

LAND AND PROPERTY TAX

A POLICY GUIDE



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Land and Property Tax:

A Policy Guide

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Urban cityscape in Tirana, Albania. Photo © UN-HABITAT

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ABBREVIATIONS

EDA – Economic development area

FAO – Food and Agriculture Organization of the United Nations

GST – Goods and services tax

HLCLEP – UN High Level Commission for the Legal Empowerment of the Poor

IGAC – National Geographic Institute in Colombia

LPT – Land and Property Tax

m² – square meters

OECD – Organization for Economic Cooperation and Development

RATES – Annual property tax based on rental value

RDA – Redevelopment area

SII – Servicio del Impuestos Internos, the Chilean Internal Tax Service

TIF – Tax increment financing

UN-HABITAT – United Nations Human Settlements Programme

VAT – Value Added Tax

ZCS – Zona características similares, the Chilean designation for property zones

FOREWORD



For cities and towns to become effective engines of economic growth, land has to be seen as key factor in wealth creation and national development.

Using a step-by-step approach *Land and Property Tax: A Policy Guide*, explains the process of initiating, developing and sustaining a land and property tax system. It also carries many useful examples and options for designing land-based taxes and what needs to be considered in their implementation. It addresses questions such as why land and property taxation are important, especially as a source of local revenue.

It shows how an efficient land and property taxation can foster infrastructure and services in cities. We all know that land is immovable. Buildings and other immovable improvements on the land are difficult to hide. Those who benefit most from public investments will likely pay taxes. Thus taxes on land and improvements can capture part of the increased land values which often result from public investments and improved public programmes.

This publication also explains many of the land taxation systems in use. It draws an important distinction between those systems representing one-off taxation, fees or charges, and those levied on an annual basis. The one-off taxes and fees are applied when something about the land changes – such as ownership or a different use for the land, and when rural land becomes urban land.

Land and Property Tax: A Policy Guide says that one-time taxes and fees are best used to fund specific projects, whereas the annual taxation can be used to fund continuing services or to underwrite modest debt levels.

The added value of this publication is the way it shows how well managed land and property taxation can contribute to the improvement of local communities. Given the political will, policies and administrative procedures adapted to cultural views of property rights, to the ways in which those rights are accepted in the community, to the realities of local land and property markets and administrative capacity, can produce a fair and stable tax system. Indeed, such a system can yield between one and two percent of GDP on an ongoing basis.

I am convinced that by giving local authorities autonomous revenues, land and property tax can foster improved local accountability and responsiveness.

This Guide, intended for government officials and community leaders at all levels, provides many useful ideas for implementing taxes based on land and property.

A handwritten signature in blue ink that reads "Joan Clos". The signature is fluid and cursive, with a long horizontal stroke at the end.

Dr. Joan Clos,
Executive Director, UN-HABITAT



The city of Shanghai, China invested heavily in property development ahead of the 2010 World Expo. Photo © UN-HABITAT/Julius Mwelu

EXECUTIVE SUMMARY

This guide provides government officials and community leaders at all levels with alternatives for implementing taxes based on land and immovable improvements. The discussion includes the reasons why land and property taxes (LPTs) are often an important source of local revenue, what the options are for designing such taxes and what needs to be considered in their implementation.

The case is put forward that land and property constitute an important base for mobilizing revenue to meet local needs. Land is immovable. Buildings and other immovable improvements on the land are difficult to hide. Those who benefit most from public investments will likely pay a larger share of the tax. Taxes on land and improvements can capture part of the increased land values that often result from public investments and improved public programs. By giving local authorities autonomous revenues, LPTs can foster improved local accountability and responsiveness.

The various types of taxes applied to land and improvements are described, with an important distinction drawn between those LPTs that represent one-time taxes, fees and charges and the annual LPT that yields on-going revenue. The one-time taxes and fees are applied when something about the land changes, such as ownership or land use. The annual LPT applies to all taxable land. One-time taxes and fees are best used to fund specific projects, whereas the annual LPT can be used to fund continuing services or to underwrite modest debt levels.

FOUR PRACTICE AND CAPACITY PERSPECTIVES

To be effective, implementations of LPTs need to be informed by, if not constrained by, four considerations.

