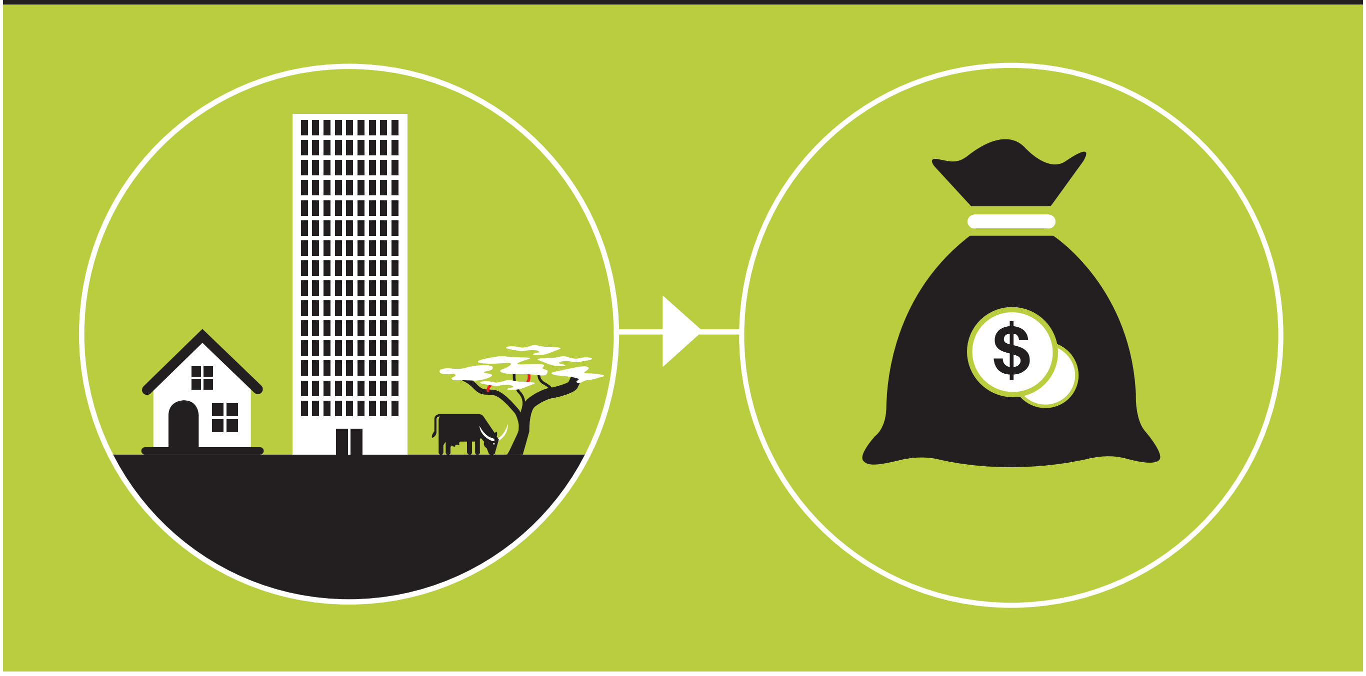
ActionAid International Briefing

Property taxes

Progressive Taxation Briefing



What are property taxes?

Property taxes can take many different forms. They are usually based on the market value, the size or the location of land and/or buildings and can apply to either residential (whether owned by an individual or a company) or commercial property. Property taxes can also refer to stamp duty and other taxes paid when purchasing a property, as well as capital gains taxes and other fees and taxes related to the sale of a property. While stamp duty and capital gains taxes are usually paid to central government, property taxes are **usually administered by local government**, apart from in francophone African countries where they tend to be collected by central government.[1] Other countries such as The Gambia, Rwanda and Tanzania have in recent years made attempts to centralize property tax collection.[2]

Property tax has existed in different forms for at least three millennia, and used to play a pivotal role in many tax systems.[3] For example, in the US property taxes constituted 45% of regional (state) government revenue in 1902, compared with only 1.2% by 1992.[4] However, in countries under colonial rule, property taxes tended not to be used much as most property was owned by a ruling elite from the colonizing country.[5] Rather poll tax (a highly regressive tax that is levied on every adult, regardless of their income or assets) was favoured by the colonizing powers. This means many developing countries don't have a tradition of property taxes in the way that developed countries do. This is reflected in the fact that OECD countries on average generate around 2% of GDP in property taxes while emerging markets generate an average of 0.6% and low-income countries 0.3%, with the average being even lower in sub-Saharan Africa.[6]

Property tax has many advantages:

- It is relatively **easy and cheap to introduce and administer**, though it relies on having access to a pool of trained experts who can evaluate the value of the property that is being taxed or specialized technology such as GPS applications, as well as a reliable register of property ownership.

- As buildings and land are hard to hide, it is **very difficult to avoid** or evade.
- As it is usually collected by local government, it is easy to **link payment of property tax to the provision of local services** such as waste collection, roads, water access, health care and education.
- If the tax is well designed it can be very progressive, i.e. ensuring that those most able to pay taxes pay more, including by introducing **thresholds** for when a property is taxable, which can ensure that the poor and marginalized in society are not liable for property tax.
- As the basis for calculating the tax (whether location, size of land or building, or the market value of the property) is fixed or fluctuates relatively little, the tax is a **fairly stable and predictable source of revenue**.
- In rural areas, a land/property tax can encourage the **productive use of the land** (for example in agriculture) as large landowners will be reluctant to not make use of land that is incurring costs through taxation.
- Property tax is also **less likely to distort local economies** and hinder economic growth as it does not provide a disincentive to work (as some argue income tax does) and does not provide a disincentive to consume (as consumption taxes arguably do).

