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## THE DETERMINANTS OF THE IMPLEMENTATION OF *AD-VALOREM* REAL PROPERTY TAXATION IN POLAND

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**Abstract:** Since the middle of the 1990s more and more attention has been paid to the necessity of carrying out a comprehensive reform of the real property taxation system in Poland. The essence of the proposed changes is a departure from the area-related model of property taxation towards a cadastral system in which the amount of tax depends on the value of a real property as determined by a cadastre. The new formula of a real property tax is, first of all, to strengthen and stabilize the finance of local governments. The experience of the majority of countries belonging to the European Union indicate that the reform initiated in Poland is moving in the proper direction – it favours the improvement of the efficiency of the real property taxation system and is consistent with similar solutions functioning in Europe and around the world for many years. The objective of this paper is an attempt to analyze arguments for and against the implementation of *ad valorem* taxation and a discussion of the fundamental assumptions for the reform, taking into consideration the fiscal and non-fiscal benefits for the finances of the economy of the territorial local government.

**Key words:** territorial local government, communes' revenues, real property taxation system, cadastre, *ad valorem* property tax.

### 1. Introduction

The current real property taxation system in Poland requires a comprehensive reform. For more than ten years the question of the necessity of its reconstruction and improvement has been raised on numerous occasions because in its current state, the method of taxation based on the area of a real property is ineffective economically and unfair socially; it does not meet the requirements of a market economy either. This state of affairs is determined first of all by the obsolete structure of taxes levied on real properties and the lack of a logically coherent real property taxation system which should be subordinated to the achievement of clearly specified objectives of both a fiscal and non-fiscal character.

The problems connected with real property taxation are complicated and require comprehensive solutions, also from the perspective of searching for efficient sources of financing for territorial local governments, in the conditions of the progressing

process of the decentralization of public tasks. For many years we have been witnessing the process of transferring some costs of sector reforms conducted by the state to local governments; unfortunately, this transfer of costs has not been accompanied by a parallel transfer of funds ensuring the execution of such reforms. This constitutes one of the major reasons for the financial insufficiency of local governments. The necessity to increase local governments' revenues is strengthened also by our membership of the European Union. A considerable degree of infrastructural backwardness requires, for example, that local governments search for additional sources of financing necessary investment projects allowing an effective absorption of EU structural funds.

The basic assumption of the reform of the real property taxation system in Poland is a departure from a model in which the amount of tax depends on the area of land, buildings or facilities towards a cadastral system in which the amount of tax depends on the value of a real property as determined by a cadastre. It is worth noting that real value-related property taxation systems are commonly used in countries with developed market economies in America, Asia and Western Europe, including almost all Member States of the European Union.<sup>1</sup> Moreover, a reform of real property taxation – which could be reduced to the appraisal of real properties, the establishment of a cadastre and the implementation of a new value-based real property tax – has been or is being implemented in the majority of post-communist countries of Central and Eastern Europe.<sup>2</sup>

In our country the process of reforming the real property taxation system has already been initiated; it is not being implemented on a revolutionary basis, but rather in the form of evolution – a gradual achievement of target solutions. This state of affairs is determined by both the scale and nature of the barriers accompanying the process of reforming the whole real property taxation system. These barriers are first of all of a technical nature (the lack of cadastral surveys), legal nature (in the case of many properties, still unresolved ownership issues), and financial nature (considerable costs of the reform), but also institutional nature (a poorly developed real property market) as well as socio-political nature (resistance of the public and the consequent unwillingness on the part of the governing bodies to make unpopular decisions).

Nevertheless, the direction of the changes has been adopted and the changes themselves are unavoidable. The question remains as to how and when they will start functioning in their target form and whether it will be possible – by the implementation of particular general system solutions – to limit to the necessary minimum the social

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<sup>1</sup> This group includes such countries as the USA, Japan, Taiwan, Singapore, Indonesia, Australia, New Zealand, France, Germany, Austria, the United Kingdom, Ireland, Sweden, Denmark, Norway, Finland, Belgium, the Netherlands, Spain and others.

<sup>2</sup> Besides Poland, this group includes the Czech Republic, Slovakia, Ukraine, Russia, Belarus, Lithuania, Latvia, Estonia, Romania and other countries which have not had any cadastres or related real property taxation systems.

costs of the reform which will be borne first of all by people owning particular properties but not necessarily having an adequately high income.

## **2. The fiscal aspects of the reform of the real property taxation system in Poland**

A real property taxation system is understood as a set of taxes applicable in a given country whose subject is the possession of things subject to taxation under effective legal regulations. The real property taxation system in Poland is made up of three taxes of a property nature (related to the possession of a real property or an increase in its value), i.e. real property tax, farm tax, and forest tax.<sup>3</sup> They are similar to each other with respect to the legal structure, but they are regulated by means of different acts: the Local Taxes and Fees Act [Ustawa z 12 stycznia 1991...],<sup>4</sup> the Farm Tax Act [Ustawa z 15 listopada 1984...] and the Forest Tax Act [Ustawa z 30 października 2002..., poz. 1682]. The subject of taxation in these cases is the broadly understood possession of real properties.<sup>5</sup> The real property tax has the widest scope because it covers land, buildings and structure while the subject of the farm tax and the forest tax is land only.

Although they are related to it, the system defined in this manner does not include property taxes related to the sale of real properties (inheritance and donation tax, civil law transaction tax), income taxes related to revenues from real properties and sale of real properties (natural person income tax, corporate income tax) and consumption tax related to the sale of real properties and the acquisition of revenues from real properties (value added tax). Functionally, the real property taxation system is related to some types of fees related to increases in the value of real properties, i.e. an infrastructure development fee [Ustawa z 21 sierpnia 1997..., art. 98a ust. 1] and a rezoning fee [Ustawa z 27 marca 2003..., art. 36 ust. 4], as well as a perpetual usufruct fee, whose character is similar to that of a real property tax [Ustawa z 21 sierpnia 1997..., art. 71 ust. 1].

At the beginning the very notion of “real property” should be clarified because its scope in tax law is different from a definition specified in civil law. Thus, real

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<sup>3</sup> In the literature on the subject, authors pay attention to the fact that the term “system” always assumes the existence of a certain whole which consists of many elements, which are mutually arranged, consistent, and logically related. It is not quite obvious that these qualities of a rational system can be found in the structures of the taxes under discussion. Cf. [Etel 1998, p. 22; Kosikowski 2003, p. 13].