1. **The LPT system should reflect and be sensitive to the accepted institutions and traditions related to land and property rights.** If land is seen as an economic commodity in the local culture, and individual private ownership is accepted, then the incidence of the LPT should fall on land owners, and sanctions should include the government's right to seize and sell the land (eventually) if taxes are not paid. On the other hand, if land is viewed by the local culture as fundamental to achieving basic human rights, or if private ownership is foreign to the culture, then it will likely be more practical to make the occupants of land responsible for paying the tax. In such settings, tax administrators need to be able to use a combination of public exposure, the denial of taxpayer services and the pursuit of other taxpayer assets besides the land if the taxes are not paid. A national taxpayer identification system is of great value in such situations.
2. **Implementing the LPT requires a fiscal cadastre and the LPT system must reflect the realities of the current formal and informal systems for registering and acknowledging rights to land and property.** If such rights are publically recorded and actively enforced by the judiciary, then the fiscal cadastre can be built around the legal cadastre or *grundbuch* (land book). But if many properties are not formally registered, then the fiscal cadastre should be used as an intermediate step that land holders can use to document and have their tenure claims recognized. The fiscal cadastre will not help much with resolving boundary issues or in resolving competing claims to ownership, but it can be used to link taxpayers to parcels of land and document that linkage, thus contributing to a broader land inventory. In this, the interests of tax administrators and taxpayers are closely aligned.

3. Since different design options exist depending on the extent and maturity of urban land and property markets, **it is critical that careful attention be paid to market conditions in different locations and for different types of property.** In those areas and for those properties where real estate markets are active and information on market transactions can be obtained, valuation approaches based on capital market value, annual rental value or an approach tied closely to market transactions should be used to establish the tax base. If real property markets exist but information is not readily available or if staff capacity is limited, a banding or cadastral value approach should be used. And if markets are limited, an approach based on the physical characteristics of the land and buildings should be used.
4. **The administrative capacity of government agencies must be carefully considered in designing the LPT and the administrative processes for its implementation.** The best strategy is to divide responsibilities for administering the tax between at least two levels of government. And cooperation between government agencies that have information critical for the efficient and effective administration of the LPT is essential. If local resources are limited, then the design of the LPT must be as simple as possible and some compromises will be needed on equity issues. For example, if land and property markets are quite active but local administrators either do not have access to quality market data or do not have the expertise to process the data appropriately, it makes little sense to plan a market-based LPT system. Far better to start with a system based on readily identified property attributes (such as land area, building area and location) that can be administered effectively and then build both the system and the local administrative capacity over time.

THE TAX REVENUE IDENTITY PERSPECTIVE

Another way to view the policy and administrative issues related to LPTs is through the lens of the revenue identity introduced in Section 5. The revenue identity consists of five elements:

- the tax base,
- the tax rate,
- the ratio of properties on the fiscal cadastre to the total number of properties,
- the ratio of taxable property value recorded in the fiscal cadastre to total actual property value and
- the ratio of taxes collected to taxes billed.

The eventual revenue received by the government is the product of these five elements. It is consequently important to consider the policy and administrative options for each, but the choices should be informed by knowledge of the four local considerations: rights related to land and property, the formal and informal systems for registering those rights, market conditions and administrative capacity.

Defining the base – Defining the base for the LPT involves three policy decisions.

- **Will the base include land only, immovable improvements only or both?** It is administratively easier to tax land only. If there is adequate administrative capacity to obtain and maintain the additional information required, both land and improvements can be taxed. There are also strong economic arguments for taxing land only, and a land-only tax may be the most effective way to extend the tax to informal settlements.
- **Will the value of the tax base be linked to capital market value or property attributes?** If real estate markets are fairly mature, there are good reasons to link taxable values to market values. But if real estate markets are not complete and reasonably well functioning, the better approach is to link taxable value to property attributes such as size and location. Administrative capacity should also play a role in this decision.



Community members construct their own houses in Borei Keila, Cambodia.

Photo © UN-HABITAT/Suzi Mutter

Linking taxable value to market value is administratively much more demanding. And if access to land is generally viewed as essential to human rights there will likely be a preference for basing the LPT on property attributes while viewing property rights as economic commodities will tend to favor a market value approach, other things being equal.

- **Will land owners or occupants be responsible for paying the LPT?** Here all four of the perspectives factor in. If property ownership is well accepted, then taxing owners will likely be preferred. If individual ownership of land is not widely accepted, the tax obligation should fall on occupants or those who have beneficial use of the land. If formal property right registration systems are well established, then taxing owners may be preferred. In areas with incomplete formal property registration, occupants and users will likely be easier to identify. This will be true as well if land and property markets are limited. And without individual ownership

and strong property registration systems it will generally prove to be administratively easier to tax occupants and users rather than owners.

Setting the tax rate—Two policy decisions are central to setting the LPT rate.

