

IMPORTANCE OF THE RECURRENT PROPERTY TAX IN PUBLIC FINANCE, TAX POLICY & FISCAL DECENTRALISATION

Anders Müller (Econ)
Danish Ministry of Taxation

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Contact information:

Anders Müller, Ministry of Taxation, Customs Tax Copenhagen
Tagensvej 135, 2200 Copenhagen N, Denmark
Phone direct: (45) 72 37 03 55 - private: (45) 33 31 45 57
Email: Anders.Muller@toldskat.dk - private: taxinn@wanadoo.dk

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1. Summary

This paper examines the importance of the recurrent property tax. What are the elements of importance and how do they compare to each other?

We are primarily looking at the recurrent property tax on immovable property. There are many other types of taxes related to property. At conferences and in the literature it is not always clear which tax or set of taxes is under discussion. Thus the first section looks at terminology and classification of taxes related to property.

The main importance of the recurrent property tax is the revenue generated by this tax. This is the fiscal policy point of view. Every country need a tax revenue to finance their public expenses – like education, health care, transport infrastructure, police etc.

The needed revenue can be generated by the different types of taxes or a combination of these. Tax policy compares how good different taxes are compared to each other. This paper describes the advantages and disadvantages of the recurrent property tax compared to other main types of taxes. It tries to answer the questions: Should the property tax be used or should it not be used? How much revenue should preferably come from this tax?

The property tax is especially suitable as a local tax. This brings us to the important issue of fiscal decentralisation. Should local government mainly be financed by local taxes og by grants from central government? What are the other local taxes are alternatives to the recurrent property tax?

For a local property tax the question is how local fiscal autonomy best is improved. The most important thing is that there is a local political decision about the tax rate. This improves the

local political accountability in relation to the local taxpayers. It is also good if the local government is responsible for the administration of the tax. However, in many cases it is decided that some of the administration is done by central (or regional) government because they can do it at lower costs due to economies of scale. This is the reason that central (or regional) government do the valuation of properties in many countries even though the property tax is a local tax. An additional advantage of this solution is that a fair treatment of different types of taxpayers can be secured this way. In other countries the local government carry out the valuation. In that case central (or regional) government will monitor and analyse the valuation results – one reason for this is that the grant system is depending on that the valuation is carried out correctly. Collection of a local property tax is usually done by the local government.

Sometimes it is argued, that a higher property tax will benefit land policy. Or it is argued that if market values become the base of the property tax then the transition to market economy will be easier and the development of the land market will happen more quickly. These questions are not examined in details in this paper, but in my opinion these effects are small and perhaps uncertain.

The paper starts with a section on terminology and classification. There are many types of taxes related to immovable property. It is important to be clear about what type we are speaking. The classifications used by IMF and OECD for their international tax revenue statistics is used.

2. TERMINOLOGIES AND CLASSIFICATIONS

The main subject of this paper is the recurrent taxes on immovable property. This type of taxes is usually called property taxes, land taxes, land based taxes, taxes on land and buildings, or real estate taxes, and they are called rates in Britain and in many former British colonies. We will use the term “property tax”, and in some cases the term “recurrent property tax” when a distinction needs to be made between this tax and other types of taxes related to immovable property. Literately property tax means a tax related to all types of property. However, the term “property tax” usually means a recurrent tax related to immovable property only¹.

The term “property tax” should not be confused with the group of taxes called “taxes on property” which appear in the overview of tax revenue in different countries published by the IMF and the OECD. In these overviews the recurrent property tax is a subgroup of the taxes on property, see table 1 below.