<sup>4</sup> The Local Taxes and Fees Act of 12 January 1991 includes, among other things, regulations concerning a real property tax.

<sup>5</sup> The possession of a real property consists basically in holding or using it, effective changes in it, collecting profits and other income from it, and its disposition. The scope of the use of a real property depends to a considerable extent on what right a possessor holds to a particular real property. It is obviously the owner who enjoys the widest use of a real property. Cf. Civil Code [Ustawa z 23 kwietnia 1964...], Volume II. “Ownership and other rights in property”.

properties subject to taxation are land, buildings, premises, structures and other facilities specified in the tax regulations irrespective of their being real properties within the meaning of the civil law. For taxation purposes, real properties will be understood as not only such typical things as land and buildings, but also, for example, roads, pipelines, railways, ponds and lakes, forests, umbrella roofs, telephone boxes, hoardings, etc. What should be recognized as a real property subject to taxation is determined by the provisions of the taxation acts [Etel 2003, p. 8].

Within the scope of the real property taxation systems effective in European countries, we can distinguish systems based on the value of a real property specified in a cadastre and systems where the area of a real property constitutes a taxation basis. There are also mixed systems in which besides area, the value of a real property is used as a basis for the taxation of particular buildings, structures or land [Etel 2003, pp. 9, 11]. This is the case in Poland, where structures are taxed according to their depreciation values, while land and buildings – according to their area.<sup>6</sup> Another example of a system based on value is a system in which the amount of tax depends on the type and purpose of a real property. Ordinary real properties located in towns and used for economic activities are taxed at higher rates than real properties used exclusively for housing purposes. A similar dependence of the amount of tax on the value of a real property occurs when local authorities determine tax rates and tax exemptions by way of adopting relevant resolutions.<sup>7</sup>

Nowadays, especially in the countries belonging to the European Union or applying for membership of it, one can observe a departure from area-based taxation systems because taxes paid on the value of real properties are better in the execution of tasks imposed on real property taxation systems [Etel 2003, p. 6]. All data necessary to determine the level of taxation are included in a cadastre, which facilitates the determination and collection of taxes. That is why taxes levied on the basis of cadastral values are called cadastral taxes, while *ad valorem* real property taxation systems are called cadastral systems.

It is indisputable that the current real property taxation system in Poland requires a thorough reform whose centrepiece should be *ad valorem* property tax. However, for at least more than ten years there has been no unanimity concerning the idea of its implementation. There is no uniform concept of the tax itself, political will or social acceptance. There is also no agreement concerning the main assumptions for the reconstruction of the whole real property taxation system. Although they do not reject the arguments for the implementation of the *ad valorem* property tax, all subsequent

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<sup>6</sup> In the case of structures, the amount of tax is based on a value adopted for fixed asset depreciation purposes, and if particular structures are not subject to depreciation, their market value is used for taxation purposes.

<sup>7</sup> An attempt to establish a relation between the amount of tax paid on a given real property and its value is classifying a real property as belonging to a particular tax circle depending on its location and available infrastructure, exempting from taxation properties which do not generate revenue or are used for socially useful purposes.

governments procrastinate and postpone the problem until the unspecified future. The representatives of the Ministry of Finance declare that in the nearest future there will be no plans to implement the *ad valorem* property tax. As they say, the major hindrance in this respect is the lack of a cadastre, or an official register of land and real properties. Besides, society in our country is not strong enough yet to be able to accept this form of taxation.<sup>8</sup>

Nevertheless, the opinion according to which it becomes necessary to conduct a comprehensive reform of the real property taxation system within the framework of a broader reform of public finances is shared by a growing number of experts. One of the key assumptions is the improvement of the public finances structure by implementing changes in the principles of financing local government units consisting in the establishment of a stable and efficient source of income. The main objective of the reform is an increase in the income of local governments by implementing the principle of the universal character of taxation together with the simultaneous, possibly the least burdensome, increase of levies related to the ownership of real properties. This is to be achieved by changes in the taxation base and the method of real property registration. It is expected that the reform will strengthen the local government structures institutionally and organizationally. The functioning of local tax administration will be improved, e.g. by increasing the effectiveness of the collection and enforcement of taxes, including by way of applying state-of-the-art IT and record keeping technologies [Nowecki 1999, pp. 62 sqq.].

The *ad valorem* tax will be collected first of all by communes, but it may also strengthen the financial position of districts. For the purpose of both a proper real property registration (a fiscal cadastre) and appraisal, it is necessary to establish principles of close cooperation between the commune and district levels of the local government structure. As a local government organizational unit, a district is the best positioned to establish a real property register in the form of fiscal cadastres for communes making up a particular district. Also with respect to real property appraisal, a district may prepare all the necessary elements, develop guidelines, and determine rates which subsequently will acquire legal validity by way of resolutions adopted by councils. Obviously, tasks undertaken by districts will generate additional revenues for their budgets, even though tax determination, collection and enforcement will remain the responsibility of communes.

A decentralized real property *ad valorem* taxation system is to constitute an effective tool of communes' fiscal policy oriented first of all towards the strengthening of local governments' financial standing. Currently real property taxes are communes' most important source of income. The share of real property taxes in communes' own income in the years 2003–2009 was at the level of 32%.

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<sup>8</sup> Cf. a statement by Deputy Finance Minister E. Chojna-Duch during a tax conference on 8.04.2008 [Skwirowski 2008].

**Table 1.** The share of real property taxes in communes' own income in the years 2003–2009

Year	2003	2004	2005	2006	2007	2008	2009
Total communes' own income (million zlotys)	16,112.0	18,732.0	20,558.2	22,683.6	26,535.5	30,694.7	30,021.9
Real property tax (million zlotys)	6,028.3	6,501.2	6,994.9	7,270.1	7,595.6	8,018.0	8,488.3
Share of real property tax in communes' own income	37.4%	34.7%	34.0%	32.0%	28.6%	26.1%	28.2%

Source: [Budżety jednostek... 2010].

Every year in the period under discussion one can observe a rise in income of commune budgets related to real property taxes, although the rate of this rise varied in particular years.

