CHAPTER 4

Moral Hazard in Property Tax Administration: A Comparative Analysis of the Czech and Slovak Republics*

Tax Policy, Tax Administration, and Moral Hazard

A federalist country adopting a tax must decide which level of government will design tax policy, which will administer the tax, and which will collect the revenues. Often, the same level of government performs all three functions, just as the federal income tax is handled in the United States. Of course it need not happen this way. In Taiwan, the value-added tax is largely administered at the provincial level, policies governing its use are set by the national government, and the revenue is split between the two government levels. In the United States, state governments establish property tax policy and local governments administer the property tax, but the majority of the revenue goes to school districts, which have no policy or administrative role in the process.

Sound arguments can be made either for combining policy and administration at one level of government or for separating them. There are also arguments for centralizing and for decentralizing the two functions. Consider first arguments for centralizing most of the property tax’s policy and administrative activities. In developing and transitional countries,
for example, centralization of policy and administration usually assures more abundant fiscal and administrative resources (Malme and Youngman, 2001). Centralization would increase access to policy resources, including technical expertise, computers and information, more sophisticated technologies, and international advisors. It would also enable overall tax policies harmonization.

Another reason for policy centralization is the key issue of establishing policy safeguards to assure property tax uniformity, both between tax jurisdictions (harmonization) and within them (uniformity). A centralized set of policies would describe the types of property to tax, the manner in which valuations are made, the level and frequency of property assessment, the tax rate applied, the use of the funds, and the required degree of transparency (Kelly, 2000).

The need to create harmonization and uniformity safeguards is an issue for every tax, especially the property tax. For all other taxes the taxable value, or tax base, is established in an arm’s-length, market transaction. However, market valuation is not possible for the property tax in transition economies, since property is sold or exchanged so infrequently that individual parcels with market-determined values cannot be seen as representative. Thus, a tax administrator must estimate a market and a taxable value for each parcel, and there is a strong chance that political or other less relevant issues can influence the process of estimation. Even in developed countries the lack of property tax uniformity can be a serious problem (Sirmans, Diskin, and Friday, 1995).

The challenges to the property tax can be even more fundamental than inept estimation. Unfettered local governments acting in a self-interested manner may decide to leave certain types of property out of the mix while including other types, or they may tax some types of property very heavily and reduce the burden on other types. Similar arguments can be made with respect to equity and stability. There exists a strong potential for a race to the bottom in terms of what kinds of property to include in the tax base and a race to undervalue some properties. Centralized policy design could prevent many of these potential abuses, so there is a very legitimate case for centralization.

Considering the major administrative functions of a property tax, there is also much to be said for centralization. Administration must include a process to discover taxable properties and to inventory and organize property-specific information, a system to estimate the taxable value of the property, billing and tax collection systems, and an audit process to ensure tax compliance and tax equity (Eckert, 1990). As is the case for policy design, almost all of the administrative functions benefit from the additional resources