IPTI Xtracts

Property Tax and Assessment News from Around the World

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Innovative financing will be key to restoring public transport

A revival of economic activities will depend significantly on public transport, which typically runs in losses. New ways of funding its expansion will, therefore, have to be found to meet demand and help the economy rebound.

A little over 100 days since the covid-19 pandemic brought India to a standstill, damaging lives, livelihoods and the economy, a glimmer of hope has finally appeared. After months of lockdown, the economy is showing some signs of recovery.

In the coming months, as we step out of the lockdown, our focus will be on rebuilding livelihoods through an economic revival. Restoring and reinventing public transport, while also paying attention to physical distancing and other hygiene protocols, will be fundamental. Securing safe public transport can ensure that workers efficiently access workplaces, students reach educational institutes, customers their stores, and service providers their clients. Only then can economic activities resume, allowing people to stave-off poverty and joblessness.

The 'new normal' can't handle old losses: India's public transport has been incurring financial losses for years now. In 2016-17, statistics from the Central Institute of Road Transport showed that state-owned bus companies incurred a combined loss of ₹16,409 crore that year (bit.ly/3gYqded). The 2018-19 annual reports of metro rail services reported losses to the tune of ₹765 crore and ₹496 crore in large cities like Delhi and Bengaluru, and ₹75 crore and ₹52 crore in second-tier cities like Lucknow and Jaipur, respectively.

In fact, public transport is inherently loss-making globally, as affordability concerns do not permit operators to charge fares that enable cost recovery. Hence, public subsidies have often been used to keep the system functional. This situation has been further aggravated during the lockdown, as public transport continued to incur 60-65% of its expenses (staff salaries and overheads) while earning no revenue.

While existing losses have made it poorer, resuming operations in the 'new normal' will require enhanced expenses to ensure passenger distancing and hygiene, thereby adding further stress to the financial pool. Revenues will also drop substantially due to a reduction of passengers-per-trip, lesser office strengths and the new work-from-home culture.

Newer paradigms in financing: The traditional approach of bridging the revenue-cost gap in India through public subsidies will not be tenable as competing demands to deal with the pandemic will strain public budgets. Is it prudent then to explore newer paradigms for financing public transport?

To our benefit, cities worldwide have several approaches that could help us reinvent our public transport and restart the economy.

Recognizing 'non-users' as beneficiaries: Many countries recognize that not just the users, but also 'non-users'—citizens who don't use public transport daily, but gain indirectly from its existence—should contribute to the system.

Among some global best practices is the transport tax levied on businesses in France, based on the size of the wage bill. The rationale is that public transport enables employees to reach work and employers are thus able to run their businesses.

In the US and Colombia, several cities have adopted a 'land-value capture' approach, which identifies the increase in property value based on the accessibility of its location, thereby levying taxes on this increase.

The US also levies gasoline taxes, and London levies congestion charges, on private vehicle users—funds that go towards supporting public transport. The view is that private vehicle-users benefit from encountering lesser traffic due to public transport.

In India, taxes on fuels and motor-vehicles are levied, but they go into a general pool and get used for multiple purposes. Creating a pool of 'dedicated taxes' that goes toward supporting public transport would give a new lease of life to public transport and the economy.

Exploiting land resources: Public transport services typically own significant parcels of valuable land that can be commercially exploited to benefit operations. So far, these lands have been mainly viewed as operational assets, never as revenue-earning.

Taking the Delhi metro, a back-of-the-envelope calculation juxtaposed against data on property sale and rental values collated from the website Magicbricks shows that it could raise over ₹4.9 trillion through the sale of property and nearly ₹1.25 trillion via 20-year leases of land owned within a 200-meter radius. The rental income alone could comfortably meet the operating revenue gap for not just the metro, but Delhi's entire public transport system. Sale revenues could help repay loans and create capital for future investments.

Similarly, the Delhi Transport Corporation owns nearly 100 depots, mostly on prime land, which are largely used for parking buses at night and preventive maintenance. In the daytime, these spaces could be rented out (like, for public parking). 'Air rights'—for the space above the depots—could be sold to residential and office complexes, boosting revenue generation, footfalls and passenger numbers.