- **Will tax rates be set locally or centrally?** Local autonomy and accountability argue in favor of local rate setting. Uniformity and tax harmonization argue for more centralized rate setting. The best strategy is likely to be a mix of the two, with a central authority establishing the range of acceptable rates, and the local government selecting the final rate within that range.
- **Will there be a single tax rate or multiple rates for different types of property?** Administratively a single rate is strongly preferred. Less information is required and there are fewer opportunities for error with a single rate. If multiple rates are used, the number should be kept to a minimum.

Managing coverage—Coverage refers to the proportion of all properties that *should be* included in the fiscal cadastre that are *actually included* there. The ability to complete and maintain the fiscal cadastre will depend heavily on how land-related rights are recognized and enforced in a community and on the administrative capacity of the government agency charged with managing the cadastre. If informal acknowledgment of property rights is common or formal registration of rights is for whatever reason incomplete, then careful consideration should be given to the incentives that land holders may have for having some government entity acknowledge possession of their land. In informal settlements, this may be a desire to establish a legally recognized claim on the land. In other settings, it may be a desire to obtain specific public services. **In all cases, administrative capacity will need to be devoted to updating and improving the fiscal cadastre.** Eventually, it may prove desirable to integrate the fiscal cadastre with a broader land inventory or other land records.

Keeping values up-to-date—One of the demanding aspects of managing an LPT system is keeping the taxable values up-to-date and consistent with the specified legal standard of value. This is especially true if that standard is capital market value, annual rental value or some approximation of how the real estate market views a property. But even if the LPT is based on property attributes, those attributes change over time. Land does not move, but land use changes, parcels are subdivided and improved, and the perceptions of desirability change. Thus consistent administrative resources and expertise need to be devoted to monitoring and updating taxable values. The methods employed will depend on the legal articulation of the value standard and on the administrative capacity of the agency charged with maintaining values. **But if values are not updated regularly, the relevance of the LPT over time will inevitably diminish, both because the actual revenue will not keep pace with growth in the community and because the tax will increasingly be seen as unfair.**

Collections—It will matter very little how the tax base is defined, how rates and values are set or whether a property is on the fiscal cadastre or not if the LPT is not collected. **But the ability to collect the tax will depend crucially on whether taxpayers feel that the tax is fair, on the administrative capacity of tax collecting agencies, on how land-related rights are viewed in the community and on the political will of community leaders.** Administrators must be able to deliver tax bills reliably, hear and respond to inquiries from taxpayers, process formal appeals from taxpayers and follow up appropriately with those who fail to pay their taxes in a timely manner.

- **What incentives do taxpayers have to pay the tax?** Taxpayers are much more likely to comply with the LPT if they feel it is a fair tax and taxes paid result in improved infrastructure and services in the community. For taxpayers to feel the LPT is fair, they must understand the basics of how the tax is calculated, and they must feel that they are being treated similarly to their neighbors who have similar property. Taxpayers should be able to see the connection between the taxes they pay and the services they receive from government.
- **What sanctions are available to tax administrators if a tax is not paid?** If land and property rights are viewed as economic commodities, then the ultimate sanction that a community can impose for non-payment of the LPT is to seize the property and sell it to pay the taxes. While this option exists in a number of countries, it is rarely actually used. And if land is seen as fundamental to human rights, seizing land is not a viable alternative. In such cases, other sanctions must be available, such as public exposure (which often creates peer pressure) and the ability to seize other assets.

Imposing sanctions for nonpayment of the LPT is often politically difficult. A community's most influential members often own or control large amounts of land, very valuable land, or both. But even if the sanction must be imposed on those not so influential, the political pressure can be extreme if the local press is reporting on families of limited means at risk of losing what little they

have for non-payment of the LPT. The pressure to provide exemptions, rebates and other escape routes for taxpayers is very high. But such escape routes undermine both the fairness of the LPT and its revenue potential. Systems can be put in place to protect the most vulnerable in society, and to assure that taxpayers are treated fairly. But fair treatment does not equal low taxes. Taxpayers should be able to understand how their tax was calculated, to have their questions answered and to appeal when they feel an error has occurred. But they must also come to accept that the tax must be paid, and that will only happen if political leaders and the judicial system support the LPT system. Support in this case means that community leaders should see that the LPT is administered fairly and efficiently, that there is a clear link between taxes collected and the services and infrastructure that result, and that tax collection is fairly, uniformly and rigorously enforced. **Ultimately, collecting the LPT consistently is a matter of political will.**

A STEP BY STEP APPROACH

Implementing or reforming the LPT in a country is a daunting task. The legal, technical and administrative considerations may seem overwhelming. The way forward can be broken down into a logical series of steps, some of which can be carried out concurrently.

