

INSTITUTIONAL ASPECTS FOR IMPROVEMENT OF THE CURRENT SYSTEM FOR REAL PROPERTY APPRAISAL FOR TAX PURPOSES IN MOLDOVA

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Abstract: *A new market value-based system for real property appraisal for tax purposes has been in the process of implementation in Moldova since 2004. The relevance and importance of such appraisal has been increasing with time, requesting improvements to the current mass valuation methodology and review of the roles played by diverse authorities and in particular by local governments, tax and cadastral authorities in property appraisal for tax purposes. The article presents a comparative analysis of diverse options for funding and handling mass real property valuation efforts. Suggestions have been developed to perform property revaluation intended to update databases and to expand the current tax base.*

Keywords: *real property valuation for tax purposes, market value-based property taxation, multi-purpose cadastre, mass valuation.*

1. Introduction

Improvement of real property valuation efforts through implementation of market-value based property taxation is a current trend in development of national tax systems in Central and Eastern Europe. The implementation of a new system for real property appraisal for tax purposes has been underway in Moldova during the last decade. In 2007 Moldova switched to a new real property taxation system where the tax base is fair market value of the concerned real property item. According to World Bank experts, the Republic of Moldova is one of the few Eastern and Central European states that has “undertaken significant development of its value-based property taxes”[2. p.17].

Real property is appraised in Moldova according to uniform methodology that is in compliance with the national laws [3,5]. The concept of real property appraisal for tax purposes started to take shape in Moldova in late 1990s in parallel with the development of the national real property cadastre.

International practice demonstrates diverse approaches to institutionalization of tax appraisal. Authorities performing such appraisal can be tax authorities, municipal governments or central governments, land development authorities, cadastral authorities, etc. In Romania, tax appraisals are performed by authorized valuers that are members of ANEVAR, the National Association of Authorized Romanian Valuers, on request of the concerned real property owners. In Moldova, tax appraisals of real property are performed by CADASTRU, a state-owned enterprise, and by its branches, territorial cadastral offices.

An economic component emerging in the real property cadastre system is contributing to improved reliability and better performance of the cadastral system. Tax appraisals of real property make use of the cadastral information system and database for subsequent development of a new tier of data reflecting technical characteristics and values of real property items. According to the appraisal techniques, tax appraisal of real property can only

be performed after the concerned real property and its owner (rights holder) is properly identified and the item is duly registered in the cadastral system. The data generated during registration of real property items forms part of the legal component in the real property cadastre; the legal component comprises a unique cadastral number and address of the real property item as well as description of its intended purpose and information regarding the holder(s) of property rights to the item. Mass valuations add to the cadastral database information regarding physical and economic characteristics of real property items being appraised, and the relevant data is filled in the cadastral economic component (ValueCad) after appraisal is completed. Integration of these components makes the cadastral database more comprehensive and reliable.

2. Main features of real property appraisals for tax purposes

A specific feature of real property appraisals for tax purposes is the provisional nature of the appraisal results. Cadastral authorities are currently using two tax appraisal systems: (1) a new system that involves determination of appraised (fair market) value of each real property item; and (2) the old system that still finds application for appraisal of certain real property types. The old appraisal system involves determination of the property's average value assessed by authorities for taxation purposes. These state-assessed average values are historical values determined as a desk exercise by Technical Inventory Bureaus for entire categories of similar real property items, and such values typically find application in all CIS countries.

A survey of international practices in the field of real property appraisal for tax purposes has yielded a conclusion that the best base for development of a new tax appraisal system for real property is the cadastral database. An additional incentive to start the development of the appraisal methodology was the national law on real property tax enacted in 2000 [5] as part of the Tax Code and developed with involvement of the BARENTS GROUP that specializes in economic consulting in developing countries and is directed by Dr Joseph Eckert.

Thus, real property tax appraisal system was linked to the real property cadastre system in terms of organization as well as methodology. The above two systems have much in common:

- the software has been developed locally;
- work deliverables were reflected in a specialized database in the real property cadastre; in particular, information generated by real property mass registration efforts was reflected in LEGALCAD and tax appraisals in VALUECAD;
- work performed to develop the cadastre and to implement tax valuation was a mass effort broken down by settlement and by real property type;
- the requirements to the two systems are uniform: information has to be objective, the system must be user-friendly and devoid of excessive information; the available information has to reflect legal, technical and economic characteristics of real property items in the best possible way.

The efforts to develop the cadastre and to perform tax valuation were funded from the budget of the central government; consequently, a special emphasis was laid on cost structure analysis and development of tariff rates and standard time limits to perform individual work stages.

