

REAL ESTATE TAXATION SYSTEM IN ALBANIA AND CHALLENGES FOR A EUROPEAN FISCAL SYSTEM

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Abstract

The fiscal system is the main source of income for the government to fulfill its functions. Taxation has a significant impact on the economic development of a country, contributing on employment, public policies, welfare of citizens etc. European countries are still trying to overcome the problems caused by the financial crisis, by using mechanisms with the least possible negative social impact. The Albanian policymakers and economic researchers should understand and adapt these new opportunities, where the harmonization of the central and local government is a crucial requirement.

The taxation of property is still facing several problems, such as: the formalization of the real estate, institutional cooperation, the determination of the taxable amount, the levying process, the role of tax's agent, legal and institutional regulations etc. This article aims to modestly contribute to the improvement of the property taxation system as an opportunity to increase revenues of the local government budget. Therefore we will discuss the problems faced by the property tax system from the transition economies point of view and comparing to the developments in the Eastern the Western countries of Europe.

Keywords: property tax, local government, tax base, buildings, agricultural land, public policy.

JEL Classification:H710, H7, H2, R22, Q15, G380

Introduction

The taxation of property is not a new element of the fiscal system, but it is a concept closely related to the concept of state and the execution of its functions. The 25 years of transition in the Albanian economy are associated with legal problems of the property alteration and the role of state in a market economy. The process of economic decentralization and the recognition of property started after the '90s. Several public enterprises were privatized, but this process was not accompanied with the legal transfer of ownership as no ownership certificates were distributed to the final owners of the property.

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This phenomenon led to the illegal fragmentation of property, especially in the urban and coastal areas. The process was characterized by informal financial transactions done mainly on cash basis, and the offices of property registration was not involved in the transfer of ownership. Consequently no benefits were received by the state budget. Even though this process started in the first years of the open market economy, these properties are still informally rented, excluding the application of the tax on rental income.

Despite of the efforts made for the registration of the real estates, neither the local government nor any agencies have a complete database or register of real estate due to the urban informality which has accompanied the process of legalization. Almost all of the country's territory is in the process of urban planning. For purposes of this process, the first step is to assess the current situation, which will serve as the basis for the decision-making and improvement of the situation. The acceleration of this process with the participation of the community, the registration of all the existing real estate, the check of the data accuracy and information exchange between all stakeholders (the local government, registration offices, tax authorities, urban development offices etc.) require accurate and immediate actions and the separation of responsibilities among actors as well.

1. Property tax base in Albania and its evaluation methods (brief comparison with European countries)

The evolution of the legal package in our country in line with the social-political development has brought continuous changes on the Law " On immovable property taxes in the Republic of Albania". After the '90s, the economic decentralization was accompanied by the first fiscal package with five important laws in the field of fiscal legislation. The objective of this session of the paper is the identification and analysis of the legal reforms on the immovable property (real estate) tax in Albania.

The deep reformation of the law on real estate tax after the change of the political and economic system has started in 1994 as a consequence of the development of the tax reform in the Republic of Albania. The first law on the property tax is the Law no. 7805 dated 16.03.1994 "On property tax in the Republic of Albania", which stipulated the two types of this tax: (I) the tax on buildings and (II) the tax on agricultural land. The implementation of the law started in 1995 and the Ministry of Finance was the responsible authority for the tax revenue forecasts and for the distribution of tax sources to the central government (40%) and the local government (60%). For the first time after the '90s, the tax was defined in Albanian Lek (ALL) per m² of the construction area. For real estate tax purposes, constructions were classified in five categories, where the most important ones were: buildings for commercial activities (100-200 ALL/ m² per year), residential buildings (6-30 ALL/m² per year), public buildings (2 ALL/m² per year).

In 1998, the administration of the property tax revenue was completely transferred to the local government units, while the former electricity enterprises continued to play the role of the agent and benefited 5% of the income collected. The Law 8982 dated 12.12.2002 "On the local tax system", classified the property tax as local tax and the local government units were given four years in order to prepare the accurate administration and infrastructure to manage this tax. In the Law No. 9632 dated 30.10.2006 "On the local tax system" (article 9, paragraph 2 - Types of taxes), the property tax is determined as local tax classified in two types: (I) tax on buildings and (II) tax on agricultural land, both taxes were subject to the above law.