**Table 2.** The rate of increase in commune budgets' income from real property taxes in the years 2003–2009

Year	2004/2003	2005/2004	2006/2005	2007/2006	2008/2007	2009/2008
The rate of increase in income from real property taxes (%)	7.8	7.6	3.9	4.5	5.6	5.9

Source: [Budżety jednostek... 2010].

The rise in communes' income from real property taxes is the result of changes implemented successively since 2003 in the real property taxation system, whose target is to tax real property on the basis of their value. These changes consist, among other things, of the possibility of diversifying the rates of real property taxes within a given subject of taxation (depending on a location, manner of use, purpose, technical condition, age, etc.), providing a land and buildings register with a basic role in determining the subject of taxation and imposing an obligation on tax authorities to maintain special real property taxation records (a fiscal cadastre). In view of the current positive effects of the changes already implemented in the real property taxation system, one may expect that an *ad valorem* tax will constitute an important element in the stabilization and strengthening of local government finances.

A problem common to many communes is, for example, a lack of funds for infrastructural investments. In the majority of cases, they are not capable of meeting the financial requirements of such investments relying on their own budgets. Naturally, communes may borrow money for such purposes, but they are not competitive on capital markets. For communes to become reliable partners on capital markets, e.g. to issue bonds or acquire a loan, they have to have stable finances,

and taxes paid on the value of real properties is one of the methods to strengthen and balance local government budgets. However, if an *ad valorem* real property tax is to be implemented and fulfil its function within the scope of local government finances, it is necessary to: (1) have a functioning and efficient system of registering real properties for taxation purposes, (2) develop a simple and easy-to-understand system of real property appraisal, and (3) determine clearly the subject and object of taxation. Only when these conditions are fulfilled will the reform of Poland's real property taxation system stand a chance of success.

In the European Union there is no formal requirement to implement an *ad valorem* property tax. In this respect, the EU allows the Member States to decide for themselves. Nevertheless, this tax is used in all countries of the old European Union. According to specialists, it is only a matter of time before the EU starts to demand its implementation also in Poland. This can be inferred from the fact that Poland has used EU funds to establish a cadastre system, so sooner or later we will be obliged to implement this form of taxation, which will be the fulfilment of previously made commitments.<sup>9</sup> Undoubtedly, the started reform will accelerate the process of harmonizing the real property registration systems in the particular Member States with the system used in the EU and will standardize the taxation of real properties within the scope of the whole European Union.

### 3. A cadastre and cadastral tax – proposed directions of change

Etymologically, the word “cadastre” comes from Greek (*katastikhon* – i.e. register) or Latin (*capitulum* – i.e. poll-tax register). The origins of the modern institution of cadastre go back to 19th-century France. It became common in the 20th century as an official information system including data on real properties, including buildings and structures, and on natural and legal persons who are their owners or possessors. Its major function is to function as a register of real properties subject to taxation and to ensure the security of transactions on the real estate market [Gaździcki 1995, p. 8].

Nowadays the word “cadastre” is understood as an official register of real properties each of which is described, appraised and recorded. The value of a real property coming from a so-called real property cadastre constitutes a basis for the calculation of a tax on the possession of real property. Used commonly in Europe and around the world, this method of taxation is described as an *ad valorem* taxation system because it is the value of a particular real property that constitutes a basis for its taxation (the so-called cadastral value).

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<sup>9</sup> Cf. PHARE 2000 project: *Budowa zintegrowanego systemu katastralnego*, PHARE 2001 project: *Zintegrowany system katastralny – faza II* and PHARE 2003 project: *Zintegrowany system katastralny – faza III*, conducted in Główny Urząd Geodezji i Kartografii (Main Office for Geodesy and Cartography), [www.gugik.gov.pl](http://www.gugik.gov.pl).

Three types of cadastres can be distinguished: fiscal, legal and multi-task [Nowecki 1996]. A fiscal cadastre is used mainly to determine real property taxes. It is the oldest type of cadastres. Its basic objective was to establish a register of real properties subject to taxation. Data included in a fiscal cadastre (concerning a taxpayer, a real property's physical description and value, and sometimes income acquired from it) are necessary for the determination and collection of due taxes. However, the fiscal function of a cadastre does not exclude its use for other purposes as the establishment of such a cadastre is relatively simple and cheap, does not require precise surveying or determining complicated ownership relationships [Etel 2003, pp. 13–14]. Fiscal cadastres are used, among others, in France, Belgium and the Netherlands.

The purpose of a legal cadastre is the registration of rights to real properties. It constitutes records of data reflecting the legal status of a particular real property, i.e. the registration and protection of rights in property, but it can be also used for taxation and other purposes (related to real property sales transactions, the development of various economic plans, in the activities of the justice system). It contains first of all information concerning ownership rights as well as other rights and charges related to a given real property.<sup>10</sup> It is related to or completely substitutes a mortgage and land register. The implementation of a legal cadastre has to be preceded by the ordering of each property's legal relations and determining its borders by way of complicated surveying and measuring procedures. Legal cadastres are used, for example, in Germany and Austria.

A multi-task cadastre comprises a selection of data of a wide thematic scope and that is why it can be used simultaneously in the execution of many tasks of an administrative, economic or social character. Obviously, the implementation of a multi-task cadastre is the most expensive and time-consuming enterprise.<sup>11</sup> This type of cadastre has become popular, for example, in Sweden. A similar situation occurs in Denmark and Finland, where three separate cadastre modules are used (i.e. for geodetic-cartographic, legal and fiscal purposes) which are correlated and technologically consistent with each other.

In the countries of Central and Eastern Europe, cadastral registers do not exist at all or are in the process of development. Because the taxation basis is the area of a real property which can be verified on the basis of geodetic and cartographic registers, it is these registers that are the main source of tax information for both

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<sup>10</sup> They include such relations as usufruct, perpetual usufruct, easement, lease, rent, loan for use, and administration.

<sup>11</sup> A multi-task cadastre is a concept to which the definition of a "land information system" adopted by Committee III of the International Federation of Surveyors (FIG) in 1981 relates. A land information system is a legal, administrative, fiscal and economic decision making centre and a tool assisting in planning and development processes. It comprises a database established for a particular area as well as the methods and techniques of systematic data collection, revision and public availability. Cf. [Gaździcki 1995, p. 13].

taxpayers and tax authorities. The major function of such registers is the acquisition of spatial data concerning real properties, therefore they do not include various types of legal or tax information. Since they are not updated on a regular basis, data included in them frequently do not reflect the factual state of affairs. Usually the scope of information included in such registers is limited to parcels of land, whereas buildings and other facilities subject to taxation are not disclosed in them at all, which favours the phenomenon of tax evasion [Wójtowicz 2007, p. 20].