Economic and ecological benefits: Reassessing subsidies and commercially exploiting land can be quick and non-fussy ways of assembling funds to enable social-distancing, add more buses and train/metro compartments, and achieve better frequency and route rationalization. They can also help cities set up hi-tech services like contact-less ticketing and live navigation.

Further, diesel and congestion taxes can encourage personal motor-vehicle users to shift to public transport, thereby promoting non-polluting and non-congesting mobility choices. They also promote economic equity by shifting the stress of paying for it from the relatively poorer users to affluent non-users.

As Covid-19 puts India's largest cities under strain, municipalities must rethink finance strategies

Land-based financing tools, property taxation reforms and capital market-based solutions could help cash-strapped municipalities gain fiscal autonomy

As Covid-19 puts India's largest cities under strain, municipalities must rethink finance strategies

As Covid-19 sweeps through India, the outbreak has been most intense in the country's largest cities. The pandemic has put India's urban public health systems under stress, both infrastructurally and economically. In addition, the municipal finance systems that support the activities necessary to fight the pandemic on the local level have also been put under pressure.

Municipalities in India raise finances through a variety of sources: they generate their own revenues from property tax, stamp duty, entertainment tax and other local cesses; they get grants from the state and Central government, they take loans from banks and other institutions as well as by raising municipal bonds. They also have revenues from sundry sources such as rents from entities that use public premises, unclaimed security deposits, fines from contractors who fail to fulfil contracts and more.

In line with the trend in big cities around the world, property tax dominates the revenue basket of India's local governments – accounting for almost 60% of their revenues.

Mismatch between revenues, responsibilities

Public Finance experts say that municipal expenditure should be consistent with the revenues raised. But in India, out of the 18 functions assigned to municipal governments by state governments, less than half have been allotted a corresponding financing source. Due to this mismatch between revenues and responsibilities, the finances of urban local governments are declining, according to the Indian Council for Research on International Economic Relations report on the State of Municipal Finance in India in 2019.

According to the report, in 2017-'18, property taxes contributed about 1% of GDP for the members of the Organisation for Economic Cooperation and Development. But the corresponding figure in India was only 0.15%..

Given the deteriorating municipal finance revenue generation amidst the Covid-19 outbreak, municipalities must urgently rethink fiscal policy.

These are some of the strategies by which municipalities could scale up revenues based on mobilising own-source revenue and accessing the debt market. These strategies include land-based financing tools, property taxation changes and capital market-based solutions.

Land-value capture

“Land-value capture” is a financial tool that has long been used to raise revenues for urban infrastructure development in states such as Maharashtra, Gujarat and Haryana. This means that any increase in land value owing to public investments, urbanisation or civic involvement is taxed to fund infrastructure and service delivery.

The crux of the land-value capture strategy lies in appropriating public benefits from land readjustments, such as when agricultural land is opened to planned development. Benefits could also be obtained from “exactions” when a developer builds public utilities as enumerated by municipal governments. This could also come from public investment. All this leads to an increase in land value, demonstrating the social function of the land as an essential collective good.

Developing countries like China and Brazil have successfully implemented land-value capture techniques to fund their public systems. The Value Capture Finance Policy Framework (2017) discusses the different types of land-value capture tools adopted in India.

Maharashtra initiatives

Maharashtra implements land-value capture in various forms such as land value tax, a betterment levy that municipalities charge property owners for specific projects through the Mumbai Metropolitan Regional Development Authority, fees for granting development permissions and by charging a premium for relaxing the rules on how much exactly a developer can build.

The Greater Hyderabad Municipal Corporation uses alternate forms of land-value capture like taxing vacant land and taxing land devoid of buildings or agriculture. Gujarat has implemented land pooling systems to pool parcels of land and reconstitute them after development.

Revenue from property tax has been declining over the past few years. This is due to several factors, such as undervalued properties, the lack of current data on taxable properties and non-compliance.

As part of Jawaharlal Nehru National Urban Renewal Mission, Bengaluru had adopted tax reforms through the use of Geographic Information System technology to track and collect property data. It has assessed values using the unit area value method, which is “based on the expected returns from the property depending on the location and usage of the property”.