Subjects of taxation are all physical and legal persons, domestic or foreign, owners or users of real estate in Albania. Taxes are calculated as annual obligation of taxpayers. The changes of the law amended in the law No. 10117 dated 23.04.2009, determined the minimum categories of the tax base and the levels of tax indicators for each category for the tax on buildings and agricultural land (table no. 1). The real estate tax is currently levied on the area of the property (m² and hectare). The tax base on buildings is levied based on the building area or its integral parts measured in m², while the tax on agricultural land is set on the land area measured in hectare. Taxes are calculated and paid on annual basis and revenues from this source are 100% managed by the local government units.

Table no. 1 Minimum reference levels of tax on buildings for municipalities

Building categories	Zone I	Zone II	Zone III
	ALL /m ²	ALL /m ²	ALL /m ²
I. Residential buildings			
- Constructed before 1993	15	10	5
- Constructed during and after 1993	30	12	6
II. Other buildings			
- For commercial activity and services	200	150	100
- Others	50	30	20

Source: Local revenues Manual, 2011

Notes:

(1) Zone I: Municipalities of Tirana and Durres. Zone II: Municipalities of Vlore, Fier, Saranda, Pogradec, Korce, Elbasan, Berat, Lushnja, Gjirokastra, Shkodra, Lezha and Kavaja . Zone III: All other municipalities (around 52 other municipalities).

(2) In rural areas (communes), the minimum level of tax for each building category is half the level of the corresponding minimum indicator of the tax set in the municipalities where the commune is located.

Despite the improvement of the legislative framework on tax administration, the real estate tax contribution in the budget remains in low levels compared to the contribution of the total tax revenues in the budget and GDP. Local government revenues account for about 4.5% of the tax revenues or 4% of the budgeted revenues. Referring to the year 2013, 59% of local government revenue derived from the income tax on small business, 23% from local taxes and the rest of 18% from the property tax (buildings).

Considering all the above analysis, we can conclude that:

- Real estate tax revenues are in very low levels.
- The tax base on real estate categories is very low, especially the tax base set on agriculture land.
- The administration process of the real estate tax remains critical. It is evaluated that this tax is not collected more than 40%.

Based on these considerations, in the context of drafting the 2014 budget after the economic crisis and the need for additional financial sources, several changes were made in the building tax base.

The new Law no. 181/2013 dated 28.12.2013 "On some amendments to the Law No. 9632 dated 30.10.2006 "On the local tax system ", changed" determined the reference levels of property tax on buildings as represented (table no. 2) below:

Table no. 2 Minimum reference levels of tax on buildings for municipalities

Building categories	Zone I	Zone II	Zone III
	ALL /m2	ALL /m2	ALL /m2
I. Residential buildings			
- Constructed before 1993	15	10	5
- Constructed during and after 1993	30	12	6
II. Other buildings			
- For commercial activity and services	400	300	200
- Others	100	60	40
III. Owned buildings or buildings in use, in territories approved as touristic villages	400	400	400

Source: Law nr 181/2013, dated 28.12.2013

Notes:

(1) Zone I: Municipalities of Tirana and Durres. Zone II: Municipalities of Vlore, Fier, Saranda, Pogradec, Korce, Elbasan, Berat, Lushnja, Gjirokastra, Shkodra, Lezha and Kavaja. Zone III: All other municipalities.

The reference tax levels are valid for buildings in urban areas (municipalities), as well as buildings in all areas (urban and rural) of Section III of the table "Owned buildings or buildings in use, in territories approved as touristic villages".

(2) In rural areas (communes), the minimum level of tax for each building category is half the level of the corresponding minimum indicator of the tax set in the municipalities where the commune is located.

(3) For buildings owned by construction companies, which are intended for sale, but that are still unsold, the tax will be set based on destination of use of the building.

- Mortgaged residential apartments will be subject to tax on buildings under the category "Residential buildings".

- Mortgaged buildings for commercial activity will be subject tax on buildings under the category "Other buildings for commercial activity and services".

By comparing the above situation of the fiscal system in Albania with other European countries, we can conclude that:

- In most countries of the region but also in countries of the European Union, real estate includes buildings, land and agricultural land.
- The real estate tax base is set on the market value of real estate, which is considered fair, effective and efficient, more accountable and with on society and the realization of revenue.
- The change from the tax based on the physical features of property to the tax base based on the market value is result of a long historical process and is conducted through several steps that should be taken into account in the developments in Albania.

2. Suggestions for increasing the effectiveness of the real estate taxation system in Albania

The above methods of real estate taxation are recommended to be used in the future in Albania as well. This is a necessity dictated by many factors, and above all by the process of integration of our country into the European Union.

