and the incomprehensibility of what experts say may be to create a credible independent panel outside of the direct influence of the politicians or administration consisting of both those who know the subject (experts) and people who know how to communicate with non-experts to help develop and interpret the reform package to the public (Pagano M. A. Jacob B., 2008).

The residential property tax is a good tax for local governments, yet it is not a major source of revenue for local governments in many countries. Political pressure to keep property taxes down and to favour certain types of properties over others (through exemptions or lower tax rates) has resulted in low tax revenues. Added to low tax rates and tax base erosion are poor assessment practices that have reduced many of the potential benefits of the property tax. Taxpay-

ers have to have confidence in the assessment system, so efforts need to be devoted to doing it well - and frequently. Property tax reform, in countries that have tried it, has been difficult, however (Bird R.M. & Slack E., 2004). No matter how economically desirable the long-run outcome of property tax reform may be in terms of the equity and efficiency of the tax, its transitional effects may be sufficiently politically undesirable to forestall any attempt at reform. In short, there will always be winners and losers from tax reform: those who were relatively overtaxed before the reform was implemented will pay less taxes; those who were relatively undertaxed before the reform will pay more taxes. The losers from a change in policy (even if they are the minority) tend to be very vocal, because they value their losses more than the winners (even if they are the majority) value their gains. Furthermore, as the losses tend to be concentrated and the gains dispersed, as is often the case with tax reform, negatively affected interests will be motivated to spend time and resources in political action that can result in permanent, institutionalized groups (for example, seniors, or the owners of office towers, hotels, and waterfront properties) that oppose reform. Another problem with tax reform is the widespread suspicion that any change in tax policy will be used by governments to raise the aggregate level of taxes so that the number of losers and the magnitude of the losses outweigh the number of gainers and the magnitude of the gains. In short, the public perception is that tax reform is not revenue-neutral—a perception which, at least in the cases where the goal of reform is to increase revenues, is often correct.


The success of property tax reform will depend on public education - taxpayers need to understand how their assessments are calculated. They need to know what will happen if their assessment increases. Will property taxes automatically increase or does it depend on what happens to other assessments in the city? Will tax rates decrease if assessment increases? What services are funded by the property tax? If property tax reform is expected to result in major tax shifts among taxpayers, the success of the reform will also depend on the introduction of some form of phase-in mechanism. Phase-ins are almost invariably politically necessary to cushion the impact of reform. Some form of relief is also needed for low-income taxpayers. Property tax credits (or “circuit-breakers”) that relate property taxes to income are best at providing relief to low-income taxpayers. For elderly taxpayers who have seen their property values increase but their incomes remain fixed, some form of tax deferral is appropriate. The property tax, at least the residential property tax, is a good tax for local government, but there is room to improve the tax and increase the revenues collected. Property taxes are difficult to reform, however, because politics generally outweighs economics in this very visible tax and the losers from tax reform tend to be more vocal than the winners. In any event, the property tax can never be the sole municipal tax, especially for local governments that are doing more than providing property-related services and where a mix of taxes is appropriate. It can, however, be used more heavily in most countries than it is at the present time.

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