

Taxing land and property for urban service delivery

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3rd March 2020 – Federal Board of Revenue, Lahore

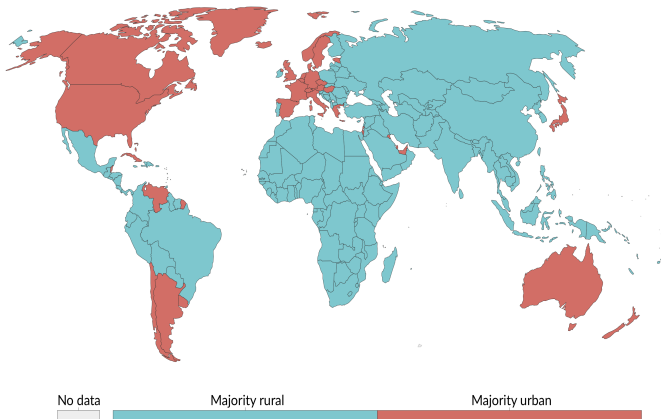
Outline

- ▶ Why tax land and/or property?
- ▶ What are main considerations while levying property/land taxes?

The world is becoming urban.

Do more people live in urban or rural areas?, 1952

Share of the population which live in urban versus rural areas. Here, 'majority urban' indicates more than 50 percent of the population live in urban centres; 'majority rural' indicates less than 50 percent. Urban populations are defined based on the definition of urban areas by national statistical offices. This is based on estimates to 2016, combined with UN projections to 2050.

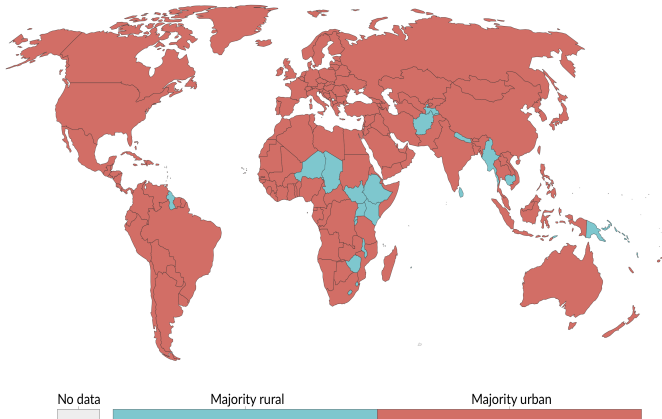


Source: OWID based on UN World Urbanization Prospects (2018) & Historical Sources (see Sources tab)
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Do more people live in urban or rural areas?, 2050

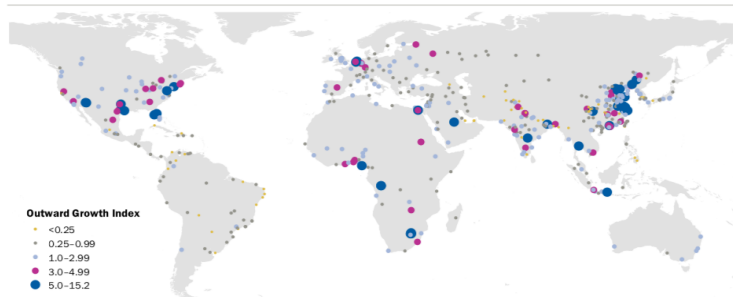
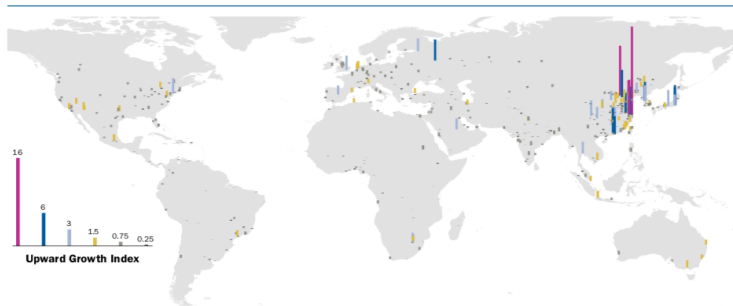


Share of the population which live in urban versus rural areas. Here, 'majority urban' indicates more than 50 percent of the population live in urban centres; 'majority rural' indicates less than 50 percent. Urban populations are defined based on the definition of urban areas by national statistical offices. This is based on estimates to 2016, combined with UN projections to 2050.