From the historical point of view, real property taxes existed in Poland already before the war. They were introduced on the basis of a decree of the President of the Republic of Poland of 14 January 1936 on real property taxation.<sup>12</sup> A tax levied on a real property was based on its rental value or current value.<sup>13</sup> Work on the reintroduction of the *ad valorem* property tax was started in late 1993/early 1994 in the Ministry of Finance, where a special Taxation System Reform Team was established. Simultaneously, the Sejm adopted a special resolution obliging the government to develop guidelines for the real property taxation reform in which a taxation base would be determined by the value of real properties.<sup>14</sup> From the very beginning an assumption was adopted that the new real property taxation system would be based on a modern fiscal cadastre.

In the government's strategy for Poland of 1994, the authors stressed the need for the Finance Ministry to implement a register of real properties for taxation purposes; such register was to be comprehensive, i.e. including all types and categories of real properties subject to a new *ad valorem* tax.<sup>15</sup> In 1995 an Inter-Ministerial Working Team for the Reform of Real Property Registration and Taxation was established. It started work on the preparation of bills concerning the implementation of a cadastral tax. They constituted a comprehensive regulation of all most important issues of the reform with respect to real property taxation and registration as well as the principles of appraisal and the organization of cadastral and tax collection services.<sup>16</sup>

The well advanced work on the real property taxation system reform was suspended in 1996, mainly for political reasons. As a result of disputes between

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<sup>12</sup> Dziennik Ustaw [Journal of Laws] 1936 nr 3, poz. 14.

<sup>13</sup> A rental value was based on the factual amount of rent under a rental or lease agreement or potential rent in the case of properties which were not rented or leased (a tax equalling 10% of a property's rental value). On the other hand, a current value was determined by comparing prices of similar properties if it was impossible to specify at least a probable value of potential rent (a tax equalling 8–12% of a base). The average amount of this tax constituted about 2.4% of a real property value, which forced possessors to use properties in a reasonable manner.

<sup>14</sup> A resolution of 5 March 1994 concerning increases in the national budget's income [Uchwała z 5 marca 1994...].

<sup>15</sup> In 1994 the activities of the Team for the Reform of the Taxation system resulted in the presentation of a document entitled: *Detailed Guidelines for the Bill on the Cadastre of Real Properties and the Real Property Taxation System* (after: [Etel 1998, p. 220]).

<sup>16</sup> A detailed discussion of this legislative package would fall outside the scope of this paper. More on this topic in: [Etel 1998, pp. 227–242; Wójtowicz 2007, pp. 185–187].

the Ministry of Construction and the Ministry of Finance, the previously adopted concept for the implementation of a decentralized fiscal cadastre was given up and substituted with the idea of developing a centrally administered multi-task cadastre<sup>17</sup> based on the existing land and building registration system. The Real Property Act [Ustawa z 21 sierpnia 1997...] was amended by the introduction of a notion of a real property's cadastral value; it was provided with legal foundations for the performance of a universal appraisal of real properties.<sup>18</sup> However, these regulations remained ineffective because they referred to non-existent regulations concerning an *ad valorem* property tax and a real property cadastre.

Work on the cadastral tax was resumed in 1998. The Ministry of Finance established a Local Taxes and Cadastre Department which was to deal with the existing real property taxation system and also to prepare its restructuring towards the introduction of an *ad valorem* property tax.<sup>19</sup> In 1999 three bills were prepared: on a fiscal real property cadastre, on a fiscal appraisal of real properties and on an *ad valorem* property tax [Jędrzejewska 1999]. These legislative proposals constituted a coherent attitude towards the issue of a cadastral tax and a real property registration system. However, they were never implemented because of the existing institutional, technical, financial and – first of all – political barriers.

Concepts for a property tax reform formulated after the year 2000 concerned mostly a real property registration system while the issue of taxation was considered of secondary importance. The authors of *A Prospective Development Programme for a Cadastre System*<sup>20</sup> assumed that a cadastre system would consist of three elements: (1) a real property cadastre to be managed by the Chief Surveyor, (2) land and mortgage registers to be managed by the Minister of Justice, and (3) a fiscal cadastre to be administered by the Ministry of Finance. Such structure of the system was to allow the following: the creation of conditions for reasonable spatial development,

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<sup>17</sup> In accordance with the act [Ustawa z 17 maja 1989...], the office of the Chief Surveyor was established. It was meant to be a central body of public administration responsible for not only the administration and supplementation of the geodetic and cartographic resources but also the technical and organizational preparation of the implementation of a cadastre as well as the preparation of guidelines for and the supervision over the universal process of real property appraisal.

<sup>18</sup> Thus, the provisions of the Act take into consideration the eventual implementation of a real property cadastre in the whole territory of Poland; it is to be a register of all real properties whose cadastral value (an official value of a real property specified in a cadastre) is to be determined by way of universal appraisal; in turn, a cadastral value is to constitute a base for a real property tax.

<sup>19</sup> The importance of this issue was stressed additionally by its inclusion as one of the priorities in *The National European Union Membership Preparation Plan* [Narodowy plan... 1998] adopted by the Council of Ministers on 23 June 1998. Among other things, this document stressed that the objective of planned activities was to substitute the three levies (i.e. real property tax, farm tax, and forest tax) with one new tax based on a real property's capital value or its so-called official cadastral value.