1. *Begin by envisioning the desired outcome.* This will require careful consideration of the four factors described in this guide, along with the desired policy goals, to assure that general principles and guidelines are adapted appropriately to local conditions. Essentially, this step involves answering the question, “What will be the best LPT system for our context?”
2. *Seek technical assistance.* Most of the challenges confronted in any given context will have been encountered before in other settings. Learning from other’s experiences can reduce both the time and the cost of the reform effort. Seek assistance from international agencies and from other countries, but be sure that those offering assistance understand the local context.
3. *Create the legal framework.* The LPT must have a sound footing in a well-crafted and appropriate legal framework. The adoption of the legal framework also signals that the most senior political leadership is willing to support the LPT.
4. *Identify the resources needed and build an implementation team.* The size of the team and the available resources will determine how quickly full implementation can be achieved. An effort should be made to build on resources and administrative structures already in place. The potential for involving the private sector in aspects of the implementation should also be evaluated.
5. *Start with one city or even one sector of a large city.* Secure the support of senior political leadership and community leaders in the selected area. It is better to limit the area initially selected until the implementation team is able to develop standard procedures that are effective and has a clear idea of its capacity. The size of subsequent implementation areas can then be adjusted to fit the capacity of the implementation team.
6. *Build or improve the fiscal cadastre.* This step will involve a basic land inventory in the city or sector selected, but the initial information collected should be kept to a minimum. Gather only the information that will be essential for administering the LPT. Other information can be added later. Consider also using self-declaration or self-assessment processes, but these should be simple in design and will require a separate infrastructure to provide assistance and answer questions.
7. *Build public support.* It is critical that the public in the selected area understand what the reforms are intended to accomplish and how the LPT will work. This will require public meetings, advertisements, meeting with community groups and potentially other media and venues for explaining the LPT. The explanations should include expressions of support from community leaders, how the tax bill will be determined, what the appeals process will be and importantly how the money collected will be invested in the community.

8. *Design the collection system carefully.* Seek to minimize the compliance cost for taxpayers and the administrative costs of collection. Consider using utilities or other agents to facilitate collection. Even if the initial cost of collection is higher than desirable in the long term, a high collection rate will foster broader acceptance of the LPT.
9. *Levy the tax.* Be prepared to respond to taxpayer questions and appeals. Work closely with local media outlets so that they understand and can help explain the changes in the tax.
10. *Trumpet success but aggressively pursue tax avoiders.* The success of the reforms should be widely publicized, but it is just as important to publicize the fact that non-payment will not be tolerated.
11. *Spend the money collected according to plan.* The long-term success of the LPT will depend heavily on the public's perception that the tax is fair and that monies collected result in improved infrastructure and local services. People will accept the tax and pay it if they can see the tangible improvements in the community.
12. *Move the implementation team to the next city or sector.* Repeat the process in the next area, adjusting the scale of the effort to meet the capacity of the team. If possible, building multiple implementation teams that can be trained by the first may expedite overall implementation.

The take-away from this guide can be summarized by saying that the potential of LPTs to contribute to the improvement of local communities is quite high. To realize that potential requires first and foremost the political will to do so. If that will exists, policies and administrative procedures adapted to cultural views of property rights, to the ways in which those rights are acknowledged and defended in the community, to the realities of local land and property markets and the administrative capacities of relevant governments can produce a fair and stable tax system that will yield between one and two percent of GDP on an ongoing basis.



High-end and sub-standard properties side by side in Mathare, Nairobi, Kenya. Photo © UN-HABITAT

1. INTRODUCTION

This guide provides government officials and community leaders at all levels with a discussion of the alternatives for taxes based on land and immovable improvements. The discussion includes the reasons why land and property taxes (LPTs) are often an important source of local revenue, what the options are for designing such taxes and what needs to be considered in their implementation.

Land policies, of which taxing policy represents one component, are widely recognized as critical elements in broader social policies to lift the poor and secure sustainable vibrant communities. To cite just one example, a World Bank policy research report states, “Land policies are of fundamental importance to sustainable growth, good governance, and the well-being of, and the economic opportunities open to, both rural and urban dwellers - particularly the poor.” (Deininger, 2003)

In every society, land policy is a complex web of social and legal institutions often the result of centuries of social evolution. To isolate any given aspect of that web inherently runs the risk of focusing attention while overlooking key linkages and important contextual factors. Be that as it may, communities need the resources necessary to improve infrastructure and services, and there is one often overlooked or at least underutilized tool that merits the attention of urban policy makers and community leaders: taxes on land and property. To see why this is so, the next section presents the rationale for LPTs. Section 3 compares LPTs and defines some commonly encountered terms relating to LPTs. Section 4 then argues that a successful LPT must reflect actual community practices and capacities along four dimensions and should recognize the pervasive nature of corruption in many countries. Section 5 introduces the idea

Land Policy: The set of agreed principles to govern ownership (or access to), use and management of land resources to enhance their productivity and contribution to social, economic, political and environmental development and poverty alleviation.

