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# POSSIBLE DEVELOPMENT OF REAL ESTATE TAX SYSTEM IN SLOVENIA

*spec. Dušan Mitrović*

*Surveying and Mapping Authority of the Republic of  
Slovenia, Ljubljana*

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## **Abstract**

*On the basis of current state of affairs, an opinion for the possible development of real estate tax system in Slovenia is presented, where the institutional, managing and technological aspects are mostly discussed.*

**Keywords:** *management, real estate tax, strategy*

## **INTRODUCTION**

On the basis of the existing real estate tax in Slovenia (Mitrović, 1998) the article deals with the possible development of a modern real estate tax system. The importance of real estate tax and the broadness of this issue will be presented in detail. The objective of this article is to prepare a proposal for a real estate taxation system, especially in the organizational sense, and the steps in this field that are dictated by market economy. The existing and planned legislation in any way connected with the real estate subject matter has been taken into consideration, as well as domestic and foreign literature.

## **REAL ESTATE TAX OBJECTIVES**

One of the general objectives is the setting up of real estate taxation system ensuring an impartial, equal and legal distribution of obligations related to real estate tax. Impartiality and equality represent a horizontal levelness, treating alike all tax payers being in the same economic position. However, vertical levelness requires a different treatment of tax payers being in different economic position (Rupnik, Stanovnik, 1995). There, it is necessary to bear in mind the simplicity and the intelligibility that will be comprehensible and acceptable for the tax paying public. The strategy of setting up a modern real estate taxation system can be based upon two options. These are (OECD, 1995):

- first, to set up a somewhat improved existing system and at the same time to build a new modern real estate taxation system,
- immediately to engage the modern real estate taxation system.

OECD (Organization for Economic Cooperation and Development) supports the second option, for they believe it is better to upset the public only once. At the time the proposal originated (in 1995), the second option was probably more suitable.

However, today it is rather questionable. Several proposals at different government levels have been operatively prepared up till now. The text to follow deals mainly with the second option and with the changes required in this field.

## TAX PAYERS, SUBJECT TO TAXATION, BASIS OF TAXATION, TAX RATE, TAX EXEMPTIONS

### Tax Payer

Real estate tax has to be paid by a user or the owner of real estate, regardless being a legal or physical person. Imposing taxing to owners is undoubtedly easier for data on ownership can be obtained from the Land Register. At this point several problems can occur. These are: not updated Land Register, unknown ownership, time-consuming registration in the Land Register, etc. Keeping data on real estate owners represents other problems, demanding a continuous control over the users. At the present almost all of the above mentioned problems with ownership are present in Slovenia. The Land Register is also not updated, the registration into the Land Register is a time-consuming process, the Land Register data are still kept in analog form, there are also problems with denationalization, land and building tenure is still not defined, the financial statement of municipal and government real estate has not been concluded yet, etc. In Slovenia, there is quite a confusion in the field of real estate. Therefore, it is difficult to speak of imposing taxes to real estate owners. Nevertheless, the state has to take measures against the owner and not the user in cases when tax was not paid. Exceptionally, the obligation of real estate tax payment can be transferred from the owner onto the user of government and municipal real estate in cases when the owner can not be traced out.

### Subject to Taxation

Subject to taxation can be real estate as a whole including land and buildings, or separately land and separately buildings. Usually the first option is applied by which the whole real estate tax is subjected to taxation, but not in cases when the owner of the land and the owner of the building is not the same person or persons. In Slovenia, there is a lot of land in the hands of owners, not even today being interested in rational land use. Therefore, the second option should be applied. In this way, investments in construction would be stimulated, which especially holds for settlements of municipal character. In Slovenia today, there is a great interest in the construction of housing premises and commercial buildings, the demand is more intense supply, resulting in high prices. The major problem investors face is the offer of land with utilities, the most blame bearing the municipalities with their investment and physical planning policy (Kavčič, 1998). Real estate tax is an instrument which will stimulate the municipalities to build on municipal land and to issue building permits for private land. The consequence of this is the increase in investments in buildings, contributing to the development of the region and to the increase in income from real estate tax.