<sup>20</sup> A document entitled *A Prospective Development Programme for a Cadastre System* was adopted by the Economic Committee of the Council of Ministers on 14 December 2000 [*Perspektywiczny program...* 2000].

the stimulation of the development of the real property market and the facilitation of economic transactions on this market, the strengthening of the function of land and mortgage registers and improvement in the functioning of common courts of law, improvement in the enforcement of tax obligations as well as the more efficient provision of information on land, buildings and premises. Simultaneously, deadlines for the performance of the particular stages of the process were specified.<sup>21</sup>

The implementation of a cadastral tax was made dependent on the completion of the process of developing a real property cadastre.<sup>22</sup> The Ministry of Finance assumed that by that time gradual changes in the real property taxation regulations would be introduced in order to rearrange and move the structure of the three property taxes towards the target *ad valorem* real property taxation system. Instead of ready legislative packages providing for a comprehensive reform of the system, what was proposed was solutions of an evolutionary character aiming at the improvement of the existing structures and the elimination of their major weaknesses [Milewska 2000]. In 2003 particular legal solutions concerning changes in the structures of the real property tax, farm tax and forest tax were adopted. They concerned first of all the following: (1) the possibility of commune councils' diversifying real property tax rates within the scope of a given subject of taxation, depending on such criteria as a location, manner of use, type of building, purpose, technical condition, age, (2) providing the register of land and buildings with a basic function of determining the subject of taxation, (3) imposing on tax authorities an obligation to keep a special real property taxation register – a fiscal cadastre [Ustawa z 10 października 2002...; Ustawa z 30 października 2002... poz. 1682; Ustawa z 30 października 2002... poz. 1683; Wójtowicz 2007, p. 194].

Since 1 January 2005 an important element in the creation of a cadastral system in Poland has been a real property tax register maintained by tax authorities in the form of an IT system.<sup>23</sup> This register is to be used in the determination of the amount and collection of real property, farm and forest taxes. It constitutes the beginning of the process of developing a comprehensive system of information on real properties which will ensure the collection, updating and exchange of information concerning

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<sup>21</sup> By 31 December 2001 land registers maintained manually (on paper) were to be substituted with computer databases, and by 31 December 2003 complete registration databases (comprising information on land, buildings and premises) were to be available. Later, i.e. in the case of urban areas by 31 December 2005 and in the case of rural areas by 31 December 2010, computerized registration databases allowing the implementation of numerical survey maps were to be established and for particular districts, reports illustrating the registers of land, buildings and premises as well as the files of buildings and premises were to be created. After: [Wójtowicz 2007, p. 192].

<sup>22</sup> This notion should be understood as a central register (records) of real properties maintained in a computerized form which will constitute a real basis for the selection of the methods of valuating real properties and calculating tax bases.

<sup>23</sup> The principles of the functioning of the register are regulated by the order of the Minister of Finance of 22 April 2004 concerning a real property tax register [Rozporządzenie Ministra Finansów z 22 kwietnia 2004...].

real properties, including legal information (a legal cadastre included in the system of land and mortgage registers), registration information (resulting from land and building registers) and tax information (a fiscal cadastre). The real property tax register is to be an instrument allowing a comprehensive appraisal of real properties [Kisilowska (ed.) 2007, pp. 506–507].<sup>24</sup>

At present the basic tool for determining a tax obligation and the amount of due taxes with respect to real property, farm and forest taxes is land and buildings registers kept by heads of district authorities.<sup>25</sup> Because of the co-existence of three taxes whose scopes partly overlap, it is the classification in land and buildings registers that functions as the major criterion for recognizing a particular real property as taxable under a given tax. So far it has been impossible to implement a uniform nation-wide information system ensuring connection between registers making up the cadastral system and connection between this system and public registers or files [*Informacja o wynikach...* 2005]. Local governments are continuing the development of proper registers and databases using EU funds.<sup>26</sup>

There are at least a few characteristics distinguishing cadastral real property taxation systems from other systems [Etel 2003]. First of all, data included in cadastral registers constitute a basis for identifying a taxpayer, the subject of taxation and a tax base, which considerably increases the effectiveness of taxation and prevents property tax evasion. A taxpayer is usually the owner of a real property. A possessor who is a taxpayer is entered into a cadastral register next to an owner.

As far as the subject of taxation is concerned, the cadastral tax covers all types of real properties. A tax base is a real property's value – it is the factual (market) value or the so-called rental value determined usually by experts on the basis of statutory regulations.<sup>27</sup> If property taxes are to function effectively, a tax base has to be close to the factual market value of a given real property. The law should guarantee regular reappraisal cycles (appraisal updates every 2–5 years). Periodic reappraisals of real properties have an additional impact on increased revenues to local government budgets at a given property tax rate.

This tax is levied by tax authorities in the form of a decision delivered to a taxpayer; there is no obligation for a taxpayer to appraise his property himself. If there are any

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<sup>24</sup> In 2001 the Real Property Management Act was supplemented with an order regulating the principles and procedures of carrying out a universal appraisal of real properties and supervision over it. Cf. [Rozporządzenie... z 19 października 2001...].

<sup>25</sup> The land and buildings register operates under the principles specified in the Geodetic and Cartographic Law Act of 17 May 1989 [Ustawa z 17 maja 1989...] and in the order of the Minister of Regional Development and Construction of 29 March 2001 concerning the registers of land and buildings [Rozporządzenie... z 29 marca 2001...].

<sup>26</sup> Cf. footnote 9.

<sup>27</sup> The rental value or revenues which could be acquired from the rental or lease of a particular real property is used as a cadastral tax base in France. A similar system functioned in Poland before the war. Cf. footnote 13.

statutory reliefs or exemptions, they apply most frequently to real properties used for public purposes, schools, hospitals, museums, etc. Local government bodies at commune level have relatively broad competencies in the shaping of the structure of real property taxes, which is expressed in their prerogative to determine tax rates as well as reliefs and exemptions. However, they have to remember that an excessive application of reliefs and exemptions, if they are not justified in a systemic manner, has a disadvantageous influence on local governments' income from the cadastral tax. The final objective should be a limitation in the number of reliefs and exemptions, and the circumstances in which they can be applied should be clearly and explicitly defined.

The process of implementing cadastral systems is complicated and requires time necessary for its understanding and acceptance on the part of taxpayers. A cadastral tax implementation programme has to include protection of taxpayers who, especially in the first phase of the implementation of the cadastral tax, will be taxed at much higher levels than before. Some compensation for this tax increase could be included in relevant regulations concerning lower rates of the income tax.<sup>28</sup> A taxation system based on the value of real properties is expensive at the stages of both its implementation and maintenance. This is related to the necessity to build a system of information on real properties, the determination and update of their value.