(Framework and Guidelines on Land Policy in Africa, 2009, pg. xiii)

of the LPT revenue identity, or what the factors are that influence how much revenue is actually collected from the LPT. Section 6 describes what should be included in enabling law and discusses the design options for defining taxable property and who must pay the tax. Section 7 continues the discussion of policy options with a discussion of how taxable value can be determined and tax rates set. Section 8 focuses on administrative and implementation issues. The section also discusses sharing responsibility between multiple levels of government in order to better achieve both equity and efficiency in administering the LPT. Section 9 provides some basic approaches for estimating the revenue potential of the LPT. Section 10 describes how LPTs can be used for both economic development and to further social policy objectives, including regularizing informal housing settlements and making the distribution of land more equitable. Finally, Section 11 summarizes the key points that government officials and community leaders should take away from this guide and suggests the way forward for those interested in implementing or improving an LPT in their community. Following Section 11 are a glossary of key terms and a list of reference works cited along with additional relevant readings.



Settlement in Cotonou, Benin that could benefit from improved taxation policies.
Photo © UN-HABITAT/Malcolm Boorer

2. RATIONALE FOR A TAX ON LAND AND IMMOVABLE IMPROVEMENTS

Improving the living standards in any community is most efficiently achieved through cooperative effort. Whether it is infrastructure improvements or enhanced local services, it is often more cost effective for communities to act through their government than to act as individuals. In many instances, it may not even be possible for individuals to accomplish what can be achieved through collective action. Such collective action requires resources, and the purpose of this guide is to help government and community leaders understand the potential of land and immovable improvements as a foundation for mobilizing such resources.

Local and national governments have several reasons to consider land and property taxes. One of the rationales for the LPT is that the base is immovable. A tax on income requires that income be defined and reported, and the failure to fully report income often contributes to the expansion of an “informal” economy. Tax income heavily at the local level and high income households are likely to relocate to nearby communities or other countries with lower taxes. A local tax on transactions such as

the Value Added Tax (VAT) or a Goods and Services Tax (GST) is also likely to shift both production and sales to other communities or even other countries. But land is permanent. Tax land and it will still be in the same location next year. To be sure, a tax on land can influence how that land is used. But, however it is used, the location will not change.

Because land is immovable and highly visible, it is in principle fairly easy to discover changes in land use, new buildings, building expansions or new subdivisions of land. Discovering the actual income of a household can be extremely difficult. Monitoring sales subject to a VAT tax also requires sophisticated audits. Discovering a new home under construction or a new business in a previously vacant structure is frequently much more obvious to the entire community.

People who live and work in a community obtain benefits from that community such as the use of public roads and other public services. If a tax qualifies as a “benefit tax” the taxes paid by a household are roughly proportional to the benefits that household receives from the community. If the LPT is well designed, those who receive greater benefit from the community will pay more in taxes.

When a community invests in public infrastructure such as road improvements, improved water systems, better sewage treatment facilities or the like, the community or neighborhood becomes more attractive and desirable. People are willing to pay more to live in that community, and consequently land becomes more valuable. Sometimes the increase in value is the result of land use decisions taken by the local government, such as granting development rights on land that was previously farm land. Sometimes the value increase is simply the result of population growth. The point is that this increased value is not the result of any investment made by the land owners or occupants, but is a direct result of public investment. The concept of “value capture” is that local governments should be able to capture

Definition: The “base” of a tax is the value or amount that is subject to a tax. The base of the income tax is personal or business income. The base of the Value Added Tax (VAT) is the price of the good from one stage of the production and distribution process to another leading to a final sale. The base of the LPT is tied to land and the immovable improvements (most commonly buildings) attached to that land. As discussed later, the base of the LPT can be defined in a number of ways, but they all share the property of being immovable.

part of the increase in private values to help pay for the public improvements that brought about the increased value.

As stated at the HABITAT Conference of 1976:

“The unearned increment resulting from the rise in land values resulting from change in use of land, from public investment or decision, or due to the general growth of the community must be subject to appropriate recapture by public bodies (the community), ...”

The LPT can be an excellent means to accomplish this value capture. If the tax base is sensitive to and reflects public investments, changes in land use or population growth, then the LPT will capture part of the increment in property value for governments.¹

If local governments are to be responsive to local needs and local priorities, at least some of their revenues must be under local control. Because the base is immovable and readily discoverable, LPTs can provide a stable foundation for locally generated resources to meet local needs.