### Basis of Taxation

The fundamental objective, related to the real estate appraisal, is the development of a system of mass appraisal of real estate based upon the market value of real

estate. Most of the countries adopted or take over the market value approach. In this case two tax bases are possible: the annual rental value or the market value of real estate. The real estate market analysis determines which option is appropriate. The choice is also influenced by the tax payer. If real estate is mostly rented and the user is the tax payer, the annual rental value is to be applied as the tax basis. On the other hand, when the tax is paid by the owner, the real estate market value is usually applied. Taking into consideration the tax payer, the default tax basis in Slovenia should be based upon the real estate market value. It should also be taken into account that real estate value derives from the highest and best use, and not from the existing or actual use. Appraisal methodology has to be defined by law. In the beginning it is very important to design an appraisal model being as simple as possible. The most effective methods are those of mass appraisal of real estate for the purposes of real estate taxation. Mass appraisal of real estate implies the knowledge of individual real estate appraisal. Both approaches require computer-assisted and interconnectable data. This means the physical and financial data, directly applied in the appraisal, should be kept in digital form in order to enable real estate appraisal.

**I**ndividual appraisal includes the separate appraisal of every individual real estate. According to the appraisal plan, the value of individual real estate is assessed from the computer database of real estate (land and buildings). Different methodologies prescribed by law are applied for this purpose. Mass real estate appraisal includes the simultaneous appraisal of a number of real estate. In doing this, different appraisal models can be used. The number of the models depends upon the types of real estate to be appraised, upon the features of local real estate markets (market regions), the real estate use and the appraisal methodologies. A model has to be produced in order to perform the simultaneous appraisal of several real estate. On the basis of previously performed analyses and the produced model of real estate appraisal, the value of real estate is assessed with the use of computers. The mass real estate appraisal also requires the assessment of real estate value of standardized real estate. In case the real estate owner files a complain about the assessed value, it is necessary to familiar with the individual appraisal (Waren, 1997); because of the appraisal of particular real estate (schools, industrial objects, objects of historical importance) and because of the real estate appraisal control. Individual appraisal ensures the assessment of the value of a particular real estate for a definite point in time. On the other hand, the mass appraisal ensures the assessment of the values of several real estate for a definite point in time with the use of standard procedures, statistical analyses and control. Both approaches require market analyses, the fundamental difference between the two being the extent and the quality of control. In practice, both approaches employ analyses of applied economics. These imply the methods of capturing, analyzing and processing data for obtaining a good assessment of real estate value.

#### Tax Rate

**T**he tax rate should be determined by law according to the proportional tax rate, i.e. a tax rate differing from the tax basis according to what the tax is being levied on, land or buildings. The tax rate for land has to differ from the one for building

and agricultural land as well as for forests and other types of land. Tax rate is a matter of municipal policy lead for a particular region of the country. The state has to define with a law the lowest and the highest tax rate for individual subjects to taxation, enabling the local communities to levy real estate taxes with regard to their interests.

### Tax Exemptions

Tax exemptions cause the decrease in income from this source and increase the tax burden of other tax payers. In this way, individual real estate owners are prevented from using their real estate in a productive manner. Approximately 80 % of apartments in Slovenia are owned by physical persons, which is a rarity in countries governed by market economy. The reason for this lies in the fact that the buying price of real estate determined by the Law on Transferring Ownership of Social Apartments from 1993 was too low, on the average only 20 % of their market value. Generally speaking, in the transition period it is not rational to dislodge owners from their homes by imposing real estate tax. On the other hand, this law caused that many apartment owners are not able to provide the basic maintenance for the real estate they own. Tax exemptions have to be applied in accordance with the stimulation of particular social and economic activities. This implies the protection of agricultural land and real estate of historical importance, the industrial development on more appropriate locations, the renovation of old buildings, especially in old city centers and the like. One of the stimuli could also be the increase of the tax rate for particular real estate which depends on the policy. Probably, it is appropriate not to levy taxes on real estate owned by the state and municipalities in order not to transfer funds from one account onto the other. Tax exemptions should be dealt with very cautiously, despite the fact current legislation favors them.