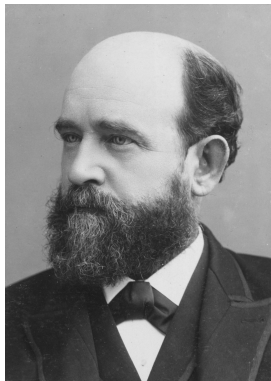
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This makes land ever more important:



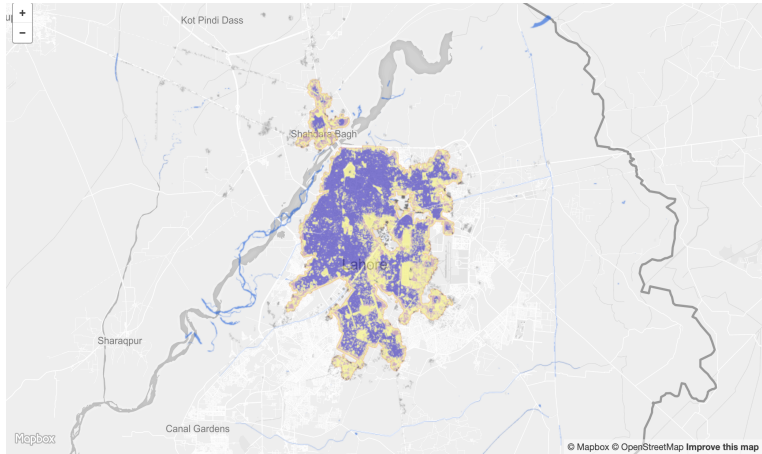
Why tax land and/or property? Reason 1

- ▶ It is **fair**. Urbanisation provides significant agglomeration rents for land owners – people who own land can extract its riches via rents without doing any work.

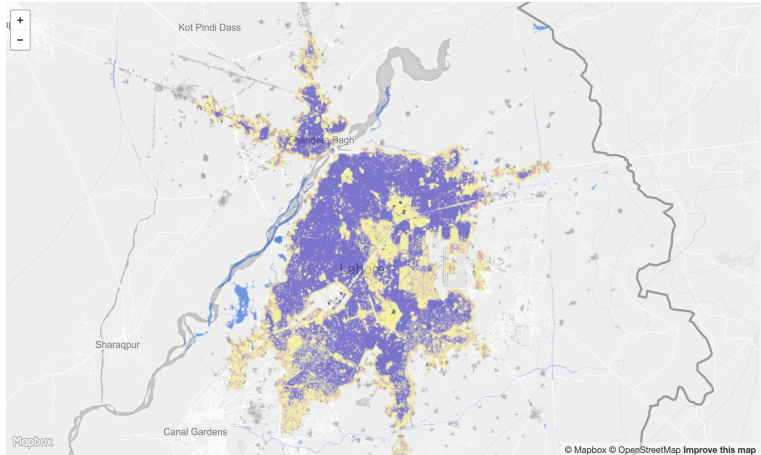


Henry George: "For it is not anything that the individual owner or user does that gives value to land. The value that he creates is a value that attaches to improvements. This, being the the result of individual exertion, properly belongs to the individual, and cannot be taxed without lessening the incentive to production. But the value that attaches to land itself is a value arising from the growth of the community and increasing with social growth."

Lahore in 1990s: 17,751 hectares of urban extent (in 1991)
with 5.1 million people (1998)



Lahore in 2010s: 37,142 hectares of urban extent (in 2013)
with 11 million people (2017)



Lahore's population growth has been accompanied by rise in land/property value (based on SBP data)



Why tax land and/or property? Reason 2

- ▶ It is (more) **efficient**.
 - ▶ Land taxes (which doesn't consider how land is used) **don't** distort economic activity by creating bad incentives, such as to under-invest, or cannot reduce the supply of land. It can even move land to more efficient use – for example, by discouraging vacant plots (see Arnott and Stiglitz, 1979 in the *Quarterly Journal of Economics*).
 - ▶ Property taxes, which take the value of the construction into account of the tax liability, will effect incentives, but evidence shows that they're **less harmful to investment and growth** than other taxes such as income and corporate tax (see OECD's 2010 *Tax Policy Reform and Economic Growth*)
 - ▶ They also encourage more intensive land use, which may lead to broader efficiency gains by allowing land to be transferred to its highest value use.

