

# Pragmatism or Principles? Property Taxation Valuation in Finland

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## Abstract

The paper discusses international best practice in mass property valuation and property taxation in comparison to the case of Finland and reveals shortcomings relevant globally. Earlier work by the World Bank, FAO and the Centre of Registers of Lithuania defined pre-conditions for successful value-based recurrent property taxes including access to quality price data, efficient tax administration, and appropriate valuation infrastructure. Finland has reliable land and property records, ample geospatial data, transparent markets and strong valuation infrastructure that adhere to international standards, and all these are applied to property taxation valuation. However, the article raises a number of issues with the equality and accuracy of the property taxes stemming from the ancient split of property taxes to separate land and building taxes, valuation that targets condominium buildings rather than apartments, restricted access to apartment market information, and a number of other factors. The article's conclusions on the way forward in Finland are relevant globally for countries and cities introducing recurrent property taxes in the era of covering digital records and transparent property markets.

**Key words:** Property Valuation, Property Taxation

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## Introduction

The article starts by making the case for recurrent property taxation primarily as a mean to finance local governments and services, and introduces best practice of mass valuation systems and value based property taxes referring to an earlier work by the World Bank, FAO and the Centre of Registers of Lithuania (Grover et al. 2016; FAO-WB 2015). Then the article presents the case of Finland, which is a small Nordic country proud of its clean nature, rule of law and good governance. However, the article notes that the recurrent property taxation in Finland may not meet the otherwise high standards of governance in the country. Finally, the article suggests a way forward for Finland including a property valuation and taxation reform applicable to Finland and beyond.

## Background

Property taxes can play an important role in a fiscal system, and in particular when recurrent property taxes are local taxes, because the tax base lies within a defined jurisdiction and has to be paid locally and can reduce local government's dependency on inter-governmental fiscal transfers. A regional conference in Lithuania (FAO-WB 2015) defined the prerequisites of sustainable recurrent property taxation to include: clear regulations, transparent property markets, access to property transactions data, good property records, efficient tax collection systems, and appropriate valuation infrastructure (standards, education, licensing and able valuers), good communications strategy and generally good tax governance.

The modern premise for recurrent property taxes is that the countries and cities have never in the history had as good and accessible land and property records as today, and achieving the basic requirements of introduction value-based property taxes is far more achievable to countries and cities across the globe than ever in the past. Consequently fiscal records can cover practically all properties and can include excellent attribute information of each property. Based on such, multiple countries operate mass valuation systems that draw market information from registered transactions and update property taxation values semi-automatically every year or in a few years' time span. Value based property tax systems can be truly based on value and treat taxpayers fairly and equally. Investing in proper valuation systems is spreading and it is becoming increasingly recognized that apart from the property taxation application, mass valuation systems have the potential to be used for a multitude of purposes (such as for

state asset valuation and management, state audits and compensation valuation), can reduce Banking sector risks and provide market information for countless other purposes with economic value also for businesses, and not only for the public sector.

It is also increasingly known that political champions for property tax reforms are rare. It seems that a title 'property tax reformer' may not be directly associated with 'political success', maybe rather on the contrary. This is unfortunate and reflects a folk song like common understanding that property tax reforms mean higher taxes. While it is true that States and cities reforming taxes would generally be after increasing revenues, the authors suggest that a property taxation reform towards true value based recurrent property taxes would generally be in the interest of the majority of property owners. Good access to market value data, functioning valuation systems, covering records and efficient property tax collection will allow lowering tax rates benefiting in particular those, who have not been capable to 'work the system' to their favor. Property tax rate is commonly kept artificially high to compensate lower than market value based taxation values that for example stem from systematically under declared property transaction prices. Such a dynamism in the taxation base leaves room for deals and manipulation, and presumably there is a wealth asymmetry in terms of who can benefit from the system loopholes. The property tax reforms for enhancing local services are a necessity and among the rare underutilized means to finance local governance. Such reforms benefit most those who need local services, but also the majority that pay unnecessary high taxes to compensate others, who have arranged favorably low taxation values for themselves. Value based property taxation systems can be made fair and efficient, and popular, if done well and with good communication.

### **Case of Finland**

Finland, and the Nordic welfare model more generally, relies on high level of equal opportunity, and universal access to same level of education, health care and services to each and everyone in the society regardless of wealth or social status of an individual. Importantly for this article, the Constitution of Finland makes clear that all citizens are to be treated equally. Chapter 2, Section 6, of the Constitution starts this way:

Everyone is equal before the law.

No one shall, without an acceptable reason, be treated differently from other persons on the ground of sex, age, origin, language, religion, conviction, opinion, health, disability or other reason that concerns his or her person.

