

Forming the Immovable Property Taxation System for Individuals



Vasiliy Igonin, Natalia Grigorievna Bondarenko, Tatiana Alexandrovna Shebzuhova, Elena Vladimirovna Bokareva, Ruslan Muradovich Allaliev, Elman Said-Mokhammadovich Akhyadov

Abstract: *The goal of the article is to consider and deepen the theoretical methodological foundations of the immovable property taxation for individuals. The following research methods were applied to achieve the goal: systemic method, abstraction method, and logical generalization method.*

The theoretical approaches to the taxation of immovable property have been used in the article, and the principles of forming the immovable property taxation system for individuals have been defined. Property taxation systems have been systematized based on the analysis of scientific literature and an expert survey, according to the following criteria: aggregate cost taxation, inheritance and gift taxation, capital gains taxation, and taxation of certain property types. The global property taxation systems have been summarized and classified according to the method for the tax base definition method, their advantages and disadvantages have been noted. The international experience of immovable property taxation based on the market, rental, cadastral, regulatory value, and property area has been considered.

Keywords: *immovable property, individual, property tax, relief, tax rate.*

I. INTRODUCTION

Immovable property as an object of taxation is one of the most difficult phenomena for research. Different approaches were applied to the immovable property taxation at different times, which provided for both separate taxation of land and immovable property other than a land plot and aggregate

property taxation. It is believed that immovable property can be a perfect object of taxation in terms of administration and implementation of the fiscal function of the tax, since such an object is difficult to hide [1], [2]. However, the use of combinations of various tax benefits and exceptions, special tax regimes, and manipulations with evaluation of objects of taxation debunk such ideas.

II. LITERATURE REVIEW

The traditional approach to the issue of the immovable property taxation was formulated in the writings of D. Netzer and H. Simon, according to which land owners and tenants should pay tax on immovable property (including land) [3], [4]. Followers of this theory argue that taxation of land used for housing is regressive in nature. That is why it is justified to introduce a separate tax on immovable property other than land. It must be noted that proponents of this theory did not investigate the relationship between taxation of immovable property and the volume of financing public services. Such a relationship at the present stage of economic development must be considered, since taxes on immovable property mainly proceed to local budgets and therefore should be allocated for financing the needs of society.

Further development of the immovable property taxation theories is also associated with an alternative approach – one of their representatives, W. Fischel [5], argued that the financing of public goods and services by local governments should be connected with the level of the immovable property taxation.

The public choice theory has become popular in the last quarter of the 20th century, which affected the research on the nature of the immovable property taxation. In particular, D. Coates, J. Edwards, and G. Keen [3] emphasized the need to study the relationship between the immovable property taxation and the process of financing the provision of public goods and services in their writings. They argued reasonably that it was inadvisable and incorrect to investigate the processes of the immovable property taxation in isolation, since taxes on immovable property were direct taxes by their nature, the burden of their payment being borne by the owner (less often the tenant) living in the relevant territory and able to evaluate the efficiency of using the taxes paid on immovable property by local government. This aspect affected both the behavior of the taxpayer (potential voter) and the behavior of the local government (groups of politicians willing to attain the voters' commitment).

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The dominant trends of the 21st century include approaches to the immovable property taxation based on viewing the immovable property as accumulated wealth. In conditions of high risk of tax evasion, taxation of immovable property is one of the ways to tax income previously hidden from taxation.

This approach can be found in the writings of E. Slack, R. Bird [6], and A. Dornfest [7]. According to the researchers, investing in the immovable property is one of the stages to legalize funds (consolidation), and the sale of such immovable property subsequently becomes an official source of funds. In this situation, taxation of immovable property is a kind of sanction for previously unpaid income tax on individuals, and its size may be a factor constraining the acquisition of immovable property for the purpose of funds legalization.

As such, the theoretical approaches to the immovable property taxation of individuals are systematized as follows (Table I).

Table – I: Theoretical approaches to the immovable property taxation of individuals

Approach	Representatives	Features
Traditional	D. Netzer and H. Simon	Land tax and tax on the immovable property other than land should be separated
Alternative	W. Fischel	Any immovable property can be taxed, but the application of reliefs and exceptions is justified, since property taxes are not neutral
Public choice	D. Coates, J. Edwards and M. Keen	Any immovable property can be taxed, but there should be a connection between the taxes paid and the size of the public goods financing
Reinstitution of the taxation fairness	E. Slack, R. Bird [4], and A. Dornfest	Any property can be taxed, the main argument being the accumulated wealth that could have been accumulated from income from which taxes were not paid

The hypothesis of the research is that the immovable property tax in developed countries plays a significant role in the social area, since it allows to significantly increase budget revenues at the expense of wealthy segments of the population and thereby balance social interests.