### SYSTEM ORGANIZATION AND ADMINISTRATION

In proposing the system organization, again it has to be referred to the advantage in the amendment and discussion of physical and taxing legislation with regard to the terms imposed to Slovenia for the ascension into the European Union. Physical and taxing legislation, being part of the Slovenian strategy for the ascension into the European Union, is defined with these laws (Poročevalec, 1997): the Law on Physical Planning, the Law on Environment Protection, the Law on Waters, the Law on the Preservation of Nature and Natural Treasures, the Law on Geodetic Service, the Law on Real Estate Market Agency, the Law on the Central Population Register, the Law on the Count of Population, Households, and Apartments in the Year 2001, the Law on the Register of Buildings and Apartments, the Law on the Real Estate Register, and the Law on Real Estate Tax. These laws directly refer to real estate appraisal Slovenia has to harmonize with the European orientations. The part of the strategy related to the physical planning defines which government bodies are competent for the preparation of legislation. These bodies are: Ministry of Environment and Physical Planning (Surveying and Mapping Authority of the Republic of Slovenia, Office for Physical Planning, Administration for the Protection of Nature), Ministry of Finance (Tax Administration of the Republic of Slovenia), Statistical Office of the

Republic of Slovenia, Ministry of Economic Relations and Development). According to the manner real estate appraisal, the needed data and registers, the existing condition of data and the competencies in keeping and updating these data and registers, as well as according to the possible development of Slovenian legislation, it is evident that the setting up of the organization and management system represents a complex problem. A possible organization of operation of such a system will be presented in the text to follow, the proposal being based upon the existing practice in other countries.

#### REGISTERS NEEDED FOR REAL ESTATE APPRAISAL

Data represent the greatest share of the costs for the setting up of a system for a market-based real estate appraisal reaching even up to 80 % of the investment, depending on the amount and the quality of required data (Eckert, 1990). The experience of the countries which set up a similar system are similar to ours. However, they stress the fact that caution is needed when defining which data are required. Updating of these data, which increases the costs, also have to be born in mind. The updating of these data in Slovenia has too many times been neglected. Many laws were written and passed, regulating the competencies and the responsibilities in managing and updating data, in most cases stopping when it came to setting up data (inadequate funding, impossible updating due to over-detailed data, inadequate staff support, lack of information support, etc.). Many registers and records were never used due to the aforementioned reasons.

The selection of data is mainly based upon the experience gained by Denmark (Danish Ministry of Taxation, 1996) and the Netherlands (Dutch Council for Real Estate Assessment, 1997). The reason why these two countries have been taken as an example lies in the fact Denmark was the first state in the world to set up a computer-assisted system of mass appraisal (Eckert, 1990). Denmark also has the longest tradition in this field for they have already started with the computerization of data (registers) for appraisal purposes in the year 1960. It is also comparable to Slovenia in terms of population and territory. Its territory covers approximately the area once as big as the Slovenian one. It also has more population. However, the fact is Denmark also has a GDP per capita exceeding the Slovenian one for the amount of one Slovenian GDP per capita. In the year 1995 the Netherlands have begun with an approach similar to the Danish one, being different to some extent in the terms of organization and administration. In my opinion, Slovenia should observe on a long term these two quite pragmatic systems of real estate mass appraisal for the purposes of levying real estate tax. Physical and financial data can be classified in terms of their content as already schematically presented in the *Geodetski vestnik* journal (Mitrović, 1998). In Slovenia various government bodies provide for general data on the development of the economy of the country and the social, spatial and other strategic data. These data are kept almost by every government body. Therefore, it is a necessity to appoint an institution which would collect these data, analyze them and configure information serving as a starting point for decision-making on a higher government level. Most of the data are kept by the Statistical Office of the Republic of Slovenia. These data impose the question of their quality, updating and system access.

## THE PROPOSED REAL ESTATE APPRAISAL AND ASSESSMENT STRATEGY FOR SLOVENIA

When preparing the proposal of organization, the following starting points have been considered: the existing state of competencies in managing and updating data, the existing trends in this field, long term guidelines of the government in the modeling of such a system and the resolutions, whether such a system would be managed by the state or would the state take over only the control, ceding the operative administration to the private sector. As mentioned before, the current trend of the existing political powers is the setting up of a system for levying real estate tax on the basis of simple real estate appraisal methods requiring less complex data. Such an approach would ensure a short term solution fitting in the current legislation involving the Ministry of Finance, the Tax Administration of the Republic of Slovenia and the Ministry of Environment and Physical Planning as well as the Surveying and Mapping Authority of the Republic of Slovenia. The Law on Real Estate Tax would regulate the position of the Tax Administration of the Republic of Slovenia as of the institution responsible for managing tax collecting (issuing provisions, receiving complaints and their solving). However, the Law on Real Estate Registration, the Law on Real Estate Tax, the Law on Physical Planning and the Law on the Register of Buildings and Apartments would appoint the Surveying and Mapping Authority of the Republic of Slovenia the responsible institution for keeping the central real estate database, serving for the assessment of the value of real estate.