Property taxes are levied on the owners or users of immovable property, and the amount of tax is usually related to the value of the property. Some countries have “area-based” property taxes where the amount of tax is related to the area of land and buildings and the location and

¹ In a few countries the property tax is also related to movable or intangible assets. In some states in the USA the property tax also covers machinery and furniture, and in Russia the property tax on legal persons includes machinery, furniture and stocks.

classification of the property. This is the case in many transition countries and the traditional land revenue on the Indian Subcontinent is also an area-based land tax. The value-based property taxes are usually related to the market value of the property. This can be the capital value or the annual value (rental value) as it is the case in the British systems of rates. Other value concepts can also be used, as the acquisition-value-base used in California or the inventory value or book value used in Russia and some other transition countries.

Table 1. Classification of taxes related to property

	IMF classification	OECD classification
Taxes on property	4	4000
Recurrent taxes on immovable property	4.1	4100
Recurrent net wealth taxes	4.2	4200
Estate, inheritance and gift taxes	4.3	4300
Taxes on financial and capital transactions ²	4.4	4400
Other non-recurrent taxes on property	4.5	4500
Other recurrent taxes on property (not immovable)	4.6	4600

The recurrent property tax is paid annually in contrast to taxes related to immovable property that are paid at the time of a change of ownership (stamp duty or capital gains tax). Table 1 shows the classification used by IMF and OECD of taxes related to property.

Some other taxes are also related to property, but are classified as income taxes. This is the case for:

- Taxes on capital gains resulting from the sale of property
- Taxes on immovable property levied on the basis of a presumed net income which take into account the personal circumstances of the taxpayer (income tax on imputed rent for owner-occupiers of dwellings)
- Taxes on the use of property for residence, where the tax is payable by either proprietor or tenant and the amount is a function of the user's personal circumstances (for example the poll tax in the UK 1990-93)

The recurrent property tax is – as mentioned – the main subject of this paper, but the other taxes related to property is briefly included in the description of revenue importance and in some of the discussions of policy issues.

² The main part of this group is stamp duties or other taxes or fees paid at registration of the transfer of immovable property. We will use the term transfer taxes for these taxes. Other names are registration taxes or property transaction taxes.

3. REVENUE IMPORTANCE AND TRENDS

The Revenue Statistics from the OECD gives a good overview of the recurrent property tax and the other taxes on property in the group 4000 for the countries that are members of the OECD. The Government Finance Statistics Yearbook from the IMF covers a much larger number of countries. However, for many of the countries the IMF publication does not include the tax revenues of local government, and since recurrent property taxes are usually local taxes only information about property taxes to central government can be found in the IMF publication for these countries. For other countries the IMF publication does include local taxes, but only the figure for all taxes on property, group 4, is listed and no information of the revenue from specifically the recurrent local property taxes is shown.

The revenue importance of the property tax can be measured by the following figures:

1. Property tax revenue as percentage of total taxes to all levels of government
2. Property tax revenue as percentage of gross domestic product (GDP)
3. Local property tax revenue as percentage of local tax revenue³

Of these the percentage of the total taxes (1) is the best measure of the importance of the tax for the total revenue system⁴. This figure best shows the development of the importance over time and compares the importance between countries.

The percentage of total taxes can be supplemented by the percentage of gross domestic product (2). This figure shows the property tax revenue as a part of the economy. This figure is important information when comparing development over time where the total tax to GDP ratio is changing considerably or when comparing countries with considerable differences in the total tax to GDP ratio. However, it should be remembered that for many countries the estimation of the GDP is very uncertain.

When analysing the role of the property tax for local government in a particular country it is very useful to compare the local property tax revenue with the local tax revenue (3). This figure is, however, not so useful in international comparisons because the role of local government and the role of local taxes vary very much between countries.

3.1 Industrialized Countries

Table 2 shows the importance of the recurrent property tax in the OECD countries. The countries are sorted after the importance of the property tax measured by the percentage of the total taxes. On average the property tax revenue is 2.9 percent of the total taxes in 1997

³ Additional figures for the importance of the property tax are the local property tax revenue as a percentage of the own revenue of the local government (that is including fees, charges and income from ownership of businesses or land), or as a percentage of the total revenue of the local government (that is also including grants and transfers from central government).