III. PROPOSED METHODOLOGY

A. General Description

The following methods were applied to solve this goal: a systemic method in the study of the immovable property taxation system as a whole; an abstraction method upon the discovery of the relationship between the immovable property taxation and economic development; and a logical generalization method in formulating conclusions.

The writings of Russian and foreign scientists and peer-reviewed publications in scientific journals were used as the source of data.

An expert survey method was also used in the study to analyze the specifics of the immovable property taxation of individuals.

Twenty eight experts became participants in the online expert survey, of which 18 were tax officials and ten were university employees, lecturers at the Department of Tax and Taxation.

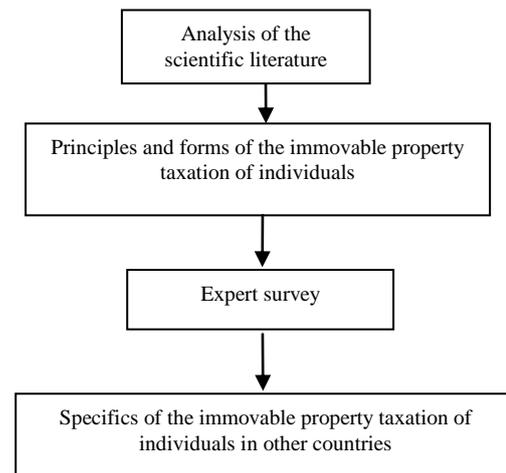
The experts were asked a number of questions regarding the specifics of the immovable property taxation of individuals.

B. Algorithm

The scientific literature on the problem of the immovable property taxation of individuals was analyzed at the first stage of the study.

An expert survey was conducted at the second stage of the study, regarding the specifics of the immovable property taxation of individuals – in particular, in other countries.

C. Flow Chart



IV. RESULT ANALYSIS

A. Findings

The analysis of the scientific literature [8], [9], [10] revealed that the immovable property taxation of individuals should be based on the principles of solvency (this justifies the expediency of a nontaxable minimum area of the immovable property other than a land plot), fairness and equality of taxation of similar immovable property at the same rates and different immovable property at differentiated rates), neutrality, economic efficiency, and fiscal expediency.

However, some interviewed experts believe that the interpretation of the solvency principle is controversial, since immovable property is a form of materialized income. Accordingly, the payment of tax on immovable property is directly connected with the taxable item. Therefore, some experts indicate that it refers to the principle of social justice rather than solvency in terms of applying the minimum nontaxable area.

Some experts believe that the interpretation of the principles of justice and equality is controversial, as they agree with the approach to maintaining social justice but emphasize that "absolute equality in taxation can be ensured only in the absence of reliefs and exceptions, and this contradicts the solvency principle" (Vladimir N., the Federal Tax Service official).

The set of principles for the formation of the immovable property taxation system for individuals can be summarized as follows, depending on the number of references and significance (rank) (Table II).

Table – II: Principles for the formation of the immovable property taxation system for individuals

Principle	Number of references, %	Rank	Meaning in the context of the immovable property taxation of individuals
Universality of taxation	100%	1	All property owners must pay the tax on immovable property
Fiscal sufficiency	89%	2	The size of the immovable property taxation should be established with due consideration for the need to fund the expenses of local budgets, since the immovable property tax should be a local tax
Social justice	78.5	3	The size of the property taxation should consider the solvency of the taxpayer and the value of the immovable property. This will allow to prevent tax evasion.
Cost-effectiveness	75%	4	The mechanism for calculating and paying the tax on immovable property should ensure the target revenues from this tax to the budget, but the costs of its collection should not be burdensome for administration
Uniformity and ease of payment	71%	5	The specifics of the immovable property taxation make it expedient to establish the timing for the payment of this tax as once or twice a year

Compiled by the authors based on the expert survey

The analysis of scientific literature [11], [12], [13] and the results of the expert survey has revealed several basic approaches used for the application of taxes on the immovable property of individuals in the world practice:

- taxes on certain property types – in this case, a taxpayer and the type of tax are determined for a particular type of immovable property. This can also include the tax on immovable property as an element of luxury or wealth, the main idea of which is taxation of excess value, which has nothing to do with ensuring normal conditions of life for the taxpayer;
- a net property tax applicable to the total amount of assets owned by the taxpayer. This tax is most effective in taxing commercial and industrial property;
- capital gains tax is a tax on income from the sale of assets owned by the taxpayer. Such income can be taxed both as part of income tax or by applying an independent type of payment;
- taxes on the transfer of the property ownership are applied to individuals who acquire ownership of the property through inheritance or gifts. There is a progressive taxation scale for such payers, which differentiates depending on family ties;

The result of the classification of immovable property for tax purposes is presented in Table III.