The problem of transfer of real estate taxation from the current system to the taxation of value has a series of problems among which the tax base is the most significant. Will the value of the tax base be linked to the value of the capital market or the physical characteristics of the property? If the real estate markets are fairly consolidated, this is a strong reason to link the taxable values with market values. But if the real estate markets are not complete and are not reasonably well functioning, the best approach is to connect the taxable value (tax base) with the characteristics of the property, such as size and location, etc. In Albania the real estate tax base is the land and buildings (land and improvements). The tax value is determined by multiplying the surface with the tax per m² in the case of buildings or hectares in the case of land. Taxpayers are all physic and legal persons who own such properties.

The tax is not uniform across the country, but it is divided into three levels according to the law. Exemptions from this tax are stipulated into Law no. 9632 dated 30.10.2006, Article 22 Paragraph 4, which states that "the state-owned and local governance units properties used for nonprofit purposes, residential buildings used for non-liberalized rent, buildings used by religious communities are exempt from the tax". Item 6 of this Article stipulates other exemptions from tax payment, which are foreseen in separate laws (work invalids, Albanian veterans of the war against enemy, blind, paraplegic and quadriplegic people).

As seen in Albania and the adoption Law No. 181/2013 dated 28.12.2013 "On some amendments to Law No. 9632 dated 30.10.2006", "On local tax system" value of the tax base is not linked to the value the real estate market but the physical property characterized as area in square meters or in hectares and location. Sometimes the increase in value of real estate is the result of land-use decisions taken by local government, such as granting development rights on land that was formerly agricultural land. In other cases, the value increase is simply a result of population growth. The concept of "the increased value size" is that local governments should be able to define a part of the growth of value of private real estate, to influence them to pay for public services brought as a result of the enhanced . Such a situation makes it necessary to shift from taxes based on physical characteristics such as surface, into the tax based on the value of the real estate market. After this change citizens would expect to see the impact of taxes that they pay for a better infrastructure, improved services and other social improvements in the community. When this is done and they see improvement in their lives, they are more willing to pay taxes and support local officials.

The long-term success of real estate tax will depend largely on the public perception that tax is fair and that the revenue collected from taxes is resulting in improvements to infrastructure and local services. Another potentially important attribute of real estate tax is that, when designed appropriately, revenues tend to increase as the local economy grows (Gjika and Shutina, 2003). If the tax base of the real estate is set on the value of the property, then standards on the valuation of both land and real estate should be determined for tax purposes. What standard should be used to determine the value (market value, the annual rental value, etc.)? To give answer to this question, several administrative issues should be considered:

- What skills and training will be required for staff in order to preserve the value of legally required levels?
- Which level of government and which agency should be responsible for maintaining accurate taxable values?

- Who will provide technical and financial resources to create and maintain acceptable assessment practices?
- Will the assessment practices be monitored and evaluated regularly in order to ensure the integrity and accuracy of the process? If so, by whom?

Part of the success of the system of real estate taxation is collection of the tax. Success requires political gathering, an administration capable and trained, correct application of the law, judicial support and sound administrative practices etc.

Administrative key issues in this area include the following:

- What agencies (institutions or entities) will be responsible for collecting the tax?
- How will tax bills be distributed?
- Where and how they will collect taxes? This is an important point because it affects compliance costs for taxpayers.
- What process will be used to handle complaints?
- What sanctions will be used in cases of non-payment of taxes?
- Will be supervision by other agencies or other levels of government?

Thoughts on the issues that have been raised above and dealing with efficiency in the collection of real estate taxes will be subject to a separate study.

Despite changes in the law approved recently for the way the taxation of real estate which constitute a novelty, yet the level of taxation of real estate is very low. If we compare the level of tax on buildings m² for buildings constructed after 1993 in Tirana with 30 ALL/m², i.e. a residential building with an area 100 m² paid 3,000 ALL per year, with fee-based the average market price of the buildings of these years is around 99,928 ALL/m² (authors' calculations).