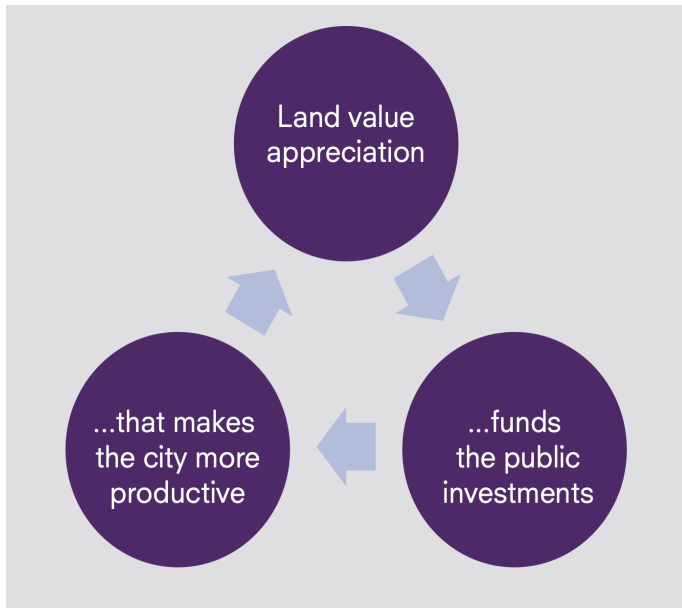
Just remember, the incentives you're creating



Why tax land/property? Reason 3

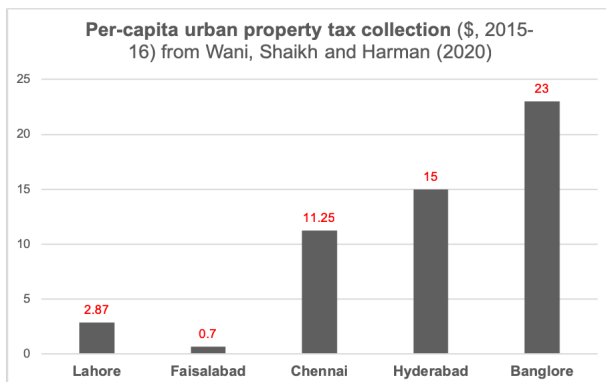
- ▶ It is the most **local** of taxes, and that is important for running cities.
- ▶ They can provide **regular long term stream of revenue for cities**. Ideally, they should correspond with the level of services provided by the city. (see Ehtisham Ahmad's beneficial property taxation paper, upcoming by IGC)
- ▶ Nationally, it is fair for people who benefit from urban investment pay for it. Why should residents of Multan pay for investment in Lahore?
- ▶ As it is place-based, you can not hide or move land/property between areas. Although the capital invested on land can be moved.
- ▶ It might be good for democracy. Recent evidence shows that property tax collection can lead to higher demands for government accountability because of high visibility. (see Jonathan Weigel JMP on Congo, or Lucie Gadenne's Brazil paper).

Together, this leads to cities into a virtuous circle



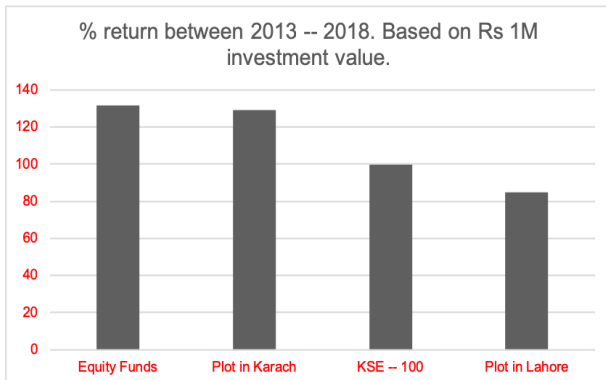
Why tax land/property? Reason 4

- ▶ It is also a **significant** source of revenue in many countries
 - ▶ In the U.S., 17pc of tax revenue comes from property taxes, and accounts for 70pc of all revenue for local governments (Norregaard, 2013).
 - ▶ Even in South Asia, Pakistan lags behind:



Why tax land/property? Bonus reason for Pakistan

- ▶ Due to low regulatory oversight and low taxes, real estate in Pakistan might be encouraging speculative investment.
- ▶ Although no robust evidence to back this.
- ▶ What we know that there is significant return in real estate. If you had 1 million PKR in 2013, you would have the following return in five years, based on where you invested (SBP, 2019):



Outline

- ▶ Why tax land/property?
 - ▶ It is fair.
 - ▶ It is efficient.
 - ▶ It is local.
 - ▶ It is significant.
 - ▶ It (might) decrease speculative investment.
- ▶ **So, what are main considerations while levying property/land taxes?**

Who to exempt?

Land/Property tax revenue = (registered **tax base** – exemptions) x taxable value determined by **valuation** x legally defined **tax rate** x **tax collection**.

What will constitute as the tax base?

At what rate will it be taxed?

How will the collection liability be enforced?

How will the tax base be valued?

Main considerations for land/property tax policy

Four questions to ask:

- ▶ Do you know who owns what?
- ▶ What to tax?
- ▶ How to tax?
- ▶ When to tax?