Figure 1 shows the potential managers of existing and required data for the computer-assisted sales comparison mass appraisal of real estate. The Supreme Court of the Republic of Slovenia with its 44 Land Register organization units keeps the record on ownership. The Businesses Register falls under the competency of the Statistical Office of the Republic of Slovenia, its updating managed with the assistance of County Courts. In such a system the Statistical Office of the Republic of Slovenia would also offer all other data kept for the purposes of various analyses and statistical processing. At the present, the Register of Population is under the competency of the Statistical Office of the Republic of Slovenia. However, this has been changed with legislative regulation and its keeping and updating is not under the competence of the Ministry of the Interior. Issuing of building permits is carried out at 60 administration units all over Slovenia. Before the new Law on Local Self-Government from the year 1995, the administration units were making part of former municipalities. The issuing of building permits is managed and updated at administration unit department, also being under the competence of municipalities before 1995. Once the Register of Buildings and Apartments is set up at the Surveying and Mapping Authority of the Republic of Slovenia, it will be possible to update the Register of Buildings and Apartments with the issuing of building permits. At the moment, the Register of Planned Areas does not exist in any of the municipalities (such a register was produced for the Municipality of Ljubljana in a pilot project). Data on land use are determined in municipalities from the municipal physical plans which have to be harmonized with the national physical orientations and interests. With regard to the organizational structure of the Ministry of the Interior with its Administration Units, it would be rational if the municipalities updated the Register of Planned Areas at these Administration Units.