At the same time, LPT foster transparency and accountability in government. Citizens expect to see the impact of the taxes they pay in better infrastructure, improved services and other community improvements. When they do see results that improve their lives, they are more willing to pay their taxes and support local officials. When the results are not apparent, support and willingness to pay erode. Moore and Rakner (2002) note that as governments move away from more or less hidden taxes on imports and exports and toward direct taxes on residents, there is likely to be a contemporary improvement in governance. As governments become more transparent and more accountable, proponents claim that the quality of government will improve (Raich 2005; Schneider 2004). There are few taxes more transparent than land-based taxes, which can lead to public outcries at tax time, but certainly increases the accountability of government to the governed.

Economists have long supported a tax on land as the effective form of taxation along with

taxes on consumption such as Value Added Taxes (V.A.T.). While economic theory is less supportive of a tax on immovable improvements, practical considerations often make such a tax desirable. (As will be discussed in section 7.2.2, it is possible to reap many of the benefits of a land-only tax while still imposing a tax on improvements if desired.)

Economists find the LPT attractive for two reasons. First, a tax on land minimizes the distortions created in the broader economy.² Second, public finance economists favor the LPT because it increases the intensity of land use and mitigates the incentives for urban sprawl and land speculation.³ If it is costless to hold land without developing it, land speculators will tend to wait for land values to increase, hoping for larger profits in future years. LPT tend to discourage such behavior by making it more costly to simply hold unproductive land. Likewise, large landowners will be encouraged to use their land more efficiently or sell idle land if they face an annual tax on their holdings.

Another potentially important attribute of the LPT is that, when designed appropriately, the resulting revenue tends to grow as the local economy grows. At the same time, because the base is large, the burden on any given household or business should be both manageable and fair.

This section has argued that land and property constitute an important base for mobilizing revenue to meet public service needs. Land is immovable. Immovable improvements on the land are difficult to hide. Those who benefit most from public investments will likely pay a larger share of the tax. Taxes on land and improvements can capture part of the increased land values that often result from public investments and improved public programs. By giving local authorities autonomous revenues, LPTs can foster improved local accountability and responsiveness. In the next section, the most common LPTs are introduced and compared.

¹ To be sure, private investment and community initiatives also result in higher land and improvement values, and such increases will be identified and taxed as well.

² For a more detailed discussion of this point, see Cohen and Coughlin (2005).

³ See for example Song and Zenou (2006) and Oates and Schwab (1997).

3. LAND AND PROPERTY TAXES AND FEES COMPARED

Over the centuries and across the world, governments have tied numerous taxes and fees to land and improvements. Table 3.1 summarizes the taxes and fees frequently associated with land and its development. All of the taxes and fees shown in the table are collected in various countries, and thus each is an option available to government and community leaders. Each also has advantages and disadvantages as discussed below.

3.1 ONE-TIME FEES AND TAXES

Development fees, impact fees, planning fees, etc., are among the one-time fees local governments charge. These fees are levied generally by local governments to offset the cost of managing the development process or to mitigate the impact on the existing public infrastructure. Development and impact fees have been applied to a wide range of “impacts.” The most obvious are roads, water, sewer and

TABLE 3.1 TAXES AND FEES APPLIED TO LAND AND/OR IMMOVABLE IMPROVEMENTS

Tax/Fee	What is taxable?	What is the basis for determining the tax or fee?	When is the tax or fee collected?
Development fees	Market value of new private investment in development	Cost of overseeing new development or mitigating impact of development on public infrastructure ⁴	Once, at the time permission to proceed with development is granted ⁵
Estate tax	Generally all land and property included in estates above a defined threshold of total value	Value of land and property transferred as part of an inheritance	Once, following the death of the estate owner
Capital gains tax	Real property when sold	Value of real property sold, less the original purchase price	Once, as part of the income tax system
Transfer taxes and stamp taxes	Any transfer of registered land title or other land rights to another party	Market value of real property transferred	At the time registered land right is formally transferred
Betterment tax	Increment in real property value due to public investment or approved change in land use	Land and improvement value after the change, less land and improvement value prior to the change	Once, at time of investment or when permission to change land use is granted ⁶
Severance tax	Natural resources extracted from land	Number of resource units (tons, barrels, etc.) extracted	Due once, when the extraction takes place; payable periodically
Annual LPT	Privately owned or controlled land and immovable improvements	Market value of land and property or Physical characteristics of land and property	Due annually; payable either annually, monthly or quarterly

4 “Infrastructure” can be interpreted broadly. San Francisco, California requires developers to replace housing that is demolished as part of commercial development.
 5 Development fees can be assessed as required cash payments or in-kind by requiring the allocation of land for public purposes such as roads, parks, schools, utility easements, etc.
 6 Betterment levies can also be exacted in-kind. Property developers can be required to either transfer portions of the land involved to the local government or they may be required to invest in specific off-site improvements. In either case, the other aspects of betterment levies apply.