How can property tax be made more progressive?

Ownership of property is one of the ways that people with inherited wealth sustain their wealth. As such, property taxes are almost always progressive, as wealth inequality is on average twice as big as income inequality.[7] Ensuring that people pay tax on their wealth, including their property assets, will therefore be a more progressive measure than making sure they pay tax on their income. Any tax system that has weak or no property taxation is therefore likely to be made much more progressive by introducing property taxes.

But assessing property taxes can be problematic in developing country contexts. For example, where ancestral lands are owned collectively by extended families, clans or communities, it can be hard to establish who is liable for payment of the tax. In many rural settings it is almost impossible to establish a market value for a plot of land as there is no local 'market' to speak of.[8] Assigning a formula-based value to such land may mean that the person or community liable for paying the tax cannot possibly pay the tax as there is a sizable discrepancy between the estimated value and the income of the taxpayer.

Establishing thresholds for, or exemptions from, payment of property tax is key to ensuring progressivity. These may be determined by the assessed value, by collective ownership, or by the nature of the landowner. So, for example, senior citizens with little income may be granted waivers or lower rates. Such provisions can also open up loopholes exploitable by clever taxpayers, accountants, or lawyers, so care must be exercised in designing them.

Examples of good and bad uses of property tax

Some countries have tried hybrid methods to estimate the market value of property. For example, some local authorities in **Malawi** and **Sierra Leone** have adopted a points-based system to establish the value and therefore the tax due on properties. Such systems are based on the size of land and buildings, with additional points added or deducted based on qualitative features of the property, such as its neighbourhood, improvements made, construction materials and access to services.[9] **Hybrid methods such as the point system have often been a success and should be explored by more countries.**

Between 2008 and 2014, **Tanzania** attempted to centralise property tax collection at the national level. However, this wasn't particularly successful in terms of revenue generation and, after lobbying from local authorities, property tax collection was decentralised again in 2014.[10] Centralising property tax collection does not necessarily yield more revenue and removes the link between tax paying citizens and local governments providing local services. While local and national realities are different in every country, **most countries would benefit from maintaining or moving to a decentralised system of property tax collection.**

In **Zambia**, there is a Property Transfer Tax (PTT) which covers sales of all types of property.[11] This way of structuring a tax is problematic for a number of reasons. First of all, the 5% tax is on the value of the property rather than on any capital gains. That means that tax may have to be paid even if a property is sold at a loss. It also means that those who make considerable capital gains on the sale of property, for example as a result of public infrastructure such as parks, roads, educational and health facilities having been built with public money near the property, will also only pay 5% in PTT. The state could thus be sacrificing significant revenue that could be collected through a standard capital gains tax. Instead, **property taxes should be collected on an ongoing (e.g. annual) basis, as well as on the capital gains when a property is sold.**

In 2013, **Cambodia** introduced a property tax of 0.1% of the market value.[12] No tax is applicable on property values below 100 million Cambodian riel (c. US$24-25k). Such a threshold means that many of society's poorest people are not liable to pay the tax. Despite the tax rate being relatively modest and the threshold exempting a lot of properties, by 2013 (three years after the tax was introduced) it already constituted 1% of Cambodia's overall tax take.[13] This demonstrates how a **relatively modest and progressive property tax can be effective in increasing overall tax revenues**, especially where other forms of taxation are relatively weak.

In **Nepal**, there is a 25% to 50% tax exemption on registration of a property deed when land is owned by a woman.[14] Widowed women also get a further 35% tax cut on property.[15] These measures do not bring in extra tax revenue, but demonstrate how **property tax can be used to encourage increased female ownership of land** and to achieve broader social policy objectives on gender.

Recommendations

Governments should:

- *Decentralise property tax collection where possible, both on revenue maximization and governance grounds. The national government has a role to play, however, in ensuring that the tax is redistributive, so that poor areas do not get poorer-quality services.*
- *Ensure that property taxes are collected on an ongoing (e.g. annual) basis, based on the assessment of the property, as well as on the capital gains when the property is sold. Property taxes based on transfer values should be avoided.*
- *Introduce thresholds and exemptions so that those living in properties with low value are exempt from property taxes, collectively-held land is treated fairly, and property taxes don't force vulnerable landowners such as senior citizens to sell their land.*
- *Ensure that commercial properties are taxed at the same or higher rates than residential properties.*
- *Invest in effective IT systems to map property ownership (e.g. using GPS and GIS technology) and to maintain effective databases of property ownership. Such systems will also help to ensure transparency and comparability within property tax systems. Successful IT systems for property tax systems have already been implemented in Malawi, Sierra Leone and in Lagos State, Nigeria.*[16]
- *Ensure that the any property tax system is appropriate for the context. Many market-value systems are difficult to administer. A points-based system, as used in parts of Sierra Leone and Malawi, will ensure that those with more valuable properties pay more tax while removing the need for an expensive and complex market-value system.*
- *Consider designing property taxes to achieve progressive social objectives such as increased female land ownership.*

This is one of a series of briefings on Progressive Taxation published by ActionAid International in October 2018. You can find them at www.actionaid.org/taxpower

Endnotes

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