Additionally, if such a system is to function effectively, it has to be operated by a qualified and competent personnel. This is connected mainly to a correct determination of a tax base because sometimes it happens that a value of a real property determined by tax authorities is very much different from a value specified by a taxpayer, which causes disputes. Cadastral systems may also discourage taxpayers intending to invest in real properties because incurring investment expenditures, they increase the value of a real property and – consequently – the amount of the property tax. Undoubtedly, this has a negative influence on investment activities, however, this disadvantageous impact may be moderated, for example, by the introduction of transition periods comprising exemptions and reliefs for newly built or rebuilt properties.

#### **4. Opportunities and threats related to the implementation of the cadastral tax**

The current real property taxation system in Poland should be considered as obsolete, inefficient and failing to meet the requirements of a market economy. During the past few decades the same acts have remained in force with slight modifications. In numerous cases, their provisions are not adjusted to today's reality, and especially

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<sup>28</sup> An example of such already initiated activities is a reduction in the number of personal income tax rates and their lowering from 19, 30 and 40% to the two currently effective rates of 18 and 32%.

– the changing ownership relation.<sup>29</sup> They are based on the inefficient system of taxing the area of real properties (buildings and land) and to a very small extent use their value as a taxation basis. For taxation purposes, real properties are valued in square metres and (conversion or physical) hectares, and not in monetary terms. This state of affairs allows communes' limited possibilities of increasing their revenues from the taxation of real properties whose value rises in parallel to increases in market prices. In the case of area, there are no additional square metres, thus revenues do not change. In a situation when real property taxes are area-based and not value-based, weaker communes located in less economically developed regions suffer. The highest property taxes per 1 m<sup>2</sup> are paid by entrepreneurs which causes a situation where the largest revenues flow first of all to communes which are the most developed economically.

The most important factor influencing work on the real property taxation reform is the noticeable absence of a uniform and reliable register allowing a proper determination of taxes to be collected from real properties. The assumption is that area, which constitutes a basis for real property taxation, is to result from registers of land and buildings. In practice, however, one can use only land registers because so far a complete register of buildings has not been developed. This is the reason for using physical dimensions of buildings as a basis for their taxation. Forests and forest land are taxed on the basis of physical data resulting from forest management plans or simplified forest management plans. In fact, however, the reliability of such plans may be questionable because their data are not updated on a regular basis. Besides, such plans have not been prepared for all forests. In such situations, commune tax authorities frequently find it difficult to determine what buildings or structures have not been registered for taxation purposes [Nowak 2005, p. 344].

Difficulties occur also while determining the area of such facilities because – as has already been mentioned – there are no documents with reliably specified areas (hence the necessity to conduct a quantity survey). This constitutes the possibility of tax evasion because tax authorities do not have any information on a particular structure if a taxpayer has not submitted relevant information. Obviously, this contributes considerably to the lower effectiveness of the whole real property taxation system and reductions in the expected revenues to local budgets.

The limited fiscal potential of real property, farm and forest taxes results also from unjustified disproportions in charges imposed on different categories of real properties (e.g. between housing buildings and other buildings, between forests with developed forest management plans and forests taxed on the basis of land registers), which contributes to the intensification of the tax evasion phenomenon. Fiscal efficiency is also weakened by the wide range of tax privileges used by communes: exclusions, exemptions and reliefs whose granting is based on rather unclear criteria

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<sup>29</sup> Not so long ago most land in the countries of Central and Eastern Europe was owned by the state which determined the principles of its purchase – usually in isolation from its factual market value.

and reduces the universal character of taxation in both subjective and objective dimensions [Wójtowicz 2007, p. 177]. The scale of consequent losses suffered by commune budgets is reflected, for example, in special Rb-PDP budget reports prepared obligatorily by communes and cities with district rights.<sup>30</sup>

The most frequently used exemptions and reductions are applied to various administrative institutions (e.g. the police, fire brigade, cultural institutions, health service and welfare institutions), entities financed from commune budgets or real properties related to job creation. And last but not least, exemptions from real property taxation specified in the Act usually are deprived of any real justification in the current market economy system.<sup>31</sup>

The negative aspect of Poland's real property area-based taxation system is the preferential system of imposing taxes on agricultural properties. These are usually pieces of land taxed with symbolical amounts or exempt from taxation at all. If a piece of land fulfils an area requirement (i.e. an area larger than 1 ha), it is treated like an agricultural holding irrespective of who it is owned by and whether any agricultural activities are carried out there. This results in numerous abuses in which preferential taxation addressed to farmers is used by entities which have nothing to do with agricultural economy.

Paradoxically, from the fiscal point of view, the high level of the taxation of real properties used for economic purposes is disadvantageous. The amount of tax paid on land owned by an entrepreneur is a few times higher than that paid on land used by other entities, which considerably increases the cost of business activities, slows down economic development, and in extreme cases may render particular economic activities unprofitable. Obviously, this phenomenon is exceptionally disadvantageous to local governments whose territories are not attractive from the economic point of view. A high level of real property taxation limits the undertaking of economic activities requiring large areas of land, even when such land comprises wasteland of low economic value and poor development prospects. Obligated to pay the same rate of tax on one square metre, a businessperson will be more willing to locate their activities in urbanized areas with adequate infrastructure, which, in turn, will have a negative influence on the economic development of poorer communes [Etel 2003, pp. 19–20].

Furthermore, the quality of real property taxation regulations is low, which causes the occurrence of numerous difficulties at the stage of determining the amount of taxes and their collection. Such difficulties are related first of all to the interpretation of the regulations in the process of applying the tax law. This can be illustrated by the considerable number of disputes between taxpayers and tax authorities,

<sup>30</sup> These data are available on the website of the Ministry of Finance: [www.mf.gov.pl](http://www.mf.gov.pl).

<sup>31</sup> Cf. Article 7 clause 1 of the Local Taxes and Fees Act, which grants exemption from real property taxes to, among other things, structures constituting elements of the railway infrastructure, the sea port infrastructure, business buildings or their parts used in forestry or fishery activities, etc. [Ustawa z 12 stycznia 1991...].

the consequence of which are numerous cases submitted to administrative courts [Brzeziński, Kalinowski 1994, p. 6]. Another negative phenomenon influencing the bad quality of real property taxation regulations is the very manner of their creation and frequent changes whose consequences become evident only at the stage of their practical application.<sup>32</sup> A separate issue is the low legislative quality of resolutions adopted by commune councils in taxation matters; councils frequently exceed their scopes of competencies or break the law in another way [Etel 1998, pp. 54–55].

