

CONSIDERATION OF A POSSIBLE SELF-REGULATING ALGORITHM FOR FISCAL APPRAISAL OF PRIVATE PROPERTY

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Abstract: with the advent of significant property taxation in Russia a need for accurate and timely property appraisal was realized. The paper attempts to propose a self-regulating market algorithm that would leave the freedom of assessment in the hands of the owner. Possible abuses of the algorithm and remedies are discussed at the end of the paper.

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For a long time accurate fiscal appraisal of private property was hardly discussed in Russia because of irrelevance of the topic to actual money. Until recently the local authority records for property contained arbitrary figures that could have been either a fraction of the real value or could exceed the real value several times. Calculated annual property tax on residential property sometimes was less than \$1 and the topic of adequate appraisal was of interest to a seller or a buyer but not the taxman.

Not anymore; recent legislation permitted “free-market price” appraisal to be entered in the registry as the basis for property taxation. Massive re-assessment of land and buildings is underway all over the country. The actual appraisal is usually done by agents of questionable professionalism and even more questionable impartiality. Public tension around overblown valuations and consecutive excessive tax is mounting in the form of multiple lawsuits. The situation thus clearly calls for some legal solution that would be free of subjectivity and would balance the interests of the taxpayer and the local government. Research revealed that similar practices are not unknown in other countries; therefore we hope that these ideas could be of some use to the broader world.

We are proposing a mechanism that is partly derived from the French droit de préemption (right of first refusal). The French practice gives the local municipality a buyout option at the deed price on all property deeds submitted for registration. Normally the said option is never exercised but serves as a check against understating the price of property in order to save on processing fees and duties. In our opinion the practice could be extended and made permanent to serve as an underpin for the assessment figure.

The algorithm

In order to achieve fair evaluation, our first proposal is to grant the owner the freedom and sole legal authority of assigning fiscal value to their property. This would probably be best done in the form of a legal right to record and change the figure in the state registry. It would make a lot of sense because it is in the owner’s interest to know the real value of their property. The burden of certified multi-parameter assessment is thus passed over to the owner with the associated costs. Also it seems unlikely that the owner would at any time object to their own assessment figure in the registry.

Possibly the best way to persuade the taxpayer to enter a correct value for their property would be a pair of economic stimuli, acting as the high and low brackets for the price. The high bracket is in fact already there: the taxpayer is unlikely to overstate the value of their property because of the associated tax. Of course, a groundless overblown registry value could be used to justify a

risky collateral and/or insurance value, but this constitutes a standard corporate risk and is of no concern to our analysis.

The lower bracket in our opinion could be implemented in the form of a permanent buyout option granted to the local authority by law. The option should be implemented in such a manner that it would be a mere check against understatement of property value and would not become a tool for random evictions. This probably could be achieved if the authority would be required to pay a premium of 20-30% over the registry value in order to exercise the buyout option. With both checks in place we would expect the owners to set and keep updated the fiscal values for their properties at about 90-95% of real market value which is perfectly ok for taxation purposes.

Stress testing of the algorithm

The proposed procedure should be sound enough to withstand a certain degree of abuse from ill-intentioned users. Let us examine possible defenses in a few imaginary situations.

Case 1. A property owner and local official conspire to defraud the municipality of public funds. The property holder appraises their property at triple value, the corrupt official exercises the buyout option, fraudsters split the obtained funds while the municipality now owns an overvalued piece of property.

Possible solution. The local authority should be prohibited to use public funds for buyout of undervalued property. Buyouts should be done only with via funds or guarantees of a reputable bank or corporation, the authority acting solely as an agent.

Case 2. The taxpayer could set the appraisal value low and use the low value to calculate and pay taxes. Then he would set the value back to normal so that the property won't get bought out by the municipality.

Possible solution. Of all appraisal figures recorded through the year only the highest one should be used to calculate the amount of property tax due.

Case 3. An ill-intentioned official notices a sharply undervalued property whose owner is overseas, missing or simply slow. The authority buys out the property at the listed price with required premium and resells it for a profit, effectively stealing the margin from the owner.

Possible solution. The authority should be required to warn the owner well in advance and exercise reasonable effort to convey the message. If the owner fail to update the assessment value within a prescribed time interval (possibly something between three months and a year)

buyout should be done via open auction so that the owner would get a fair price for their property even if the undervaluation was intentional.

Conclusion

The proposed self-regulating algorithm seems to be sound, at least theoretically. Possibly the same procedure could be used to facilitate municipality buyouts of land for public use. Up-to-date valuation and a significant buyout premium should be sufficient to provide a fair compensation for eviction and relocation.

In the case of a buyout for public use there could arise a need for a legal procedure that would fix the assessment value at some point in time in order to prevent overvalued holdout abuse.