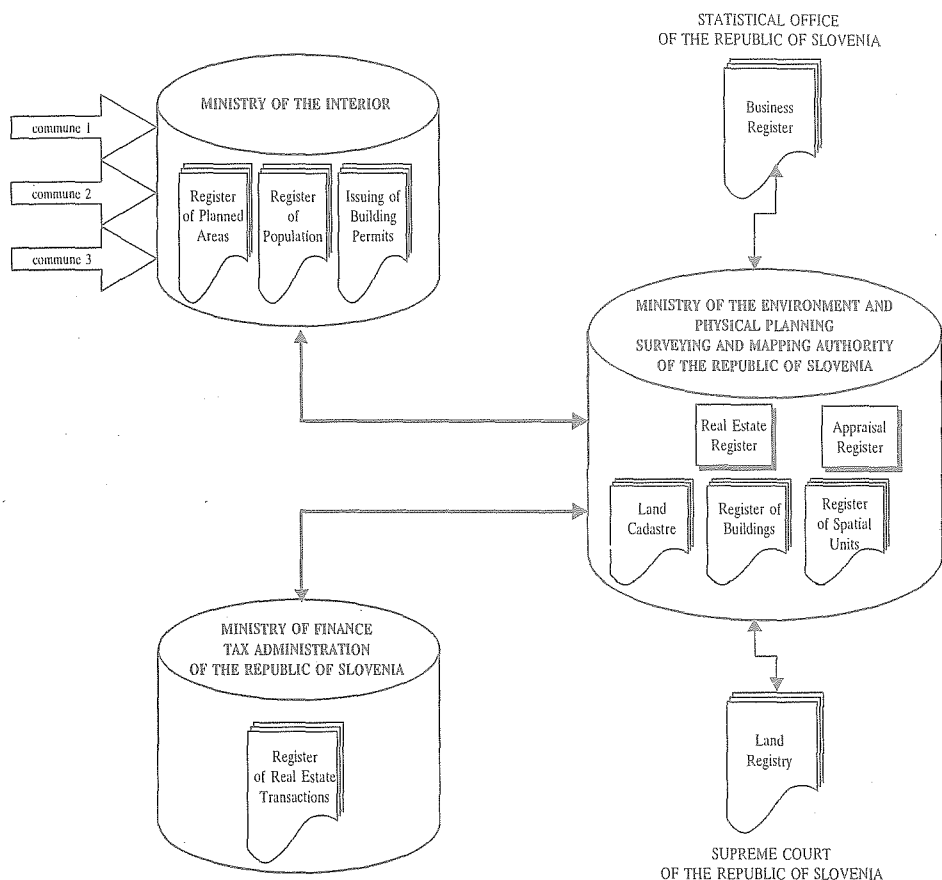


Figure 1: Potential Managers of Existing and Required Registers

The Register of Real Estate Transactions should fall under the competence and the responsibility of the Tax Administration of the Republic of Slovenia keeping and updating data. The updating of financial data on real estate would be performed with the content of deeds of sale and the declaration of the seller of real estate which are determined by law. The Tax Administration of the Republic of Slovenia will also have to manage the keeping of the system for issuing and mailing provisions on real estate and their value, receiving complaints, solving complaints and the like. The Surveying and Mapping Authority of the Republic of Slovenia is already keeping and updating the Land Cadastre, the Register of Spatial Units (state boundary, municipal boundaries, cadastral communes, census circles, house numbers and the like). It has also commenced the project for the setting up of the Register of Buildings and Apartments. At the same time, the legislation for the real estate tax is under preparation, which will replace the compensation for the use of building land and estate tax in the future. Simultaneously with the aforementioned and for the same purpose, the Law on the Real Estate Registration, ensuring data for real estate appraisal, is also under preparation. Surveying and Mapping Authority of the

Republic of Slovenia would represent an appropriate organization for the mass appraisal of real estate within the modern real estate taxation system. This proposal is sustained by these facts: education in the field of real estate and real estate appraisal is already in progress at the Faculty of Civil Engineering and Geodesy, i.e. a long terms strategy has been produced to adjust the curriculum in order to encompass a large part of the subject matter related to real estate. In the European countries, the real estate subject matter and the real estate appraisal is dealt with by the surveyors. Most of the required registers are already kept by the Surveying and Mapping Authority of the Republic of Slovenia, which with the existing organization structure of operations represents a sound foundation for the operative appraisal. The existing information support to working processes at the Surveying and Mapping Authority of the Republic of Slovenia is on a high level and well defined. The staff at the Surveying and Mapping Authority of the Republic of Slovenia have enough knowledge and experience in the field of geoinformation systems.

The need for the establishment of provinces is more and more present in Slovenia. A Bill on Provinces has been prepared for this purpose. Provinces should become the right hand to municipalities in the implementation of their tasks. Therefore, the bill proposes the provinces should take over particular tasks from the state and the municipalities. With regard to the transfer of administrative procedures from the state onto the province, an interest exists mainly for the transfer of those tasks under direct competence of the ministries: inspection, taxation matters, geodesy, military and defense matters, as well as administrative tasks transferred onto municipalities regulated by law. The Ministry of Interior believe that it is not appropriate to consider the transfer of administrative tasks onto the provinces at the very beginning, at the moment being under the competence of administrative units within the framework of the Ministry. According to their opinion, it would be more appropriate the administrative units merged to from districts. Once stabilized, the tasks could be transferred onto the provinces. From the existing legislation and this proposal on the organization of keeping and updating the system of real estate appraisal, it is evident that in the future the Surveying and Mapping Authority of the Republic of Slovenia, the Tax Administration of the Republic of Slovenia and the Ministry of the Interior will become increasingly connected. Therefore, it would be logical to start thinking today about the optimization of working processes, information systems, staff structure, organization structure and the like.

With regard to the number of provinces, the opinions of experts differ. The question is should the criterion for the establishment of a province be at least 100,000 inhabitants or should the priority be given to particularity of municipalities. Dr. Igor Vrišer (Taškar, 1997) says it would be necessary to decide first whether the priority should be given to regionalization with small of large provinces when discussing the provinces (regions) as intermediate administrative and self-governing units between the municipality and the state. In the first case, their number would be between 25 and 17, in the second case their number being between 14 and 7. Larger regions would meet the European normatives, giving Slovenia 8 provinces: Primorje (Koper), Goriška (Nova Gorica), Gorenjska (Kranj), Osrednje slovenska (Ljubljana), Dolenjska (Novo mesto), Savinjska (Celje), Podravska (Maribor) and Pomurska (Murska Sobota). All these provinces would have more than 100,000 inhabitants.