Table – III: Forms of the immovable property taxation of individuals

Specifics of the formation of the taxation item	Type of the taxable immovable property
Aggregate cost taxation	Personal immovable property of individuals
Inheritance and gift taxation	Immovable property transferred to an individual as a gift or inherited
Capital gains taxation	Profit from the sale of immovable property of individuals
Taxation of certain types of	Undeveloped land plots

immovable property	Land plots with buildings
	Buildings and constructions
	Taxation of the immovable property as a luxury item

Compiled by the authors based on the expert survey

According to the experts, the forms of the immovable property taxation presented in Table III are valid in most countries. Their functioning has its own specifics that depend not only on the country of use, but also on its economic nature.

B. Discussion

The experts note that levying special taxes on immovable property (inheritance, capital gains) is primarily due to the need to fill local budgets, and secondly to use their regulatory effects (decrease in speculative transactions in the real estate market, prevention of tax evasion for individuals, etc.). The experts say that different countries use different tools to implement this idea – from special rules for taxing the income from the immovable property ownership to the introduction of individual taxes.

The capital gains tax is levied in Denmark, Ireland, Portugal, Switzerland, and France (the tax is levied on the difference between the selling price and the buying price). A special tax in the case of the sale of the immovable property is levied in Germany, Japan, Spain, Austria, Belgium, and Greece (the tax is set on the selling price) [14]. The inheritance taxation exists in various forms in almost any country. Inheritance may be subject to a separate tax, as part of other taxes (personal income tax), duties, and fees upon registration of the inheritance.

The experts note that the mechanism of the immovable property taxation in the world is constantly improving in the course of its development. This process was made possible due to the long evolution of the real estate taxation, which resulted in the formation of a perfect mechanism for the implementation of the fiscal function of taxes on immovable property. Further development of the immovable property taxation is associated with the implementation of its regulatory properties. According to professor Nikolai M., "the implementation of the regulatory properties of taxes on immovable property is ensured not only by manipulating the tax rates and reliefs, but also by choosing the procedure for evaluating the tax base."

For example, a land plot and everything that is on it (buildings, structures, etc.) are considered in unity as a taxable object in the UK and the US. However, in the process of evaluating the immovable property for its respective physical components (land, buildings, and structures), the taxation value is found separately for land and for constructions. This differentiated approach in the UK has helped to prevent accelerated urbanization of agricultural land. The increased tax burden on buildings and structures for land property, as well as tax reliefs for agricultural land contribute to the preservation of the land plot in kind, even if the plot is in the zone of active urban development [15].



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According to the experts participating in the survey, the methodological approaches to the immovable property taxation of individuals existing in the world tax systems indicate their significant differences related to the level of economic development of the country, state structure, specifics of the state tax system, and the mentality of citizens.

However, summarizing the global systems of the immovable property taxation according to the method for establishing the tax base, the experts divide them into two groups: value-based property tax systems and area-based property tax systems. Value-based taxation of the immovable property requires its identification and evaluation.

The current world practice of the immovable property taxation indicates that a tax based on the market value of the property or part thereof, the so-called ad valorem tax, is characteristic of countries with a highly developed economy. The OECD member states (the US, Canada, and Japan) are typical representatives of this group. Taxation of immovable property in these countries has reached a high level of administration through the development and use of a fiscal immovable property cadastre, combining information about land plots and real estate located on them, as well as the introduction of an automated system of mass property evaluation for a fair and effective evaluation of a group of real estate related to a certain jurisdiction for calculating the property tax. The method of mass evaluation for tax purposes is a complex model, which takes a large number of factors into account (economic, social, demographic, legal, administrative, environmental, etc.).

Due to the use of mechanisms for mass evaluation of immovable property, a taxation system is in place in the US whereby the market value of the property is annually revised, and the tax rate is changed accordingly. This allows to make the immovable property taxation as fair as possible from the standpoint of the objective distribution of the tax burden in the context of constant transformations in the real estate market and in the economy of the country as a whole.

City municipal councils set the tax rate that would allow the city to collect no more than the amount it needs to fulfill its financial obligations. In case of changes in budgetary needs, the city council adjusts the tax rate when preparing the city budget for the next year. This method of calculating the tax rate ensures transparency of the entire process of the immovable property taxation, which is associated with specific city social events and their cost, and creates an opportunity for taxpayers to control it.