There are currently no doubts concerning the efficiency of market-value based property taxation. In Moldova, the central government funded mass appraisal efforts (determination of

fair market value) for all key types and categories of real property. These appraisal efforts covered all residential housing in cities and towns, commercial and industrial real property, garages built and owned by associations of garage owners, land plots in associations of small garden plot owners, agricultural land and structures located thereon and used for business purposes; family houses in the municipalities of Chisinau and Balti. An effort has been launched to collect information on residential houses in rural areas throughout Moldova in order to perform their subsequent appraisal. However, no specific deadline has been set for completion of these tax appraisal efforts concerning real property.

The lessons learnt from implementation of the new real property tax appraisal system in Moldova enable us to make certain preliminary conclusions regarding its strengths and weaknesses.

Strengths of mass real property valuations for taxation purposes:

1. There are indissoluble links between the real property valuation system and the real property cadastre. The idea of prioritizing the establishment of a real property cadastre as a system of legal data on each real property item and holders of rights thereto was promoted in Moldova as early as the stage on which the methodology was developed for mass real property valuation efforts in this country;
2. The results of real property valuation for tax purposes are highly reliable because valuation is based on reliable cadastral data about the property item being appraised and holders of rights to that item. Efforts have been made to minimize possible errors in identification of real property items and their owners;
3. The institutional structure has been streamlined for real property valuation for tax purposes. Appraisals are performed by territorial cadastral offices which are also responsible for registration of real property items and which maintain the most comprehensive register of transactions with real property, employ highly skilled professionals and use up-to-date software and a unique database;
4. Additional strengths of the mass real property valuation system for taxation purposes also include:
 - possibility to perform an appraisal of a large number of real property items against a tight deadline;
 - savings of funds and other resources because mass valuations are performed according to a simplified standard procedure, as opposed to separate appraisal of a particular item of real property;
 - possibility to perform an unprejudiced market analysis and to develop valuation models based on a large body of information;
 - fairness and objective nature of the resultant appraisal because a large number of real property items are appraised at the same time and subjective impacts are minimized through use of different experts for different valuation stages;
 - sufficiently large body of information and data available to substantiate and to defend the appraised values.

Challenges faced by Moldova in development of the mass valuation system:

1. Mass registration of real property has not been completed and so it is not possible to complete valuation efforts in respect of all real property types and categories. According to the cadastral system, approximately 600,000 family houses in villages and approximately

400,000 agricultural land items (“vegetable garden items”) outside cities and towns are not yet covered by the cadastral registration as of 01.01.2016 [4].

2. The current laws are very liberal towards companies and businesses. Although the Moldovan law says that all real property items must be registered in the cadastre, no mandatory deadline has been set for this registration. As a consequence, the cadastral database on commercial and industrial real property is not complete and so not all real property items can be properly identified and appraised in that category. Since real property owned by companies and businesses is mainly income-generating property, which is typically valued higher than residential property, this real property category could be a major source of tax revenue for the budgets of local governments.

3. The current procedure for commissioning of new construction projects is not perfect and a large number of construction projects currently underway have actually not been properly legalized. The owners of some completed construction projects do not have adequate legal evidence to substantiate their entitlement to the project site, the required clearance from urban planning authorities or other documents which are necessary to legalize the construction project. As a consequence, such real property items cannot be properly identified, registered and appraised for tax purposes;

4. Territorial cadastral offices are not interested to improve skills of their valuers because the entire methodology is developed in the head office and local offices only perform routine and standardized work. As a result, valuers employed by local cadastral offices are not able to deal effectively with real property owners or to provide adequate explanations regarding the objective and goals of real property valuation for tax purposes and advantages of value-based (*ad valorem*) taxation of real property. That leads to a high number of complaints from real property owners and has an adverse impact on the perception of the cadastral system by general public;

5. The new valuation system is only funded from the central government’s budget whereas actual benefits from higher tax revenues collected to the local governments’ budgets are enjoyed by local governments. Since the central government does not enjoy direct returns from its budgetary expenses to fund the new valuation system, there is a conflict between the central government’s budget with its ongoing expenses to finance valuation efforts for tax purposes and the local governments’ budgets which enjoy additional tax revenues;

6. Delays with implementation of the new valuation system for tax purposes are decreasing its efficiency. The effort to appraise all real property items is not yet complete, but many appraised values used currently are already obsolete. The ratio between the appraised value and the fair market value (which ratio is a key measure of mass valuation quality) significantly differs from the optimum range of 0.85 to 0.95 [1, p.78]. The reason is that the initial appraised values of real property determined correctly were never reviewed afterwards and there were no real property revaluations for tax purposes. That is why the difference between the initial value of real property appraised for tax purposes and its current market value is growing with each year. According to a survey, appraised tax values of apartments, residential houses and commercial real property in Chisinau are significantly below their market values – whereas appraised tax values of warehouses and industrial real property are almost twofold of their current fair market values. The higher the difference is between the appraised value and the market value, the lower is the taxpayer’s confidence in the new real property valuation system for tax purposes. With time, appraised value will become a pure symbol similar to the average state-assessed value (“inventory value”) that used to be the taxation base.

