IPTI Xtracts

Property Tax and Assessment News from Around the World

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Change in system to fix property tax

Ordinance promulgated; revised tax structure to come into effect from next financial year

The State government has issued a GO promulgating an ordinance to change the system of levying property tax from annual rental value basis (ARV system) to capital value (CV) system. The government, in the GO 198, issued the 'Rules for levy and assessment of property tax'. The government will levy the property tax (PT) based on the CV of the property.

As per the GO, the capital value of lands and buildings fixed by the Stamps and Registration Department for the purpose of Registration will be deemed to be the guideline value for fixation of property tax for which, zones and localities together with their boundaries; classification of the building; usage of the building; age of the building; plinth area; and door number (or) digital door number (or) unique Property Identification Number (PTIN) will be taken into consideration in determining the capital value.

The PT will be fixed at such percentages of the capital value of lands or buildings or both as may be fixed by the municipal council/ corporation as the case may be. "The percentage of the property tax so fixed, shall not be less than 0.10% and not more than 0.50% of the capital value (CV) in the case of residential buildings and shall not be less than 0.20% and not more than 2% of the capital value (CV) in the case of non-residential buildings, which shall be effected from the Financial Year 2021-2022," the GO said.

The Vacant Land Tax shall be levied at 0.20% of the estimated guideline value of the land in case of municipalities and 0.50 % in case of municipal corporations. In the case the vacant lands where garbage is being dumped and unhygienic conditions are prevailing a penalty of 0.10% of the guideline value in case of municipalities and 0.25% in case of municipal corporations will be levied till the garbage is lifted and unhygienic conditions eases.

Move draws flak

Meanwhile, the Communist Party of India - Marxist (CPI-M) State leader and Andhra Pradesh Pattana Poura Samakhya convener Ch. Babu Rao took objection to the ordinance. He wondered how the government can issue the ordinance when the elected local bodies were not there. The Central government under the garb of

Atma Nirbhar and offering loans to the States was pushing the reforms. It would be burdensome to the people, who were already reeling under crisis due to the COVID, if the property taxes were to be collected based on the new system, he said adding, the burden would be about ₹10,000 crore per annum.

How can Indian cities collect more property taxes to strengthen their finances?

Property owners are likely to be more willing to pay higher taxes if they are made aware that the money will be used to improve services.

Urban local governments in India have faced many challenges while coping with the Covid-19 pandemic. They need to strengthen their finances to meet the additional responsibility of handling the impact of the pandemic.

Property tax is an important source of their own revenue, and given the fact that a large number of state and local sources of revenues have been subsumed under the Goods and Services Tax, there is a renewed emphasis on property tax.

The Fifteenth Finance Commission in its Report for 2020-'21 states that for urban local bodies to qualify for grants from 2021-22 onwards, states have to notify floor rates for property tax and thereafter show consistent improvement in the collection in tandem with the growth rate of state's own Gross State Domestic Product.

The Ministry of Finance, as part of the additional borrowing of 2% of Gross State Domestic Product to states for 2020-'21 under the Atmanirbhar Bharat Abhiyan, has also called for states to reform property tax valuation, by linking floor rates to prevailing guidance values/circle rates and putting in a system for periodic revision of property tax rates in line with an increase in price. The Ministry of Housing and Urban Affairs has recently issued a toolkit for property tax reforms to help states and local governments meet these conditionalities.

It is not for the first time that the government of India has attempted to reform property tax. Reforms were initiated under the Jawaharlal Nehru National Urban Renewal Mission. It required states/ cities to undertake reforms in property taxes, with the objective of "establishing a simple, transparent, nondiscretionary and equitable property tax regime that encourages voluntary compliance". These reforms have continued under the Atal Mission for Rejuvenation and Urban Transformation.

Thus, for the past 15 years, property tax reforms have been linked to financial incentives from the centrally sponsored programmes. Despite this, the need to include property tax reforms by Fifteenth Finance Commission and the Atamanirbhar Bharat Abhiyan may suggest that the previous reforms did not yield adequate results.