⁴ The total tax revenue should include all taxes and duties. Social security contributions paid to general government should also be included to facilitate comparisons between countries.

and 1.0 percent of the GDP. The recurrent property tax revenue to the local level of government is on average 34 percent of the total local taxes.

Table 2. Recurrent property tax revenue – OECD countries 1999

	Percentage of		
	total taxes	GDP	local taxes (1997)
USA	9.2	2.6	73
UK	8.4	3.1	99
Canada	8.3	3.2	84
Japan	8.0	2.1	28
New Zealand	5.7	2.0	91
Australia	4.4	1.3	100
France	4.2	1.9	23
Iceland	2.8	1.0	15
Sweden	2.2	1.2	0
Denmark	2.1	1.0	7
Ireland	1.9	0.6	100
Spain	1.9	0.7	12
Netherlands	1.9	0.8	62
Italy	1.8	0.8	33
Germany	1.2	0.4	15
Portugal	1.2	0.4	19
Finland	0.9	0.4	4
Austria	0.6	0.3	5
Norway	0.5	0.2	3
Turkey	0.5	0.2	n.a.
Switzerland	0.5	0.2	2
Luxembourg	0.3	0.1	5
Greece	0.3	0.1	0
Belgium	0.1	0.0	0
Average	2.9	1.0	34

Source: Figures calculated by Anders Muller based on OECD (2001) *Revenue Statistics*. Does not include the new members of OECD (Mexico, Poland, Czech Republic, Hungary, and Korea).

There are indeed very big variations in how important the property tax is in the different OECD countries. In the USA the property tax is 9.2 percent of total taxes, in the UK 8.4 percent, and in Canada 8.3 percent - while the property tax revenue is only 0.1 of total taxes in Belgium and 0.3 percent in Greece and in Luxembourg. Thus, the importance of the property tax is 60 times higher for the top 3 countries than for the bottom 3 countries.

Fig. 1 gives a graphic representation of the big differences in the importance of the recurrent property tax. It also shows the variations between countries for the other taxes related to property, like the net wealth tax and transfer taxes. It becomes clear that the variation is more in *how* the different countries tax property than it is in *how much* they tax property. Most of

the countries with very low revenue from the recurrent property tax have considerable revenues from the net wealth tax or the transfer tax. The net wealth tax is for example 5.3 percent of total taxes in Luxembourg and 4.1 percent in Switzerland, and the property transfer tax is 2.0 percent of total taxes in Belgium, 2.7 percent in Greece, 1.8 percent in Luxembourg, and 2.2 percent in Switzerland. Comparing the whole group “taxes on property” shows that the top 3 countries applies these taxes 5 times more than the bottom 3 countries. That is a lot less than the 60 times difference for the recurrent property tax.

The difference between the top and bottom countries becomes even smaller when considering the income tax of imputed rent for owner-occupiers of dwellings. This tax has many similarities with the recurrent property tax and it is levied in 10 OECD countries⁵. The revenue from this tax is 1.1 percent of total taxes in Denmark in 1997. For the other countries there is no information about the revenue. However, the countries that has the highest revenues from the recurrent property tax does not levy income tax on imputed rent, and many of the countries with low revenue from the recurrent property tax do levy income tax on imputed rent.

Table 3 shows the average importance of the different taxes on property. The importance of the transfer tax is $\frac{1}{2}$ of the importance of the recurrent property tax, the importance of the net wealth tax is $\frac{1}{4}$ and the importance of inheritance and gift taxes is $\frac{1}{6}$. These different taxes on property are applied in all or almost all of the 24 OECD countries except the net wealth tax, which is levied in 14 of the countries.

⁵ In 1997 the imputed rent is levied in Belgium, Denmark, Greece, Italy, Luxembourg, Netherlands, New Zealand, Norway, Spain and Switzerland. Later Denmark has replaced this tax with a property value tax on owner-occupiers of dwellings and summer houses.