7. The tax valuation methodology has not been adjusted since early 2000s. Not all tax appraisal stages have been developed in sufficient detail. The current attention to dealings

with holders of rights to real property is not sufficient, although such dealings are one of the concluding valuation stages. There is no official procedure for appeals against valuation results;

8. Till presently, a database has not yet been established for information about actual transactions with real property; such a database should be used as a tool for verification of the valuation model quality and a source of information for decision-making to perform revaluations. There is no established approach for tax appraisals in a weak market environment or where reliable market information is lacking.

3. Institutional development of the real property valuation system

Further development of the real property valuation system for tax purposes will depend on the central government's concept for administration of Moldova's national economy. The recent years have seen attempts to dramatically review the current model for the national valuation efforts; opinions have been voiced that individual valuation of each separate real property item should replace mass valuation efforts. There were suggestions to amend Moldova's Tax Code by imposing on taxpayers the obligation to engage real property valuers at own expense and to submit reports on valuation of their real property to tax authorities. However, the Moldovan Government performed a thorough survey of international practices, took into account the existence of an automated system intended to perform mass real property valuations for tax purposes and of a developed real property cadastre system and decided to continue funding mass real property valuation efforts.

A new tax was enacted in Moldova in 2016; that is a property tax based on the market value of real property. That tax is also known as "luxury tax" in some countries. Payers of that tax are owners of real property (residential real property) with a total area of over 120 square meters and an appraised value of over MDL 1.5 million. The classification takes into account the total area and the total value of all real property items (i.e. all apartments, houses, summer cottages ("dachas")) owned by the taxpayer. From the perspective of real property valuation, it is important that the central government has thus officially recognized the high quality and objectivity of the results yielded by mass real property valuation efforts for tax purposes.

Basing her conclusions on the survey of international practice and of the national real property valuation efforts for tax purposes, the author of this article envisages the following options for institutional development of the real property valuation system in Moldova:

1. Strong centralized government regulation will be maintained. According to that option, cadastral offices will continue to perform tax valuations. Valuations will be performed according to the current procedure and techniques developed at an earlier stage by combined efforts of the head cadastral office and territorial cadastral offices. This option does not envisage competition and therefore it gives rise to the risk that valuation quality will decline in the long term and the existing weaknesses, errors and treatment of valuation efforts as routine work will persist and aggravate. Valuation efforts will be funded solely by the central government, and this situation will contribute to aggravation of the conflict between the central government's budget and the budgets of local governments. Obviously, re-evaluations of real property for taxation purposes will be seldom and they will lack a common system.
2. The state and state-owned enterprises will phase out from valuation efforts and private businesses will take over tax valuation activities. However, the central government will still develop major valuation methodologies, standard time rates and tariff rates for diverse valuation stages. The government will determine the amounts of funding

necessary to perform valuations and set valuation deadlines and mandatory requirements to valuation quality. Valuation contracts will be awarded in competitive tenders that involve objective analysis of each bidder's capacity. This option places main emphasis on the appraising company's liability, guarantee fund and third party liability insurance contracts.

3. Valuations will be performed by state enterprises as well as by private companies. Efforts that are more labour consuming (such as gathering of information and data on transactions with real property, mass gathering of data regarding real property, examinations of real property items to update the existing cadastral data, etc.) can be performed by private valuation companies. This option of arrangements for tax valuation efforts can be an optimal solution for large scopes of similar work, for example, mass gathering of information about separate-standing family houses in rural areas. Possible weaknesses of this option include the risk of inadequate work quality, infringements against the approved data gathering methodology and the issue of having to correct committed errors. On the other hand, a strength of this option is the possibility to perform large scopes of work with a tight timeline, thus facilitating prompt completion of the valuation effort. The author believes that this particular option presents an ideal combination of the state's regulatory function and private business mobility.
4. The central government and local governments will jointly undertake and finance the efforts to appraise and revalue real property.