Do you know who owns what?

- ▶ In information-scarce environments, governments may not know who exactly owns what – in other words, doesn't have a good cadastre.
- ▶ To levy property/land taxes, tax authorities need to have reliable information, but also keep it updated.
- ▶ **Unclear property rights can end up inferring large costs on tax administrators.**
- ▶ In Pakistan, historically, land records have been kept manually. However, technology is being increasingly used: especially those kept by the Punjab Land Record Authority. But, challenges remain, especially in urban informal settlements. Compounded by a weak court system which makes disputes long and costly (for the tax collector too).
- ▶ Improvements can have big pay-off: Bogotá spent USD4 million updating its land cadaster b/w 2000-2003, but generated a USD24 million increase in annual property tax revenues every year afterwards (see Collier et al., 2018)

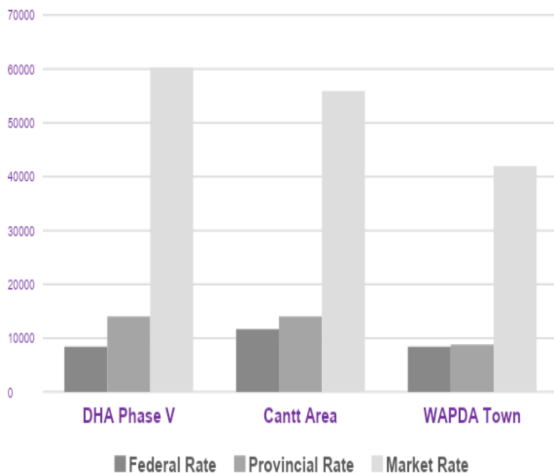
What to tax?

- ▶ Should tax just land, land and improvements, or just improvements?
 - ▶ Land creates the least economic distortion, so it does not discourage productive activity. But, requires data on real land value.
 - ▶ Land and improvements would capture the truer value of the asset, but can discourage productive activity.
 - ▶ Just the improvements on land?
- ▶ Should different types of properties be taxed differently?
 - ▶ Commercial vs. residential properties
 - ▶ Owner-occupied vs. rental properties
 - ▶ Exemptions? (schools, hospitals, low-income communities? Asset rich, income poor?)

How to tax?

- ▶ What are the different methods which can be used to calculate the value?
 - ▶ Area based: Tax the property **based on its area or location**, based on a fixed rate per unit of land and or structure. This usually includes few coefficients related to value, such as the quality of structures.
 - ▶ Rental-value based: Tax the property based on its **perceived rental value**. Data may be easier to obtain if high proportion of properties are rented and is buoyant, i.e. should change reflecting economic circumstances. However, it typically reflects present use rather than best use of property which could induce inefficient market behavior. Thin rental markets can make data hard.
 - ▶ Capital value: This is the most accurate **market-based assessment** of land and property value, but require a vibrant real estate market to generate data. Governments also need to keep up-to-date data on contents and characteristics of properties.

Figure 5: Difference between federal, provincial valuation and market rate in Lahore (Sept 2018) ²²



When to tax?

- ▶ Should you tax land/property 'one-off' based on transactions or recurrent?
 - ▶ In Pakistan, the UIPT is a recurrent tax, while the provincial Capital Value Tax, stamp duties, and FBR's withholding tax and capital gains taxes are transaction based.
 - ▶ Transaction-based are bad for efficiency "as they may reduce turnover of property and hence distort the allocation of this important component of capital." (Norregaard, 2013) In Toronto, Dachis et al. (2012) show that the Land Transfer Tax caused a 15pc decline in the number of sales. Need Pakistan-specific evidence on this.
 - ▶ Essentially, people may keep properties in their sub-optimal use, as **transaction-based taxes discourage transfer**.
 - ▶ It may also incentivise property owners to understate taxable value, which may weaken the database. (as Alm, Annez, and Modi show in the case of India in a 2004 paper).
 - ▶ Keeping transaction-based taxes low and using them to build database for recurrent taxes.

Some policy directions for Pakistan

- ▶ Giving **land more weightage in property taxes**. Annual Rental Value is a poor proxy, and changing it can lead to large tax increases, even on D.C. rate (as Cheema and Abbas show in an upcoming paper).
- ▶ Value assessments need to be **timely** to capture changes in value, ideally these values (and how they're calculated) should be publicly available.
- ▶ Trade-offs between various policy decisions around **exemptions** should be evaluated carefully.
- ▶ Tax should be **local**, as it is in law but not in practise. And, as much as possible, linked to benefits received.
- ▶ **Transfer taxes** on land/property should be used minimally and be subjected to research on welfare losses they may be leading to.

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