At the core of the Nordic welfare model, the globally high level taxes on income and added-value, which have provided for efficient wealth distribution, but public sector financing challenges and growing public deficits, and aging population with new level of needs for local services, have generated interest to balance taxation burden and explore enhancing also other taxes with lower national level impact.

The Finnish recurrent property tax is a municipal tax (Property Tax Act 654/1992). It applies mainly to land and buildings other than forest and agricultural land and areas owned by the municipality, which are exempted. The recurrent property tax valuation targets land and every building on the real estate separately applying mainly sales comparison method for the valuation of land plots and replacement cost method with age deduction for buildings (Act on the Valuation of Assets for Taxation 1142/2005; Finnish Tax Administration 2015). The recurrent tax base is the value of the real estate at the end of the previous calendar year. In general, the system is pragmatically build and applied, works well and collects effectively property taxes without major litigation or even discussion or particular attention.

However, the recurrent property taxation yields<sup>1</sup> in Finland are low in global comparison and there seems to be several issues of equality and efficiency in the valuation methodology. The main property market commodity in Finland are apartments, but as the recurrent taxes target land and buildings, the apartments are not subject to tangible value based property tax. Instead, the Condominium Company<sup>2</sup> pays taxes on its land and (apartment) building(s). Most Condominium Companies charge the tax share from the apartment owners based on a simple living area based formula. This way an apartment owner<sup>3</sup> with an apartment of 50 SQM and the best sea view in town pays the same recurrent property taxes with another 50 SQM apartment owner on the ground floor of the same building that sees parked cars from the kitchen window.

Also, the scarcity of comparative land plot sales in the established city centers force land tax valuation to be based on mathematical modelling applying distant sales, advanced indexing and value maps based on average values. This type of land plot valuation tends to systematically result to lower values that the

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<sup>1</sup> According to the OECD Data, the Finnish property tax collection was 1.4% of GDP in 2015 against the OECD average of 1.86% and for example 4.1% in UK and France. Source: <https://data.oecd.org/tax/tax-on-property.htm>

<sup>2</sup> In Finland, condominiums with privately owned apartments are governed most commonly as Condominium Companies (asunto-osakeyhtiö) where each apartment equals to defined shares in the company and there are no other shareholders than the apartment owners (see Falkenbach et al. 2009).

<sup>3</sup> Apartment owner in Finland is technically an owner of the shares which give a right to occupy, lease and sell a certain apartment belonging to a condominium company.

market value. The methodology, guidelines and value maps have been developed in co-operation with a governmental science think tank, the Technical Research Center of Finland (VTT), and the Tax Administration since 1993. The valuation guidelines and value maps have been updated based on needs and the latest revision dates back to 2005-2006. Note that the last land value map update thus dates back to 11 years, while many OECD property valuation systems produce new values annually or every few years. The policy is to aim to a 'reasonable market-based value accuracy', which is defined as 75% range of the market value. While this hardly can be considered a solid system, no major complaints are known and in fact the matter is hardly discussed at all, and the political discourse is totally ignorant on the tax base.

The reconstruction cost valuation applied to the buildings is based on an annual Degree by the Ministry of Finance, which updates reconstruction cost norms for countrywide application (Finnish Tax Administration 2015). The same average reconstruction costs apply to all locations and it is thus notable that the Finnish building tax valuation system does not seem to take into account the impact of location to the material and labor costs in construction. Significant or not in the Finnish context, it is known that the Finnish reconstruction valuation for building tax may result to issues with the true taxation rates. There have been cases where true property tax rates are higher in the suburbs than in the city centers. The obvious explanation for this could be that the average national construction costing over appreciates the construction values in cheaper market areas and under appreciates the values in the areas of higher demand. Even more an issue emerges, if a building is no longer current at all for the property market. There are buildings in Finland's rural areas, which are in good working order, but which nobody wants to buy. Factories have emigrated, businesses failed, but buildings remain. In such cases, the true market value of a building could be very low or even negative when considering maintenance and demolition costs, but the reconstruction value used for taxation would remain the same as if the building existed in an area of high market demand. Value based property taxes should not result to taxes on worthless properties. The reconstruction valuation for building taxes in Finland does not seem to treat all taxpayers in a fair way.