Fig 1. Taxes on Property - OECD countries 1997

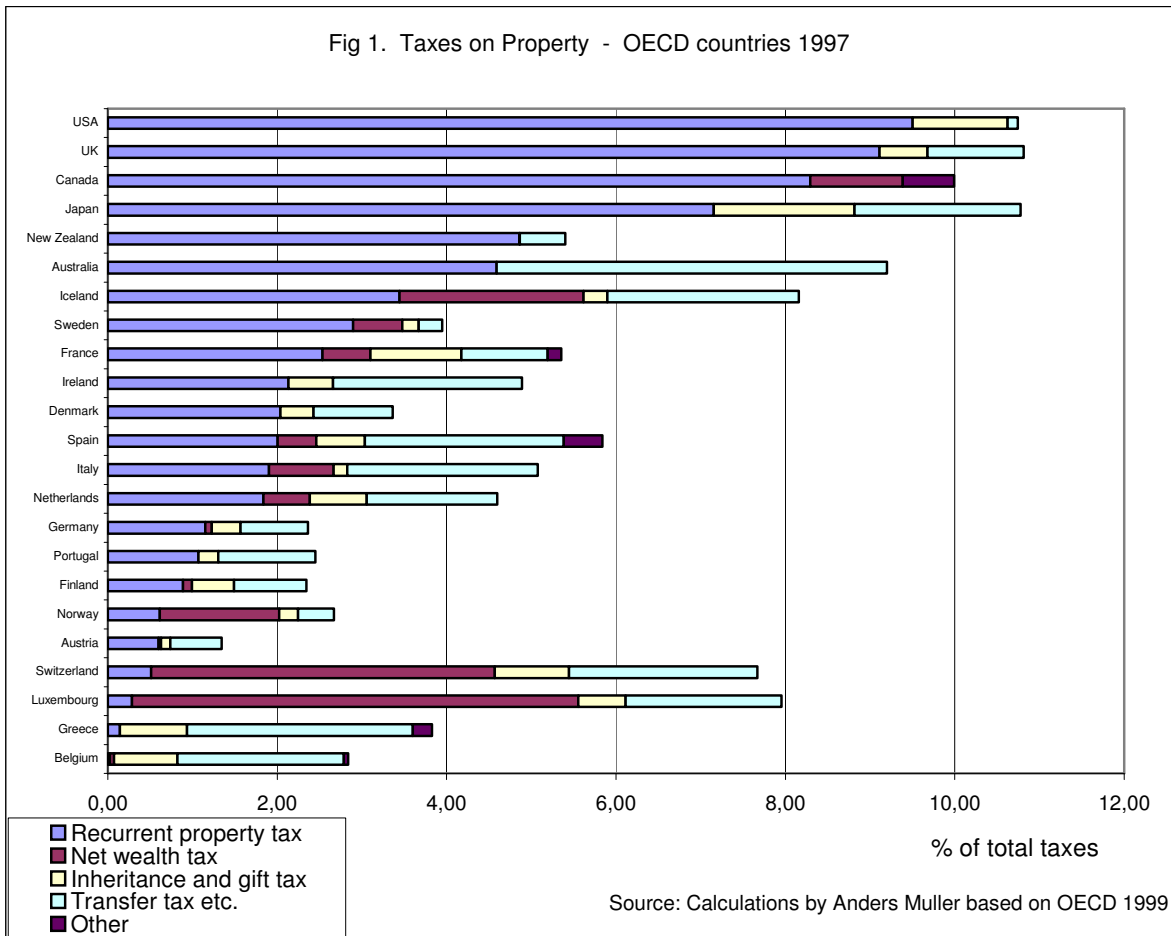


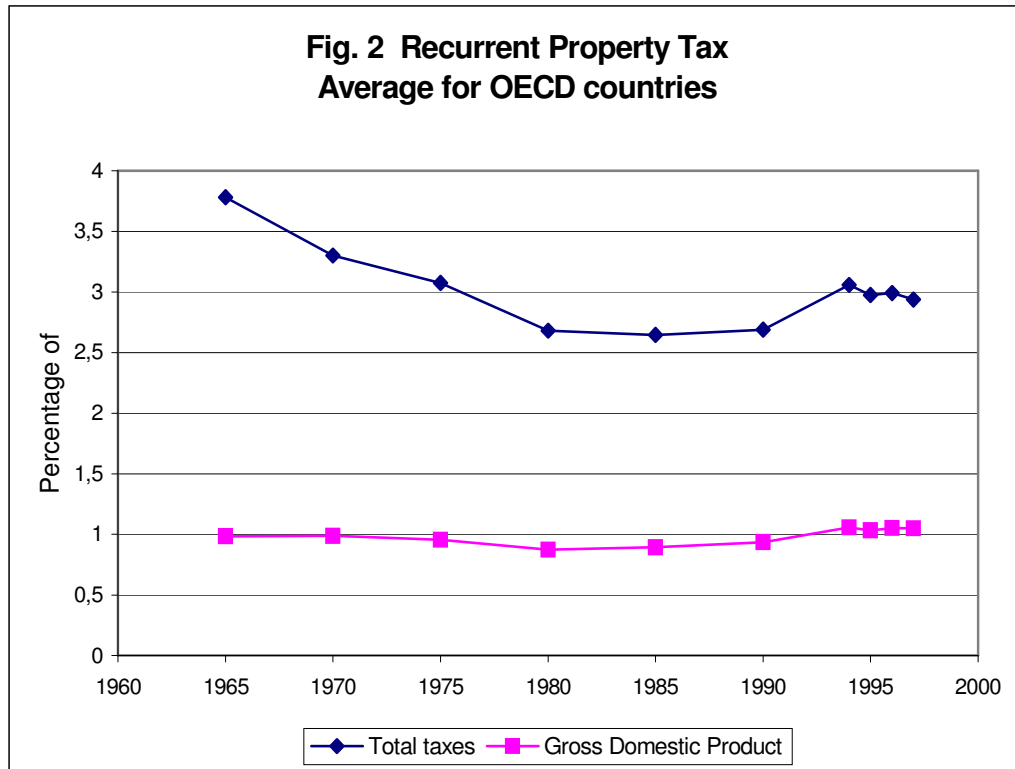
Table 3. Taxes on Property in the OECD Countries – 1997

	Recurrent property tax	Net wealth Tax	Inheritance and gift tax	Transfer tax etc.	Other	Taxes on property
Percentage of:						
Total taxes	2.9	0.8	0.5	1.5	0.1	5.7
GDP	1.1	0.3	0.2	0.5	0.0	2.1
Local taxes	34	1	0.2	2	-	38
Number of countries with this tax	23	14	22	22	5	23

Notes: - Unweighted average of all countries including those that do not apply the tax.
 - Turkey is not included since information of local taxes were not available for this period.
 Source: Calculations by Anders Muller based on OECD (1999) *Revenue Statistics*.

Revenue Trend

The development over time from 1965 to 1997 of the average importance of the recurrent



property tax is shown in fig. 2. Measured, as the average percentage of total taxes there is a constant decrease in the importance from 3.78 percent in 1965 to 2.65 percent in 1985. Since 1985 there has been a moderate increase from 2.65 to 2.94 percent in 1997.

Measured as the average percentage of the GDP the decrease in importance from 1965 to 1985 is much smaller than the decrease in the percentage of total taxes. The reason is that during the same period the total taxes as a percentage of GDP increased from an average of 26 percent to 37 percent. This means that the main reason for the decreasing importance of the property tax 1965-85 was the rapid increase of the importance of other taxes. Since 1985 the increase in the importance of the property tax has been larger when measured as a percentage of GDP than as a percentage of total taxes. The reason is that the average tax/GDP ratio has continued to increase from 37 percent to 39 percent.