Unfortunately, in Polish conditions, real property taxes do not constitute an effective instrument of influencing an efficient use of a particular real property, stimulating development of the real property market or shaping a reasonable spatial structure in Polish towns and cities. This is connected with the taxpayers' relatively low perceptibility of the burden of real property taxes (especially in the case of housing or agricultural real properties) and the lack of relation between the amount of taxes and the level of measurable economic effects resulting from the use of a real property. This can be seen in an analysis of resolutions adopted by communes with respect to tax rates and exemptions in which granted tax reliefs or exemptions resulted mainly from social considerations and did not nurture, for example, the stimulation of economic development by the preferential taxation of real properties related to business activities [Wójtowicz 2007, p. 226].

Eventually, from the perspective of the functioning of area-based real property taxation systems, the key characteristic proving their obsolete character is their detachment from taxpayers' paying capacity. Tax rates per one square metre are determined at the level acceptable for the majority of taxpayers. This is advantageous for more affluent taxpayers who own real properties of considerable value. Taxes paid on 1 m<sup>2</sup> of a flat located in a city centre are the same as taxes paid on 1 m<sup>2</sup> of a shanty located on the outskirts of a city. In such circumstances, taxes paid on a real property's area and not its value will be of a rather symbolic nature. Because the values of real properties located in urbanized areas are usually much higher, local government budgets lose a lot on this arrangement. In this particular example, an increase in the value of a real property will not translate into a higher level of taxation. The same tax will be paid on two pieces of land worth 10,000 zlotys and 100,000 zlotys respectively, which – considering the current rising tendencies in real property prices – encourages people to acquire and hold real properties for speculation purposes.

However, this area-based real property taxation system is approved of by taxpayers. A simple dependence between the area and the amount of tax results in the clarity of its structure. Another positive aspect is the fact that the determination and collection of this tax does not require a well-developed or specialist tax

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<sup>32</sup> Frequent changes in the said regulations result first of all from the necessity to correct on a current basis badly functioning solutions and from the excessive degree of the reform's involvement in the political life. Cf. [Ruśkowski 1995].

collection machinery. The collection of taxes is simple and does not require costly mechanisms of real property appraisal and valorisation characteristic of cadastral systems. Nevertheless, the current real property taxation system is also characterized by numerous weaknesses. Its major disadvantage is the structure of the taxable base where the amount of tax is determined by the area of a real property. This influences first of all the amount of revenues acquired by communes from real property taxation, which constitutes their major source of cash [Etel 2003, p. 22]. Furthermore, Poland's real property taxation system is not consistent with solutions applied in other EU countries and has been criticized by EU experts, who ascertained the necessity of its reform [Konieczny 1996].

Will this form of real property taxation turn out to be effective in Poland? The answer to this question is not unambiguous. It will definitely be a more equitable form of taxation as taxes are to be paid in proportion to the value of a real property, i.e. they will be the least burdensome to people with small properties. Let us use an example. There are two flats – one in Warsaw, with an area of 50 m<sup>2</sup> and a market value of 400,000 zlotys; the other – with the same area – located in Opole and worth 250,000 zlotys. To simplify, let us assume that both communes use the same real property tax rate for 1 m<sup>2</sup> of a flat's area, i.e. 67 groszy. At present taxes paid by an inhabitant of Warsaw and an inhabitant of Opole are the same and equal 33.50 zlotys. However, if the cadastral tax were introduced, assuming that the tax were paid at the rate of 0.1% of a flat's value, an inhabitant of Warsaw would pay 400 zlotys a year, while an inhabitant of Opole – 250 zlotys. One can see a clear differentiation in the amounts of tax charges, depending on the value of a real property – the richer will pay more.

Another issue is that equitable does not mean less. In fact, in the case of this solution, all taxpayers will pay more and, paradoxically, those less fortunate will suffer the most. And this is the point where we touch the core of the problem. The example above may be also used as an argument against an *ad valorem* taxation system. One can frequently hear statements according to which Polish society is still too poor to afford such a tax.

Thus, what conditions would the cadastral tax have to fulfil to mitigate reasonably the least acceptable consequences of its implementation and simultaneously to preserve its essence and economic advantages? The consequences of the implementation of the cadastral tax in Poland will depend, to a considerable extent, on its final form which undoubtedly will be influenced by the amount of the tax, the tax base, the differentiation of tax rates for particular types of real properties, e.g. housing premises, premises for rent, business premises. The amount of the tax will be determined by the factors influencing the value of real properties such as a location, technical standard, access to the infrastructure and municipal services, etc. Undoubtedly, the owners of expensive and attractively located properties will pay much higher taxes, but in view of the fact that communes' income is spent on

public purposes related to infrastructure, education or culture, they – as inhabitants of their communes – will benefit the most.

The real property taxation system will be certainly ordered (assuming that tax rates are reasonable) and the security of transactions on the real property market will be improved. The cadastral tax will discourage people from speculative purchases of real properties, which at present contribute to the fast increase in their prices. The implementation of this tax will be advantageous for the finances of local governments and for the real property market. It is a good idea to tax property instead of income streams. It makes the taxpayer pay attention to the more effective use of his property. Empty flats and building plots will disappear. If an undeveloped plot of land costs money, it will make no economic sense for the owner to hold it; he will sell it to somebody who will know how to use it effectively. This will surely improve the management of land and housing resources, causing a boom on the property market. Furthermore, the proposed changes will be beneficial for property appraisers who will be working on the development of the cadastre.