The rate of property tax collection could be improved by updating municipal tax registers and property revaluation, along with imposing taxes on non-compliers and wilful defaulters.

Accessing debt market

Debt financing through debt market instruments like municipal bonds and pooled finance allows future repayment of immediate borrowings that could be used for current expenditure. Municipal bonds are debt securities issued by municipal bodies to finance their capital expenditure. Investor confidence could be increased by floating municipal bonds that are linked to the corporation’s performance on delivering services like education, healthcare, water and sanitation and infrastructure. These bonds are usually devoid of any security in the form of any bank or state government guarantee.

In 1998, Ahmedabad Municipal Corporation first issued taxable, tax-free, and pooled finance bonds. In 2020, Ahmedabad issued such bonds for the fifth time and raised Rs 200 crores for infrastructure development.

Municipalities also raise funds as pooled finance, a technique typically followed by their counterparts in the developed nations. Pooled financing, a form of aggregation of funds from different investors, allows funds to be raised from the markets and distributed among different local bodies based on their project requirements. Municipal corporations in Tamil Nadu have successfully pooled together to access the capital markets for funding their water and sewerage projects.

Furthermore, municipal governments can also explore the options of public-private partnerships and Corporate Social Responsibility funds. The strategy of municipal corporations entering such partnerships not only helps incorporate private sector efficiencies to finance projects but also facilitates public access to subsidised private establishments.

Innovative mechanisms such as land-based financing tools, property taxation reforms and capital market-based solutions could help municipalities gain fiscal autonomy, especially in the wake of the coronavirus pandemic.

Mumbai's nearly trillion-dollar real estate market set to see greatest wealth erosion in history

Whichever value one adopts it is clear that the stakes in Mumbai real estate are very high. At a valuation of $800 billion, it is equivalent to 43 percent of India's total stock market value and 29 percent of GDP.

The total value of all homes in the US is $33.6 trillion. An analysis by Zillow, a real estate database company, estimated that housing value in the US is 160 percent of the country's GDP. The value of homes in New York alone is equal to the GDP of India.

It's been on my mind for a while to do an exercise in valuing aggregate property in Mumbai. Given the limitations in India's data gathering as well as the nature of the real estate business, it is not easy. However, that doesn't mean an honest attempt can't be made. For this, I rang up Uday Tharar to help me with a measured assessment. Tharar is an economist who keeps a hawkish eye on emerging markets.

FROM PROPERTY TAX TO PROPERTY VALUE – A SIMPLIFIED CALCULATION

A property owner is obligated to pay property tax. Different cities calculate property tax on different parameters. In the case of Mumbai, it is based on Capital Value through a formula established by the municipal corporation. It assigns weights to various parameters of the construction. The Capital Value is often much lower from the market value of the property. The annual property tax collection by the municipal corporation is Rs 5,000 crore.

There are significant leakages with regards to property tax collection in several cities of India. The reason is a lackluster assessment rate, poor collection efficiency and flawed property valuation techniques according to a High-powered Expert Committee Report set up by the Ministry of Urban Development in 2011. In a research paper titled "Financing India's Urban Infrastructure: Current Practices and Reform Options" by Soumyadip Chattopadhyay in 2015, the author says that 'almost 44 percent of the properties have been found to be outside the tax net."

Defaults and disputes in payment of property tax are not uncommon. Recent reports suggest that the outstanding amount of property tax in Mumbai has risen to Rs 15,000 crore with over 70 percent pending due to disputes. Exemptions to certain institutions and individuals also exist.

It is no surprise then that property tax revenue in India as a percentage of GDP is less than half that of even developing countries.

Given these factors and benchmarks, it will be fair to say in an ideal environment – annual property tax revenues in Mumbai should be in the range of Rs 10,000 – 12,000 crore. Why am I doing this calculation? To determine the aggregate property value in Mumbai. The property tax amount is generally between 0.1 percent to 0.4 percent of property value – residential properties at the lower end of the range while commercial properties at the higher end of the range. At an average of 0.2 percent, that means Mumbai's property value is between a whopping Rs 50 lakh crore to Rs 60 lakh crore ($667 billion to $800 billion). Assuming 80 percent of this amount is residential, that leads to a residential realty valuation alone of between $533 and $640 billion.