The figures also seems to indicate that property tax reforms which increases the revenue from 0 percent to 2 percent of total taxes can be carried out over a few years without creating serious political resistance.

Behind the increase in the importance of the property tax from the 80'ies to the 90'ies is primarily the development in the 5 countries shown in table 4. Earlier, these countries only had insignificant levels of revenues from the recurrent property tax, but they are now collecting property tax revenues amounting to approximately 1 to 3 percent of total taxes.⁶

In Japan the importance of the property tax increased (5.2%-7.4%) from 1990 to 1994, in New Zealand the importance decreased (6.3%-4.8%) during the same period, and in the USA the importance decreased (10.5%-9.5%) from 1994 to 1997. In the other OECD countries the importance of the property tax has been rather constant during the last two decades.

Table 4. Countries with Considerable Increasing Importance of the Property Tax (Recurrent property tax revenue as percentage of total taxes)

	1980	1985	1990	1994	1999
Finland	0.0	0.2	0.2	1.1	0.9
Italy	0.0	0.0	0.0	2.0	1.8
Portugal	0.0	0.0	0.9	1.0	1.2
Spain	0.2	0.1	1.4	1.7	1.9
Sweden	0.0	0.9	1.2	2.0	2.2
Average	0.0	0.2	0.7	1.6	1.6

Source: Calculations by Anders Muller based on OECD (2001) *Revenue Statistics*.

Local Importance

The recurrent property tax is mainly a local tax in the OECD countries. Only in 3 countries is the property tax fully a central tax and only in one of these, Sweden, is the property tax revenue significant (the other two being Greece, and Belgium). In all the other countries between 98 and 100 percent of the property tax is a local tax or a tax to the local and the state level in federal countries.⁷ As a result on average 34 percent of the local taxes (not state level) derives from the recurrent property tax. Table 2 shows the big variations between the countries. The local importance of the property tax has been very constant over time (the average figure has increased from 32 percent in 1975 to 34 percent in 1997).

Most of the revenue from the net wealth tax, the inheritance and gift tax, and the transfer tax are central taxes or taxes to the state level in federal countries. Only 20 percent, 8 percent and 18 percent respectively of the revenues are to the local level of government. The result is that the revenue from these taxes to local government are insignificant, see table 3.

⁶ In Italy, Portugal and Spain the increasing property tax revenue is part of a general increase in the importance of local taxes.

⁷ In the UK the property tax on businesses is classified as a central tax earmarked for distribution to the local government according to population figures. Thus only 42 percent of the recurrent property tax in the UK is a local tax according to this classification.

3.2 Transition Countries

Table 5 shows the importance of the recurrent property tax in a number of countries in transition from a socialist economy to a market economy. The table shows the property tax revenue as percentage of the total tax revenue to all levels of government (and including social security contributions). For Poland, Czech Republic and Hungary the source is the OECD statistics – the same source as table 2, 3 and 4. For the rest of the countries the source is consultant reports made by me, information given to me at OECD seminars, or the IMF revenue statistics.

Table 5. Selected Transition Countries
(Recurrent property tax revenue as percentage of total taxes)

	1994	1997	1998	1999
Poland	2.7	2.9	3.0	3.1
Czech Rep.	0.8	0.6	0.6	0.6
Hungary	0.2	0.4	0.4	0.5
Estonia	1.0	1.1	1.1	1.2
Latvia	3.5	3.3	3.8	3.5
Lithuania	0.8	1.9	1.9	2.0
Average	1.5	1.7	1.8	1.8
Russia	3.3	5.4	7.4	
Belarus	0.5	3.2	3.1	
Slovenia	1.7	2.2		
Albania	0.9	0.6		
Romania	0.8	0.9		
Bulgaria	1.2	0.3		
Croatia	0.7	1.0	0.9	
Slovakia			1.3	
Azerbaijan	0.9	1.2	2.1	1.6
Kazakhstan		6.4	7.8	

Source: OECD (2001) *Revenue Statistics*: Poland, Czech R, Hungary. IMF (2002) *Government Finance Statistics*: Belarus, Romania, Bulgaria, Croatia, Slovakia, Azerbaijan, Kazakhstan. Reports by Anders Müller: Russia, Albania. Country reports given at OECD seminars (Estonia, Latvia, Lithuania, Slovenia).