However, as dr. Vrišer says, some of the regions to some extent particular would be disregarded. These regions are south-eastern Koroška, Spodnje Posavje, Zasavje and Notranjska. With regard to the proposals for the regionalization of Slovenia, an administrative division of Slovenia into 8, 12, 15, 17, 19 or 20 regions can be expected. Regardless of the number of future provinces, it is important the proposed keeping and updating organization of mass appraisal of real estate in compliance with the current legislation trends in the field of organization. The three main organization units which should participate in the information system are part of a regionalization process, except the administrative units which should be transferred onto the provinces in few years time. For this purpose, harmonization would be required in the merging of administrative units into districts making part of the reorganization of the Ministry of the Interior. At the beginning, Slovenia should consider the state management of the system of mass appraisal of real estate. This also includes the operative appraisal and not only the system keeping and control. The proposed organization structure of real estate appraisal is shown in figure 2.

#### National Council

The National Council would be a body defining the guidelines in real estate tax collecting as well as in the real estate appraisal. The Council would be constituted of the representatives of all political parties, the representatives of the ministries participating in the system and the representatives of larger Slovenian companies. It would represent the highest decision-making level of the system in the field of appraisal and physical planning policy. The Council would be funded through the state budget for the current and the investment management of the system and the like.

Managing and operational tasks are classified into two parts differing in terms of their content:

- real estate appraisal and appraisal control,
- production and mailing of tax forms to owners or user of real estate, as well as the receiving and solving complaints.

#### The Surveying and Mapping Authority of the Republic of Slovenia

The Surveying and Mapping Authority of the Republic of Slovenia would provide for the production of real estate appraisal methodologies, the formation of models, and the harmonization of the appraisal with the regional administrations (Regional Geodetic Administrations). The Surveying and Mapping Authority of the Republic of Slovenia would operatively implement the mass appraisal of real estate for the purposes of tax collecting. The mass appraisal with computer-assisted data (Appraisal Register) would be performed in Ljubljana at the Main Office, already intending to set up a central database on real estate. Forms on real estate would be produced for the mass appraisal of real estate and would be sent to the Branch Offices of the Regional Geodetic Administrations. Staff working at Branch Offices would attend to the updating of the Land Cadastre and the Register of Buildings and Apartments through the connection with the central database of real estate. Beside this, in cooperation with the representatives of local communities, the assessed values of real estate would be reviewed, i.e. the appraisal for individual real estate would be

performed if the circumstances require so. Regional Geodetic Administrations would assure supervision upon the appraisal execution.

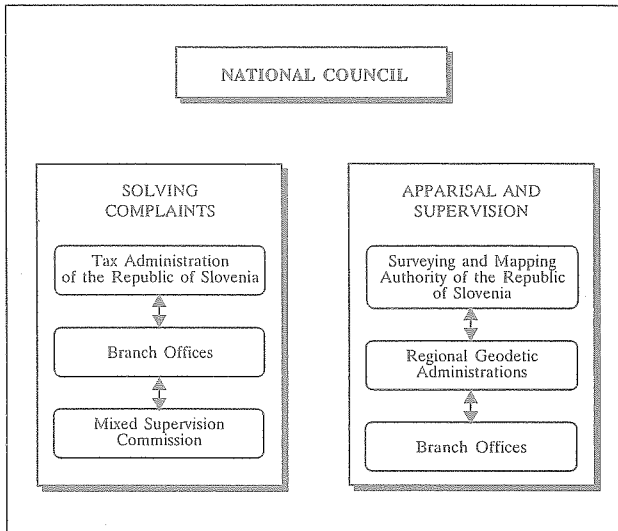


Figure 2: Proposed Organizational Structure of Real Estate Appraisal

The cooperation of the representatives of the local communities is of high importance, for they are well acquainted with the circumstances on the local market. These need to cooperate mainly with the Main Office of the Surveying and Mapping Authority of the Republic of Slovenia when determining the models or market areas, and when defining prices of standardized land and buildings.