Urban Housing improvement scheme in Istanbul, Turkey. Photo © UN-HABITAT

electric utilities. New growth often requires expansion of existing public infrastructure systems. But that infrastructure can also include services. For example, in cases where new development is expected to increase the burden on public education, education impact fees have been levied. Because these fees are intended to offset the costs from new development experienced by communities, a number of local judicial systems have held that the fees assessed should approximate the actual costs incurred. Under such limitations, it is difficult to realize a substantial increase in new local revenues from development fees, though they may be an important source of funds to address the pressures of new growth. One limitation of development and impact fees is that they tend to be very cyclical, meaning revenues fluctuate quite dramatically with market conditions. In good times, the fees can be quite substantial, while they may disappear altogether in recessionary times.

The second type of one-time taxes listed in Table 3.1 and often applied to land and property is the estate or inheritance tax assessed as

wealth (including land and improvements) is transferred as part of an inheritance or estate. In some instances a distinction is drawn between an **estate tax** which is levied on the total value of a person's estate, and an **inheritance tax** which applies only to property that is passed to an heir. In either case, the tax as it applies to land and property is assessed based on the market value of the real estate. Often an exemption is granted for estates below a specified value. In the case of estates heavily invested in real estate but lacking the cash necessary to meet the estate tax, this tax can prove quite burdensome for the heirs. They may be forced to sell all or part of the real estate in a very short period of time in order to meet the tax obligation. One recent survey of 30 European countries found that only five had no inheritance tax. (AGN International-Europe, 2010)

The **capital gains tax** is assessed on the profits resulting from the sale of a property. Capital gains tax differs from the inheritance tax in that it applies to the sale of real property rather than the inheritance of property. Capital gains taxes are most commonly integrated with the income tax system. If an investor sells a property, then as

part of completing the income tax filing for that year, a calculation is made of the net proceeds from the sale (sales price minus the amount invested in the property), and the tax on those proceeds is paid with the income tax. Often, the tax rate on capital gains is lower than the rate on other income. It is also frequently the case that the rate varies with the length of time that the property is held, in an effort to reward long-term investors while penalizing speculators. Capital gains taxes are often criticized as discouraging capital investments though they are still employed in a number of European and other industrialized countries.

Transfer taxes are assessed when the statutory title to land is transferred to another party. The transfer tax differs from the capital gains tax in that the capital gains tax is a tax on income (the value of the sale, less the original investment), whereas the transfer tax is a tax applied generally to the total value of a land transaction and must be paid in order to complete the transfer of title to another party. It is often charged even if the transfer is not the result of a sale.

Transfer taxes are common around the world. The tax is most commonly applied to the market value of the real estate being transferred. Table 3.2 summarizes the transfer tax rates in effect in a sample of countries in early 2010. It is clear from the table that there is wide variation in transfer tax rates.

In considering the appropriate rate for the transfer tax, policy makers should consider carefully the incentives created by the rates selected. High transfer tax rates may discourage business investment. And high transfer tax rates are likely to encourage misrepresentation of sales prices by buyers and sellers, which undermines other aspects of the tax system. Perhaps most detrimental, if taxpayers perceive the transfer tax to be too high, they are less likely to register the property transfer at all.

Betterment levies are intended to allow the community to capture part of the increased value

Statutory title refers to a legally registered ownership claim or right that can also be defended in the courts. In contrast, many property rights are communal or informal.

that often results when infrastructure is improved or permission is granted to change land use. Betterment levies differ from development or impact fees because they are an explicit attempt to share in the private value gain resulting from the public action. They differ from annual LPTs in that they are a one-time assessment and generally apply only to the increment in value resulting from the public investment or the change in land use.

In Denmark, for example, when farmland is legally transferred to an urban zone, a special land development gains tax (*frigorelsesafgift*) requires payment of approximately 50 percent of the increase in value resulting from the change in zoning. Similar land use changes in Poland can bear a tax of up to 30 percent of the increment in value when the land is sold within a five year period. In Argentina, provinces and municipalities may finance certain public works by *contribuciones de mejoras* (betterment levies) when the improvements result in increased land values. Rezk reports that as a rule, the governments “identify certain categories of beneficiaries and share part of the cost of construction among them in proportion to estimated benefit” (Rezk, 2004, pg 285).