4. Tax policy

Table 6. Comparison between different types of taxes – from a tax policy point of view.

	Recurrent property tax (4100)	Income tax (part of 1000)	Taxes on goods and services (5000)	Transfer taxes on imovable property (part of 4400)	Capital gains on imovable property (part of 1000)
Possible revenue	++	++++	++++	+	++
Economic neutrality	+++	-	-	-	
Equity and fairness	++	+++	+	+	++
Efficient enforcement possible	++++	+	+	-	-
Simplicity for taxpayers	+++	+	++	+	++
Simplicity for tax administration	++	++	++	+	+
Resistent to international tax competition	++++	++	+	++++	+++
Suitable as a local tax	+++	++	+	++	+
Other policy issues:					
Environment			(+)		
Health			(+)		
Land policy	(+)				
Develop land market	(+)				
"Price" for restitution of property rights	+				

Source: Anders Muller

5. Fiscal decentralisation

The first question about fiscal decentralisation is: What part of the activities of the government in general is carried out by the local government? Table 7 shows this for the countries entering the EU and for a number member states.

On average 20 percent of the government activities are carried out by the local government.

Table 7. Importance of the sub-national revenue and the composition of it (tax, non-tax, grants). 1999

	Total sub-national revenues (% of total govrn. revenue)	The percentage composition of total sub-national revenue		
		Tax revenue	Non-tax revenue	Grants
Bulgaria	17	46	14	40
Czech Rep.	21	47	36	16
Estonia	22	68	9	23
Hungary	27	33	17	50
Latvia	26	56	20	24
Lithuania	23	91	5	4
Poland	29	24	24	51
Romania	13	70	14	17
Slovak Rep.	6	67	21	12
Slovenia	12	59	18	23
Mean - applicants	20	56	18	26
Belgium	33	79	3	18
Denmark	44	51	8	40
France	19	47	19	34
Italy	22	34	14	53
Netherlands	23	10	14	76
Spain	18	37	9	54
Sweden	31	75	6	20
United Kingdom	21	14	13	73
Mean - members	26	43	11	46

Source: OECD (2002) *Fiscal Decentralisation*.

Table 8. The composition by type of tax of the sub-national tax revenue, 1999
 Percentages of total sub-national tax revenue. OECD classification of taxes is used.

	Taxes on property (1) (4000)	Taxes on income, profits, cap. gains and payroll (2) (1000+3000)	Taxes on goods and services (5000)	Social security contrib. and other taxes (2000+6000)
Bulgaria	10	89	0	1
Czech Rep.	6	89	5	0
Estonia	9	91	1	0
Hungary	14	45	0	41
Latvia	21	77	2	0
Lithuania	9	91	0	0
Poland	40	57	4	0
Romania	17	78	2	3
Slovak Rep.	28	60	12	0
Slovenia	20	72	8	0
Mean	17	75	3	5
Belgium: state	6	0	39	0
local	0	0	15	0
Denmark	7	93	0	0
France	52	5	11	34
Italy	22	8	26	45
Netherlands	63	0	38	0
Spain	36	26	35	3
Sweden	0	100	0	0
United Kingdom	100	0	0	0
Mean	35	38	17	10

(1) Includes recurrent property tax and other taxes related to properties (see table 1)

(2) Mainly sub-national taxes on income, profits and capital gains (1000). Taxes on payroll and workforce (3000) is only used as a sub-national tax in Bulgaria (61%), Hungary (0.3%) and France (4%).