**The Tax Administration of the Republic of Slovenia**

The Tax Administration of the Republic of Slovenia would collect and analyze data on real estate transactions, and provide for a regular publication of statistics with regard to the sale on individual local markets of real estate. This is an important element of the system for the public has to acquainted with the prices of real estate subjected to transactions. With its organization structure, the Tax Administration of the Republic of Slovenia would inform all owners or users on the values of real estate, and also receive complaints on the assessed values with the assistance of Branch Offices of the Tax Administration of the Republic of Slovenia. Complaints resulting from incorrect data on the owner or real estate would be solved by the Tax Administration of the Republic of Slovenia. However, those complaints originated due to owners not agreeing with the real estate value or due to incorrect data used in the process of appraisal would be handed over to the Surveying and Mapping Authority of the Republic of Slovenia. The first level of dealing with complaints on incorrectly appraised real estate would be solved at the Branch Offices of Regional Geodetic Administration performing an individual appraisal of the real estate in question. The second level would be the association of Heads of Branch Offices with the Regional Office or the Regional Geodetic Administration jointly solving complaints on the regional level (the Regional Geodetic Administration would cover

one region). The third level of complaint solving would be represented by a mixed inspecting council its members being the representatives of the Tax Administration of the Republic of Slovenia and the Surveying and Mapping Authority of the Republic of Slovenia.

## CONCLUSION

A modern tax system is not designed only for increasing the state budget, but also carries a broader importance. It is beyond all question that the most important reasons are the horizontal and the vertical levelness of taxes, the instrument of physical development and the possibility of directing owners to engage a more economical and rational use of real estate. Such systems unite three communities of interest, the state, the municipalities and the population. To put this system into practice, all involved parties should bear some interest in the subject matter. Data from registers offer the state information needed for the development of the society at different levels of decision-making. Finally, the state could sell particular data to users (investors, mediating agencies, future buyers or sellers of real estate, banks, notaries, insurance companies, building companies, etc.). Some of the Western European countries encounter difficulties in ensuring the funds for their budget for the citizens apply all kinds of diversions to avoid paying taxes (income tax, purchase tax, real estate tax) which is an additional reason for setting up registers unambiguously determining the extent of estate. The primary interest of the municipalities in Slovenia at the present is to increase the income from taxes. The main reason for the increase of income from real estate taxes would be represented by the registration of all real estate, their owners or users, and by the payment of taxes imposed to these (today only those registered in municipal records pay taxes on real estate). With regard to the existing level of democracy in Slovenia, the main interest of the population is to prove ownership. Ownership of real estate represents a status which enables the raising of favorable loans on the capital market if legislation permits so. This means the population should be motivated with benefits they obtain in such way in order to participate in the registration and the payment of real estate tax. Furthermore, the population in developed countries is aware of the fact they have the obligation to pay taxes in order to enable the state to function properly.

On the basis of the study of the subject matter discussed above, it can be said that the following steps should be taken in Slovenia when setting up the real estate taxation system:

- to begin with the systematic registration of real estate transactions as soon as possible,
- to ensure the conditions (legislation) for the setting up of financial institutions on the capital market which would provide more favorable loans to physical and legal persons,
- to persuade the general public of the country (politicians, population, municipalities) that long-term planning is needed as well as the introduction of such a system,
- to ensure the conditions for a detailed analysis and pilot study of the real estate market, including the existing legislation,

- to produce a strategy for the setting up of such a system (financing, organization, competence, responsibilities, training),
- to specify, calibrate, test and appraise the models requiring empirical verification,
- to produce bills and regulations defining in detail the system operation.

I hope that this article clearly exposes the necessity for a long-term and systematic approach, incorporating a series of data managers and users. This means intensive cooperation and harmonization as well as susceptibility to other data managers in the system is required. In this case conditions have to be fulfilled in order to motivate all data managers (government institutions, municipalities, public utility companies) for the achieving of the common objective. Today there is still a problem with the ministries and the municipalities perceiving only themselves and their interest. Finally, I would like to say that the sales comparison approach to real estate appraisal represents science and art at the same time (Eckert, 1990). Therefore, systematic education of the population is an urgent demand.

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 Neva Žibrik, M.Sc.