In our opinion, the central government should fund the effort to complete mass valuation work and to perform general revaluation of all real property categories in Moldova. The statutory frequency for such revaluations should be set by the law – most probably, such re-evaluation should be performed once in every 5 to 6 years. In the periods between such general statutory re-evaluations, local governments can initiate updating re-evaluations of all real property (or of any real property category) located within the territory covered by the concerned local government's authority. Such updating re-evaluations should be funded by the concerned local governments. Local governments can also directly participate in gathering of initial data and information necessary for the re-evaluation effort and in clarification of the existing information about real property and holders of the real property rights. Since gathering of initial data and information about real property is the most labour-consuming and costly stage, local governments will thus be able to cut down the expense of valuation or updating re-evaluation of real property for tax purposes.

4. Improvement of funding arrangements for tax valuation and re-evaluation of real property

A major amendment made to the Tax Code of Moldova during 2016 is the amendment regarding changes in the funding arrangements for tax valuation of real property. Starting on 01.01.2017, real property valuation and re-evaluation efforts can be funded by the central government as well as by local governments and from other funding sources allowed by the law. That is a fair solution because real property tax is a local tax and revenues from its collection go entirely to the concerned local government's budget.

In other words, local governments are now allowed to conclude direct contracts with Cadastre State Enterprise for valuations of real property and to decide which real property categories should be appraised or revalued for tax purposes. The enactment of this new legal rule is expected to have the following beneficial effects:

- local governments will be given a realistic opportunity to increase tax revenues to their budgets;
- local governments will be more independent from the central government's budget;
- it will become possible to implement investment projects with the objective to improve living standards, engineering lines and social infrastructure in particular settlements;
- there will be other possibilities open to local governments to improve their community perception and image with their possible voters in future elections.

At the same time, certain reserve is recommended regarding application of this legal rule. There is a risk that tax burden will grow considerably and cause lower tax collection, discontent in the community and even social protests and unrest. Local governments should take extra care to make the expense part of their budgets more transparent and to use the collected tax revenues efficiently and productively.

From the perspective of tax valuation, the arrangement where the party ordering valuation and revaluation of real property is the local government may also have certain adverse consequences. Firstly, separate tax valuation of real property items in a single settlement will reduce the beneficial impact of mass valuation and increase per unit cost of valuation work (i.e. the cost of appraising one real property item). Secondly, the principle of fair taxation will be somewhat infringed because real property owners in the settlement where the local government concludes a contract to perform real property valuation will pay property tax based on a higher appraised value (market value) - whereas residents of neighbour settlements where the local governments do not conclude contracts to perform real property valuation or revaluation will pay property tax based on obsolete appraised values of their real property items. Thirdly, the dates of real property valuation for tax purposes will be different in different settlements, thus clearly making the resultant appraised values not comparable in macroeconomic terms.

In view of the above, the author believes that the budgets of local governments should only be used with appropriate care for mass valuation and revaluation of real property.

In the author's opinion, another option to fund tax valuation efforts could be the establishment of a special-purpose development fund from allocations from real property tax revenues collected by local governments – the way it was suggested in the draft law on real property monitoring. In that case, development of the real property valuation system will also be funded from the budgets of local governments, but the economic substance will be somewhat different. Instead of subsidies for fulfilment of the governmental programme to implement a new tax valuation system, the cadastral system will receive ongoing funding it has “earned” for its further development. The suggested development fund can be used to finance the following work types and efforts:

- establishment, maintenance and frequent updates of the database on prices in transactions with real property;
- continuous analysis of the real property market throughout Moldova (for all real property types and for all settlements);
- updates of information registered in the real property cadastre;
- real property re-evaluation efforts for tax purposes;
- efforts to complete initial mass registration of real property.

In our opinion, this financing arrangement will be the most satisfactory one. It will be the first step on the way to a self-sustainable system of real property valuation for tax

purposes. The author believes that this particular system funding (more exactly, self-financing) arrangement is quite realistic, can be implemented and will yield the best results.

5. Conclusions

As result of the performed survey, the following directions were identified for further improvement of the current system for tax valuation of real property:

- Development of the arrangements for joint funding of real property valuation and revaluation efforts by the central government and local governments and in particular the establishment of a targeted real property valuation development fund;
- Introduction of amendments intended to improve tax valuation laws in order to clarify the role of local governments in the implementation of the new real property valuation and taxation system in Moldova;
- Development of mass valuation techniques and approaches that will involve local governments in gathering of initial data and information about real property and holders of rights to real property.

Improvements to the legislative framework are also necessary to ensure that the property market develops and that there is transparency in property transactions and prices.

6. References

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