Source: OECD (2002) *Fiscal Decentralisation*.

Table 9. Tax roles of sub-national governments (SNG) and central governments, various years

		Total sub-national Taxes as % of total taxes	Role of sub-national governments (as % of total sub-national taxes)					Taxes on property (4000) as % of sub-national taxes (1999)
			SNG sets tax rate and base	SNG sets tax rate only	SNG sets tax base only	Revenue sharing	CG sets both rate and tax base of SNG tax	
Bulgaria (2000)		10				100		10
Czech Rep. (1999)		11	3	5		92		6
Estonia (1999)		16		9		91		9
Hungary (1999)		10	49			51		14
Latvia (1999)		17					100	21
Lithuania (1999)		22					100	9
Poland (1999)		8		42		58		40
Romania (2000)		11		6	1	75	18	17
Slovak R. (2000)		4	7	28		65		28
Slovenia (2000)		8	17	1	0	82		20
<i>Mean (by country)</i>		<i>12</i>	<i>8</i>	<i>9</i>	<i>0</i>	<i>61</i>	<i>22</i>	<i>17</i>
Belgium (1995)	Local	6	13	84		3		0
	Communities	13		3		97		6
	Regional	10	8	92				
Denmark (1995)	Municipalities	22		96		4		7
	Counties	9		93			7	
Netherl. (1995)	Municipalities	1		100				63
	Polder board	1		100				
Spain (1995)	Local	9	33	51		16		36
	Regions	5	15	7		78		
Sweden (1995)	Municipalities	22	4	96				0
	Counties	11		100				0
UK (1995)	Local	4		100				100
<i>Mean (by tier)</i>		<i>9</i>	<i>6</i>	<i>77</i>	<i>0</i>	<i>16</i>	<i>1</i>	

Note: France and Italy not included due to lack of data.
Source: OECD (2002) *Fiscal Decentralisation*.

Table 10. Size of municipalities (number of inhabitants). 2000.
Percentages of municipalities.

	Under 1,000	1,000-2,000	2,000–5,000	5,000–10,000	Over 10,000
Bulgaria	0%	2%	9%	24%	65%
Czech Rep.	80%	10%	6%	2%	2%
Estonia	10%	39%	36%	9%	6%
Hungary	54%	21%	16%	5%	4%
Latvia	32%	39%	20%	4%	5%
Lithuania	0%	0%	0%	3%	97%
Poland	0%	0%	23%	43%	34%
Romania	2%	14%	56%	21%	7%
Slovak Rep.	68%	19%	9%	2%	2%
Slovenia	3%	9%	37%	22%	29%
Average	25%	15%	21%	14%	25%

Source: OECD (2002) *Fiscal Decentralisation*.

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The only periodical journal about property tax from an international point of view.
14 issues since 1994. Now in cooperation with the International Property Tax Institute.

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Income taxes, consumption taxes and natural resources taxes shall go to middle level leaving property and payroll taxes to lower or local level. In more details, own-sourced revenues for local governments can be classified as 1) taxes to cover its general expenses, 2) charges to support its services, 3) fees to cover direct costs on specific functions like issuing marriage, birth and death certificates, 4) asset and investment proceeds to support its services in issuing licenses and permits, and 5) other small revenues (Farvacque- Vitkovic & 5 Finally, the importance of aids and donors poses a risk of macroeconomic policies, fragmentation in budgetary decision of central government and fiscal decentralisation objective. Land and property taxes play an important role in countries where the local governments work relatively well. Such taxes generate about 3 percent of GDP in the United States, the United Kingdom and a few other countries. But the taxation of real property is not easy because it requires reliable and updated cadastral values or current market values for the taxed properties. The existence of a decentralized fiscal structure has often been a major impediment to needed tax reforms. Let me provide a few examples. Brazil has been trying to reform its value-added tax for many years but it has faced great difficulties because the current value-added tax is levied at the state level.