According to the experts, local authorities can classify the immovable property by its use. As a rule, this classification is carried out in two directions:

- the establishment of special coefficients for each property class, which specify the tax base; and
- the establishment of various tax rates that correspond to a certain property class.

The application of different tax rates for each class of the immovable property is practiced almost everywhere in the US.

A system based on the rental value of the immovable property has been widely spread in the global tax systems. It is used in some countries of Europe, Asia, and Africa: in the UK (nonresidential real estate), Spain, France (d'habitation tax),

India, Thailand, and Tunisia. The difference of this system from the previous one is that the base is not the full value of the property, but its rental value, i.e., the value that could potentially be received by the property owner from renting it. In this case, the tax rate is slightly higher than when using the cost value as a tax base. The use of the rent as a tax base is a consequence of the historical development of the state (Great Britain or its former colonies, where the land and everything that is on it belongs to the monarch) or depends on the specifics of the formation of the state cadastre, where its rental value reflects the price characteristic of the property (Spain, Portugal, and Greece) [16].

A property-based taxation system based on the annual cost of rent has raised many objections in recent years due to the complex process of determining rental value and administering tax. The experts distinguish the following negative features:

firstly, the cost of rent is difficult to evaluate, since there is insufficient information on the annual cost of rent for unique commercial real estate properties, whereas a generally accepted method is used in the case of evaluation;

secondly, it is difficult to calculate the rent for a group of real estate objects using the method of mass evaluation, since the distribution of costs for its maintenance is subjective and is decided between the parties to lease relations: the lessee and the lessor; and

thirdly, the experts do not have access to information on rental income in most cases, since information on such income is not always publicly available.

As a result, there is a transition from the rental-based tax base to the value of real estate (the UK, Portugal, and Indonesia) in some countries. The availability of information on rents or real estate sales prices is the key factor in choosing between the market value and the annual rental price as a tax base. For example, the d'habitation tax (housing tax) in France is levied only on immovable property that is officially on lease and is paid by a person, who is its user as of January 1.

Despite the shortcomings indicated by experts, this immovable property taxation system is being reformed, which allows finding more efficient tools for administering property taxes. Such tools include zoning of the city territory for setting the appropriate rental price.

The cadastral value as a tax base is mainly used in the developed European countries, including France (fonciere tax), Germany, and Sweden [14]. The immovable property taxation system in these countries is distinguished by the fact that the property value is written in the state cadastre, which is noted by detailed procedures for keeping records of immovable property, high accuracy of determining land ownership boundaries, and guarantees of registered rights. According to the experts, a distinctive feature of the group of countries where market value is used as a tax base is that the collection of information, analysis and evaluation of property are carried out by the state cadastral authority, which has offices throughout the country, while various institutions (registration, appraisal, and insurance companies) deal with these issues in the first group.

However, the value is revised every three to five years in a group of European countries.

Unlike a value-based property taxation system, an area-based taxation system does not require the evaluation of taxable items. Such taxation is most often used in developing countries (countries of Central and Eastern Europe, Latin America, and Africa).

According to the experts, the reason for using this system usually lies with the insufficient development of the real estate cadastre or a unified register of real estate rights, as well as the low level of development of the real estate market, which is manifested in a high number of shadow sale and lease transactions. This makes it impossible to obtain objective information for the application of valuation mechanisms in determining the tax base for the tax on immovable property [17]. Taxation of immovable property in the CIS countries has some specifics as well. As a rule, the immovable property of individuals is taxed using different methods of calculating the tax base. The tax base for the immovable property owners in each country has its own special calculation mechanism: the inventory value is used as the tax base in Belarus, Azerbaijan, Uzbekistan, and Kazakhstan, the cadastral value is used in Russia, Moldova, and Armenia, and the market value is used in Georgia. At the same time, special clarifying factors are used in some countries when determining the tax base, which consider for the size of population and the type of settlement, the location of the property within the settlement, and its functional, qualitative, and physical characteristics. Tax rates are also differentiated in some countries. For example, they differentiate depending on the set value of real estate in Russia, Kazakhstan, Moldova, and Armenia: the higher is the value, the higher is the tax rate.

V. CONCLUSION

The results of the study have confirmed the hypothesis that the immovable property tax in developed countries plays a significant role in the social area, since it allows to significantly increase budget revenues at the expense of wealthy segments of the population and thereby balance social interests.

Taking in consideration the above, it can be argued that a market value-based property taxation system is inherent in countries with developed market economies and requires considering a wide range of factors, including the existence of the established real estate cadastre, the existing system of mass real estate evaluation, the existence of a mechanism for pre-trial consideration of taxpayer complaints against the evaluation of tax obligations, and the necessary level of solvency and tax discipline of citizens.

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