PROPERTY PRICE FALL

Today, everyone in the city, including many developers, no longer dispute that prices have fallen and are falling. Property prices have corrected between 10 to 15 percent since 2016. In premium products, the fall has been steeper. That implies Mumbai real estate has seen a wealth erosion of over $100 billion. By the time the market overcomes the worst of the COVID-19 crisis, it is not inconceivable that wealth erosion would have reached levels closer to $200 billion. Remember, as developers cut prices for their own projects – it brings down the valuation of nearby properties as well and impacts the wealth (notional) of home-owners as well.

Tharar believes the wealth erosion in real estate was overdue. He says, "Property demand always comes with a lag to income growth. Personal disposable income growth in India is trending down averaging a mere 10 percent per annum since 2015 (the year when property prices peaked) compared to average growth of 14 percent between 2005 and 2015. This is now being reflected in lower property demand, which in turn, determines property prices. The price correction is inevitable in such a scenario."

Is there another way to measure Mumbai's property value? Yes. Pankaj Kapoor, CEO of real estate advisory firm Liases Foras, has a different tool for measurement. With the use of satellite images that mapped all micro-markets of Mumbai on various parameters including proximity to the central business district, schools, open space, presence of premium brands, density etc – Kapoor established values to locations and corresponded it with Census 2011 data on the 23.6 lakh households staying there. His valuation of Mumbai residential real estate is $951 billion.

Whichever value one adopts, it is clear that the stakes in Mumbai real estate are very high. At a valuation of $800 billion, it is equivalent to 43 percent of India's total stock market value and 29 percent of GDP. I don't deny that real estate valuation in the commercial capital is inflated and needs to correct. But for a segment that comprises a large base of wealth, it is a shame that there is yet such inadequate data and information from the authorities.

Opacity in data and information may have helped Mumbai real estate overshoot on the upside previously. If not addressed – this time that same opacity will make Mumbai real estate overshoot on the downside and drive the greatest wealth erosion in the history of Indian real estate.

Good news for Delhi's unauthorised colonies! Govt exempts property owners from income tax

The government had last year legalised unauthorised colonies in the national capital, giving house owners legal property rights.

In a big tax relief for Delhi's unauthorised colonies that were regularised last year, the government has exempted owners from income tax even if they had purchased land or house at rates below the prevailing market price.

The government had last year legalised unauthorised colonies in the national capital, giving house owners legal property rights.

Since these colonies were previously unauthorised, some may have purchased houses or lands at below the circle rate fixed by the government for registration of properties.

Now, the government has decided to give such owners exemption from payment of income tax. Without this exemption, such owners have become applicable on the difference between fair market value and actual purchase price.

The Central Board of Direct Taxes (CBDT) through a notification said the exemption would come into effect from April 1, 2020, and would be applicable for Assessment year 2020-21 and subsequent years.

It said tax would not be levied on "any immovable property, being land or building or both, received by a resident of an unauthorised colony in the National Capital Territory of Delhi, where the Central Government..regularised the transactions of such immovable property based on the latest Power of Attorney, Agreement to Sale, Will, possession letter and other documents …. in favour of such resident".

Presently tax is levied only on the differential of fair market value (FMV) and actual purchase price, if the house property is acquired at a price lower than the circle rate.

Nangia Andersen LLP Partner Suraj Nangia said this is a peculiar case, where the property might have been acquired by respective individuals a long time back by way of General POA (Power of Attorney) or other similar authorisation and only such purchase has been regularised in process of regularising the unauthorised colonies.

"Therefore practically, all the acquisitions before that date of regularisation have been tax exempted by way of present notification, so that individual residents don't have to pay tax on any notional income, even if FMV as on date of regularisation is more than the purchase price of such property," Nangia said.

Over 1,700 unauthorised colonies In Delhi were regularised in December last year after Parliament passed a law allowing ownership rights to be given on the basis of power of attorney, agreement of sale, will or possession letter.

Since the purchase price of these house properties were less than the circle rate prevailing in those areas, the differential in the price would have been subject to income tax in the hands of the owner.

The I-T exemption given by the CBDT through notification dated June 29 exempts the owner of these properties from payment of tax on the differential of FMV and purchase price.