Actually, it can be argued whether the Finnish property tax system is a value based system at all? Essentially, the property tax is based on an area based approximate valuation and some administrative tinkering rather than to an evidence based market valuation (see e.g. Mangioni & Viitanen, 2014). The Act on the Valuation of Assets for Taxation does not clearly define the value base, but the Section 32

stipulates that the maximum total value of property taxes of the parts of the property cannot be higher than the *fair value* (market value) of the property. However, such a safeguard only means that the combined tax value needs to be lower than the market value and the government handles this by aiming to 75% of the market value. The play is safe, nobody brakes the law, but this is not a market value based system. However, a Supreme Administrative Court decision (KHO:2014:128) confirmed that the Finnish Tax Administration (2014) is right in defining the *fair value* as the total value of separately valued land and buildings. Although legal, the system hardly deserves a praise on technical terms and has led to a very unclear regulation and guidance on how to assess property tax values in Finland (See Finnish Tax Administration, 2015).

Further, the authors think however that the property tax valuation practices in Finland do contradict with the Property Tax Act 654/1992 that obliges property taxes to be based on the property value. We have shown above that the tax collection is in fact not based on property values, but to a lowball system that provides taxation values with its own logic and norms, instead of using the market value as the only reference norm. It is clear to all subject matter knowledgeable in Finland and that the property taxation valuation is compromised in the current practice.

In addition, the question needs to be asked on whether the property tax application in Finland de facto (at least commonly, or at minimum, often) results to lower factual tax rates to definable groups of citizens than to other definable groups of citizens. The question is thus whether the property taxation in Finland meets the Constitution's obligation to treat all citizens equally. The question concerns primarily the property owners in established city centers versus suburban dwellers, and property owners within condominiums with substantially higher value properties than others in the same condominium. The authors suggest that many, if not most, city center or top floor property owners get a better property tax deal than their pairs in suburbs or lower floors. In summary, the authors suggest that the Finnish property tax valuation practices treat citizens unequally and thus the application of property taxes in Finland is currently unconstitutional.

It is therefore time to reform the property tax system in Finland. While the Finnish property taxes are local taxes they are not earmarked to support any particular service, and this can impact their legitimacy in the public eye or the interest of local politicians' (often large land owners are well represented in the Finnish local politics) to pursue property revenue enhancing reforms. Nevertheless, Finland has a large territory

for its small population, and as the tax paying population increasingly moves to cities, the pressure is mounting to make better use of local taxes and mitigate the need to increase fiscal transfers to municipalities.

### **Way Forward; Proposal for Property Valuation and Taxation Reform in Finland**

Not unlike elsewhere, Finland should reform its recurrent property taxation to be based on a unified property tax for land and buildings, and apply true market values as the base for the property tax. The obvious solution for the residential properties should rely on the sales comparison valuation method almost exclusively. In the case of condominiums, and in order to meet the constitutional requirement of equal treatment of citizens, the taxes should focus on the key commodity in the market, which is apartments, and not to the buildings as a joint entity. Apartment taxation valuation based on apartment sales would automatically take into consideration the varying property values inside the buildings. However, there are structural issues in Finland, which would need to be solved first. Apartment sales registration would need to be integrated to the land registry, which currently is not the case as the apartment sales are 'housing share sales' and not property sales<sup>4</sup>. Actually apartment sales are not public at all in Finland, which from an international perspective is extraordinary. Opening of public access to the apartment sales prices should be a priority not only for the taxation purposes, but also in order to support the market functionality and reduce Banking sector risks.

Definitely, Finland should also get rid of the historical duplication of valuation systems, which is largely artificial and serves no real purpose. A new system should be developed that integrates the current land and building valuation systems and develops the values mainly from the sales comparison and sum methods of the entire property value without artificial separation to land and building values. Such a new mass valuation system should be capable of producing values to all properties and all apartments every year. This would also increase the efficiency of the property markets when there would be more accurate information available as the Dutch examples show (Gieskes et al. 2014).

### **Conclusions**

The case of Finland shows that in the era of fast progressing urbanization and complex built environments the separate land and building taxes are not only unnecessary, complicate and inefficient, but also struggle

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<sup>4</sup> Land plots and condominium company's buildings are registered in the public land and building registers, but apartments are not.

to treat property owners equally, even to an extent that may not be lawful or constitutional. The importance of sustainable sources of local revenues is growing as the expanding urban areas need services and infrastructure, and the scarce urban space will have to be better managed and attended. Instead this is the time to make good use of improving land records and use them as the base for developing efficient mass valuation systems valuing each property, land and buildings together, and each part of buildings in the case of condominiums, separately if they are also sold separately. The rule should be that whatever is the object of sale (i.e. the land and buildings jointly and not separately, or an apartment rather than an apartment building), should also be the base of valuation for taxes. The authors think that full property based property taxes and land records based mass valuation systems capable of producing annual property tax values to each property will become the norm in OECD countries in the mid-term and will spread fast to municipalities and cities of the transitional and developing countries as well.

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