However, as of today there is no uniform concept of cadastral tax in Poland. It is not clear what its rate is to be, who and how is to appraise real properties for taxation purposes or what to do with taxpayers who have very low income and simultaneously own properties of considerable value. If the cadastral tax were implemented without any protective activities, many low-income taxpayers owning attractively located properties – for which they have worked for many years or sometimes all their lives – would have serious problems with allocating a few hundred zlotys each year to pay the *ad valorem* property tax. One could say that a possible solution is to sell an expensive flat and move to a less attractively located place. But will such a solution, resulting *de facto* in expropriation, be really equitable? Naturally, similar situations will take place, but they can and should be prevented, e.g. by the introduction of a system of tax shields for taxpayers with the lowest income. Also other instruments can be used for this purpose, e.g. a minimum value exempt from taxation, a tax credit (consisting in postponing the payment of the tax until a real property is sold) or a periodic tax exemption for people using the housing benefits system. In this respect, a certain solution could be to recognize the cadastral tax as a mortgage on a real property; consequently the tax will be paid by the new owner. Similar solutions are used successfully in France.<sup>33</sup> Obviously, it is necessary to develop detailed criteria concerning who could take advantage of such privileges and to specify the maximum amount of the tax that could be turned into a mortgage, e.g. not more than 10% of a real property's value. Another solution could be reliefs in cadastral tax depending on a taxpayer's current income; they would have to be granted under clearly specified criteria.

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<sup>33</sup> In France, poor people may apply for an exemption from the current cadastral tax which becomes a mortgage to be paid by a real property's future buyer.

## 5. Conclusions

The positive experiences of many European countries supported by the postulates of the doctrine confirm that *ad valorem* taxes are much better than area-based taxes in the execution of the tasks expected of an efficient real property taxation system. The implementation of a cadastral system, which should be the final effect of a reform of Poland's real property taxation system, may generate a number of both fiscal and non-fiscal benefits in the longer term.

The major fiscal effects include the following: the strengthening of local governments' financial standing, a more equitable distribution of tax charges, the simplification and greater transparency of local governments' finances. The restructuring of the real property taxation system in Poland should be perceived not only as the rationalization of the badly functioning subsystem of local government taxes but first of all as an extremely important element in the reform of the whole system of local government finances [Ruśkowski 2001, p. 18].

The implementation of an *ad valorem* real property tax can be expected to cause a considerable improvement in the structure of public finances due to the creation of a stable and efficient source of local governments' income coming from taxes with a dynamic, market-oriented base [Brzeski, Frenzen 1999]. The sealing of the real property registration system will contribute also to an increase in revenues for local government budgets and a reduction in the scope of the gray market. Similar consequences for local government budgets will be generated undoubtedly by a verification of the currently effective catalogue of reliefs and exemptions. The application of a modern and integrated cadastre using modern IT technologies will allow a more efficient transfer of collected data and improve the functioning of local tax administration units thanks to which the effectiveness of the collection and enforcement of taxes will increase.

At the same time, the non-fiscal effects of a real property taxation system reform include the following: an improvement in the economic effectiveness of using real properties and a stimulation of rational transformations in the spatial structure of Polish towns and cities, the development of the real property market, an acceleration in the privatization of municipal properties and a strengthening in the system of direct local democracy [Wójtowicz 2007, p. 11].

The *ad valorem* property tax will surely become an instrument stimulating the development of the real property market, and such development may have a favourable influence on changes in the spatial structure of towns and cities. The tax based on the value of real properties will stimulate their more effective management and use, consistent with signals coming from the market. This will cause the development of policies favouring well-thought out investments and will force property owners to make rational decisions concerning held land or buildings, among others, with respect to rental, sale, exchange or division of real properties. This will cause greater mobility on the market and a more effective use of housing resources. It will also

limit the holding of plots of land with access to the utilities for speculation purposes. Furthermore, the cadastral tax will contribute to acceleration in the privatization of communal properties and their better management. The social and political aspects of changes in the real property taxation system in Poland are very important as well. The cadastral tax will facilitate the strengthening of local democracy and the development of self-government. This will be caused by a greater transparency of the *ad valorem* taxation system and the enhanced awareness of local communities that additional investments in their communes are possible thanks to taxes that are fiscally efficient and paid by everybody according to clearly specified criteria.

Undoubtedly, the reform's success will depend to a considerable degree on the public's (taxpayers') approval of changes in the current system. But before they are accepted, they have to become familiar and understood. A taxpayer should know what he or she pays for and understand what he gets in return. Therefore, it is extremely important to inform and educate the public as well as to train local government employees who in the future will be dealing with the determination of *ad valorem* property taxes.

Transition from the area-based real property taxation system to an *ad valorem* taxation system is a matter of time only – there are no doubts about that. The question remains: when will it happen? The experience of many countries, including those belonging to the European Union, indicates that the real property taxation reform initiated and currently under implementation in Poland is moving in the right direction. Naturally, it is a complicated and long-term process which comes across many hindrances related, for example, to the necessity of incurring huge costs in the implementation of a real property register and transforming it into a cadastre, to a universal appraisal of real properties subject to taxation or to social costs generated by the introduction of the new system. However, all such problems can be overcome, which is exemplified by the countries that have built modern and effective cadastral systems. One should also remember that the real property system reform constitutes an opportunity for the creation of a stable base of local government finances (at the level of communes and possibly districts), the initiation of normal market mechanisms in the real property market and an improvement in the local governments' investment climate.

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## DETERMINANTY WDRAŻANIA OPODATKOWANIA WARTOŚCI NIERUCHOMOŚCI W POLSCE

**Streszczenie:** Od połowy lat dziewięćdziesiątych zwraca się uwagę na konieczność przeprowadzenia kompleksowej reformy systemu opodatkowania nieruchomości w Polsce. Istotą proponowanych zmian jest odejście od powierzchniowego modelu opodatkowania nieruchomości na rzecz systemu katastralnego, w którym wysokość podatku zależy od wartości nieruchomości wynikającej z katastru. Nowa formuła podatku od nieruchomości służyć ma przede wszystkim wzmocnieniu i stabilizacji finansów samorządowych. Doświadczenia większości krajów należących do Unii Europejskiej wskazują, że rozpoczęta w Polsce reforma zmierza we właściwym kierunku – sprzyja poprawie efektywności systemu opodatkowania nieruchomości i pozostaje w zgodzie z podobnymi rozwiązaniami funkcjonującymi od lat w Europie i na świecie. Celem opracowania jest próba przeanalizowania argumentów „za” i „przeciw” dotyczących wprowadzenia opodatkowania *ad valorem* oraz omówienie podstawowych założeń reformy, z uwzględnieniem korzyści fiskalnych i pozafiskalnych dla finansów i gospodarki samorządu terytorialnego.

**Słowa kluczowe:** samorząd terytorialny, dochody gmin, system opodatkowania nieruchomości, kataster, podatek katastralny.