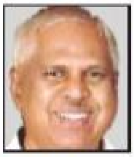
PROPERTY TAX

Give Better Amenities, Will Pay



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The cash-strapped Bruhat Bengaluru Mahanagara Palike (BBMP), Bengaluru's municipal corporation, recently proposed a 25% hike in property taxes. Currently, with the abolition of octroi, cities are left with only a few sources of revenue. These include property tax, which accounts for about half of the revenues of metropolitan cities, but less so in smaller urban local bodies (ULBs) where user charges account for a larger share.

In India, the responsibility of designing the property tax system is that of state governments, while ULBs are allowed to fix tax rates within a certain range and are free to pursue their own collection strategy. Given the immobile nature of the tax base (property), the property tax is quite appropriately the local tax, since there are no major inter-jurisdictional spillovers.

Property tax, in theory, is a buoyant source of revenue with urbanisation and economic growth, since substantial capitalisation occurs with property. Localities where new modes of public transport (such as the metro) come up, those characterised by commercial developments, infrastructure such as new roads or highways, experience exponential spurts in their property value. Ideally, the city should capture the benefit of such capitalisation in the form of higher bases and rates.

As per estimates of the high-powered expert committee on urban infrastructure, 2010, property tax revenues in different states of India are 0.16-0.24% of GDP. But many developing countries collect around 0.60% from property taxes. Hence, property tax is not as buoyant as it should be.

As per GoI's Economic Survey 2016-17, Bengaluru and Jaipur were collecting no more than 5-20% of their property tax potential for that year. This indicates not only modest tax rates but also collections. Thus, urban areas have potential to contribute substantially to their own economic development by increasing the tax rate to the potential as well as widening the tax base.

There are several reasons for this. Many Indian cities use archaic methods of property valuation. They don't even capture the number of properties in the city boundaries. Also, there are many non-paying properties. The guidance value of property to which the tax rate is linked is abysmally low. With high stamp duty at the time of property sale, buyers and sellers take shelter in undervaluing their property. If market values are used to base the property tax, urban areas will be able to raise their revenues manifold from this source.

A survey of the largest cities in India showed that the major factors contributing to poor realisation from property tax are a poor assessment rate (an average of only 56% of properties were covered); weak collection efficiency (more than 60% of property tax demand was non-paying); the use of flawed methods for property valuation; loss on account of exemptions (11.7%); and poor enforcement.

Many cities, such as parts of Kolkata, continue to have the archaic annual rateable value (ARV) system, which basically depends on the rental stream of income from a property to determine the tax base. However, in states and cities that still have rent control, the annual rateable value will yield an amount that is itself 'frozen' by rent control, undoubtedly only a fraction of their value.

However, things are changing. Delhi, and parts of Kolkata, now have a unit area system of property valuation in place, whereby properties are valued on the basis of its vintage, year of construction, building material used, civil furnishing, square footage, neighbourhood characteristics, etc. This is a 'buoyant' method, whereby capitalisation will get captured in the property value.

There are also a lot of property exemptions for certain property categories. These should be done away with. The Geographic Information System (GIS) can be used to map properties, as is being done in many cities, and can be included in the demand for tax. There is no question that non-paying properties should be brought into the tax net, with a penalty two to three times that of the original tax. Still, cities lack institutional innovations to secure prompt payment of adequate taxes.

The property tax in the US is a quid pro quo for services rendered, reflecting the quality of public services, most importantly of schools. While in Indian cities, no such quid pro quo readily applies, it is natural that taxpaying citizens expect roads to be motorable, be clear of garbage, and well-lit. When such services are below expectation, there may be a disincentive to pay the tax.

But it is the ULBs' responsibility to make citizens willing to pay. That is when a city's income can keep pace with that of its residents.

FILE PHOTO

Really worth paying the tax yet?

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