Property taxes in India seem low

The economic rationale for property tax is that it enables urban local bodies to capture a part of the "unearned" increase in property values. The argument is that urban property values rise as a result of infrastructure investments by urban local bodies (eg a road facing property or a park facing property has higher value than nearby properties in the same location). It is also a "progressive" tax, as higher value properties pay higher taxes.

Property tax revenue as a share of GDP in India was 0.15 % in 2017-'18, which compares unfavourably with 0.6 % for developing countries and 2.1 % for developed countries. It also suggests a potential to increase property tax revenues at least four to five times when compared with developing countries.

Variations across states

Within India, there are significant variations in property tax revenues. Across states, Gujarat, Maharashtra, Madhya Pradesh and Chhattisgarh have higher property tax levels and their collection in relation to their Gross State Domestic Product is comparable to other developing countries, ranging from 0.5% to 0.7%. On the other hand, Tamil Nadu, Uttar Pradesh and Telangana have low levels at only 0.2% of Gross State Domestic Product.

So, the property tax collection may have less to do with the state's level of economic development, and more to do with the assessment regime (ie the tax base, tax rate) as well as frequent and regular reassessment and proper administration (billing and collection efficiency). The Fifteenth Finance Commission's condition that property tax "improvement in collection in tandem with the growth rate of GSDP" may put better performing states at a disadvantage.

Tax based on property values

Both the Fifteenth Finance Commission and the Atamanirbhar Abhiyan suggest linking property tax assessment to "prevailing guidance values/ circle rates". So far, Karnataka and Maharashtra have moved to property taxation linked to circle rates.

However, according to "Finances of Municipal Corporations in Metropolitan Cities of India" report, in Mumbai "the shift … has not been smooth".

"The steep increase in tax levied led to a spurt of litigations against the new system and the Bombay High Court gave an interim order in 2014 to levy tax with half the expected increase," the report stated. "Only recently, in 2019, the court upheld the capital value system while directing certain changes in the assessment method".

The Maharashtra Municipal Act, 1965, states that "The property tax levied on the basis of the capital value of any buildings or lands… shall not, in any case, exceed forty per centum of the amount of the property tax payable in the year immediately preceding the year of such revision". It further states that for small properties (500 sq ft or less), the property tax assessed on capital values will not exceed tax payable before revision for five years. Given this, it is unlikely that linking property tax with circle rates will yield a significant increase in local revenue.

Along with the fair valuation of property, periodic and regular re-assessment of the property tax base is critical to bring assessed values in line with market realities. In municipal Acts of many states, it is recommended to carry out an assessment of properties once in every five or four years.

When such assessments are done only every four or five years the sudden increase in tax payable in the year of re-assessment leads to a drop in collection efficiency. This could be overcome if the tax rates are increased every year as gradual increases are likely to be more acceptable to property owners.

Collection efficiency needs improvement

Besides under-assessed values, cities also face inefficiencies in billing and collection systems. Poor billing efficiency reflects the inability of urban local governments to fully cover all taxable properties in the tax net. With the rapid expansion of cities, assessing and taxing new properties remains a challenge.

Studies suggest the billing coverage of properties ranges from 63% to 80%. Thus, there is considerable potential to increase billing and collection efficiencies by using digital systems such as geographic information system and computerised billing and collection system.

For improving property tax coverage, a simple reform is to match the property records with utility data records from electricity companies. For example, the Indore Municipal Corporation matched property tax records with electricity records and found that "51% of properties did not declare commercial/mixed usage".

Greater Hyderabad Municipal Corporation has synchronised building permissions with the property tax database, so that within 15 to 20 days – an alert is automatically sent to the revenue department to generate property tax receipt based on the constructed plinth area.

Collection efficiency of property tax ranges from 47% to 74%. For improving collection efficiency, many local governments have made efforts to simplify bill generation and payment by the introduction of online systems and providing incentives for early payment of dues.

Besides incentives, strict enforcement on delays and defaults such as interest payments on outstanding dues, disconnection of water supply, "naming and shaming" in the local press and issue of warrants have also been used.

Consultation and involvement of the public at various stages of planning, design and implementation of property tax reforms is also critical for its success. The willingness of the property owners to pay increased taxes is likely to be higher if they are made aware that their tax rupee is going towards service improvements. For this to happen, there is a need for transparency and greater awareness among the public about the costs of services in their cities.