Table no. 3 Data on the apartments market in city of Tirana, 2015

No.	Zone	ALL/m2 usable space	No.	Zone	ALL/m2 usable space	No.	Zone	ALL/m2 usable space
1	1/1	98,000	12	5/1	190,000	23	8/3	72,000
2	1/2	80,000	13	5/2	131,000	24	9/1	130,000
3	2/1	187,000	14	5/3	107,000	25	9/2	100,000
4	2/2	135,000	15	5/4	80,000	26	9/3	75,000
5	2/3	95,000	16	6	65,000	27	10/1	145,000
6	2/4	110,000	17	7/1	120,000	28	10/2	140,000
7	2/5	80,000	18	7/2	100,000	29	10/3	100,000
8	3/1	75,000	19	7/3	85,000	30	11/1	87,000
9	3/2	60,000	20	7/4	65,000	31	11/2	75,000
10	4/1	70,000	21	8/1	110,000	32	11/3	70,000
11	4/2	60,000	22	8/2	100,000			

Source: Manual No. 2, Council of Ministers, dated 6.8.2014

The fee 0.1% of the market value applied in most European countries, for the same area of the building value tax is 9,992.80 ALL, more than triple the value of the first, the indicator turns on a fee 0.03% (table nr. 3). In zone II and zone III this indicator reduced by you. In the region, this indicator is about 1% of the value of the building and in the EU countries even higher, so it is imperative to improve the management of real estate tax).

We think the process should be done in several steps:

I. The consolidation of the current system through the collection of taxes from all subjects. Increased inter-institutional cooperation to formalize real estate and creating a register of real estate tax and a land register for agricultural land.

II. Use of revenue from this tax on infrastructure and other public services by increasing transparency and its impact on awareness of the taxpayers it is going to improve services for them. The transition from the current system of taxation base on the surface, in the manner of taxation of real estate value as a modern way of managing real estate taxation, based on the experience of the European Union.

One point of view is that taxes related to a particular property should be commensurate with public services that are used by those who own the property. An alternative point of view is that more valuable properties tend to be controlled by people with higher income and greater capacity to pay taxes. Administrative expenditure monitoring system of real estate taxation is somewhat unclear. A study has suggested that the cost of administering the annual tax on immovable property shall not exceed four percent of the revenue collected (Gallagher, 2004). It is probably more important to adopt a method of sustainable for a particular context and monitor report time.

The effectiveness of a tax on land and property is measured by the increased revenues in sufficient levels to fund the target of public services.

For a system of real estate taxation in order to work properly, there must be a separation of administrative responsibility between the levels of government.

Conclusions

The management of real estate taxation is a significant problem that must be taken into account for the growth of local government revenue. This problem is of a special importance in the current economic developments, where the economic crisis is still present in our country and will serve as an opportunity though modestly to meet the needs of liquidity.

Taxes collected from real estate should be used for expenditure on infrastructure in the form of investment or expenditure for its maintenance as a sensitive element, linking better the taxes paid by the community to the benefits in return of this payment.

The modest changes made to the law on local tax system for some changes in rates of real estate tax for buildings are reasonable and without significant impacts on the tax burden to taxpaying entities.

The amount of revenues collected by local government authorities from real estate taxes is very low compared to the amount forecasted in the budget each year as well as the specific weight in GDP. There is a large fiscal evasion in the collection of real estate taxes from buildings of all types, but especially from residential buildings and also the agricultural

land tax. The efforts made by local government units in this regard so far have been low and often politically influenced.

The tax rate on residential buildings is currently very low and regular payment of them must be worth more to the effect of tax morality (awareness of the taxpayers) considering that 25 years have passed since the process of democratic change. The taxpaying should be seen as a necessity for the benefit of public services.

Despite the shortcomings of the current taxation system of real estate, the most fundamental task remains its consolidation. The new territorial reform of the country has increased this necessity.

The sanctions imposed for non-payment of this tax are almost nonexistent. Sanctions, their calculations and collection should be clear and applicable.

Recommendations

The consolidation of the current system of real estate taxation is a complex process that should be achieved in several steps, emphasizing the followings:

Increasing the efforts and performance of the public administration of local government in terms of real estate tax collection, predicting a new report of this tax collection.

Increasing inter-institutional cooperation to formalize real estate and establishing a fiscal register of real estate tax and a cadastral register for land.

Establishing a specialized national unit that will help in the process of formalization of the immovable properties.

Using the revenues collected from this tax on infrastructure and public services by increasing transparency and awareness that this tax is going to improve the public services offered by the central and local government.

The tax base should be the market value of the real estate and the tax rate should be determined in percentage of the given market value considering building destination. The market value can be changed every 5-10 years and can be determined by Offices of Real Estate Registration. The set of the tax should be product of a broad discussion taking into account the participation of interest groups and political decision-making.

The most important issue that should be understood by policymakers is the fact that the management of the real estate taxation system should be evaluated better than to date. This could also involve the further expanding of the tax base, including other real estate exempt by the current law in force.

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