Betterment levies have a long history, but most recently they are seeing some resurgence in India. Under the Town Planning Act, a number of cities have adopted or are considering a betterment “charge.” Mumbai is only the most current city moving ahead with such a tax. Over the years, betterment levies have generally not fared well. They tend to be politically very unpopular and perhaps as a result, difficult to collect in any sustained way. Mexico is just one case where betterment levies are permitted but

TABLE 3.2 TRANSFER TAX RATES: 2010⁷

Region	Country	Transfer tax rate
South and Central America	Argentina	~2.5%
	Brazil	2%
	Chile	0%
	Costa Rica	~2.3%
	Peru	3% - 9.5%
	Venezuela	0%
North America	Canada	~2%
	Mexico	2% - 5%
	United States	0% - 2%
Asia & Australia	Australia	5.5%
	Cambodia	~4%
	China	8% - 10%
	Indonesia	5%
	Japan	2.5% - 6%
	Republic of Korea	4.6% - 9.4%
	Malaysia	1% - 3%
	Philippines	0.5%
Europe	Belgium	10% - 12.5%
	Cyprus	3% - 8%
	Denmark	0.6% - 1.5%
	Finland	4%
	France	0.7% - 5.1%
	Germany	4.5% - 4.5%
	Greece	19%, 9% - 11%, 1%
	Ireland	0% - 9%
	Italy	~10%
	Luxembourg	~10%
	Malta	5%
	Netherlands	6%
	Norway	2.5%
	Portugal	0.8% - 7.3%
	Spain	0% - 7%
Sweden	3%	
Switzerland	0% - 3.3%	
United Kingdom	0% - 4%	
Russia & former Soviet Union	Czech Republic	3%
	Poland	0%
	Romania	0%
	Russia	18%
	Ukraine	22.4%
Africa	Burkina Faso	8%
	Dem. Republic of Congo	3%
	Mauritius	5% - 15%
	Mozambique	2.4%
	Niger	1.5%

⁷ Sources: World Bank, www.Doingbusiness.org; Taxand, 2010, *Real Estate Tax Calculator*; National Conference of State Legislators, 2010, *Real Estate Transfer Taxes*

not widely used because of implementation issues. (Bird, 2004) Betterment levies assessed in-kind have been more successful. These in-kind transfers may take the form of land transferred to local governments or off-site infrastructure improvements required by local governments.

A variation on the betterment tax is being implemented in São Paulo, Brazil. In this approach, a local government agency identifies the amount and type of additional development that will be permitted in a given area. The agency then issues Certificates of Additional Construction Potential (CEPACs) for that area, and sells the CEPACs through an electronic auction. The first auction took place in the Agua Espraiada area of São Paulo in July 2004. One hundred thousand CEPACs were offered at a minimum price of US\$150. All were sold producing US\$15 million in revenue. The income was earmarked in advance to two infrastructure investments: the construction of a new bridge and 600 affordable houses in a designated slum area. Sandroni (2010) provides a more detailed discussion of the multiple CEPAC auctions that have been used in São Paulo.

Not all such auctions have been so successful. When the minimum auction price resulted in essentially an increase in land costs for developers as in the Faria Lima area, developers have been less responsive. Sandroni (2010) concludes that countries attempting to replicate the São Paulo experience should use extreme care. The CEPAC mechanism requires both a buoyant real estate market and a robust financial market as well. It also requires considerable expertise on the part of public servants.

Severance taxes are also one-time taxes, applied to natural resources such as oil, coal, metals, etc., that are extracted from land. Except for forest products or other renewable resources, once the resource is extracted, it cannot be replaced. Severance taxes are most commonly excise taxes, meaning that the base for the tax is the number of resource units extracted, rather than the current market value of those resources. For example, a flat-rate severance tax of a specified

amount may be applied to each barrel of oil extracted, regardless of the world price of oil on the date of extraction. While severance taxes can generate enormous sums in the short or medium term, policy makers should bear in mind the finite nature of this type of resource, and should consider carefully how best to use the revenue to benefit future generations as well as the current population.

One of the principles of good fiscal management is that one-time resources should generally not be used to fund on-going services (or recurrent expenditures in general). Hiring employees and creating service expectations which rely on one-time or highly volatile revenue sources frequently results in fiscal and political challenges. Most of the taxes discussed above would be considered “one-time” revenues. A local government may collect a development fee to help expand a road, but there will be no further revenues from that project to maintain that road or pay for street lighting. Transfer taxes can be collected only when the statutory title changes hands which may be years apart. Betterment levies have faced a number of practical challenges around the world and over the years, but even if collected as designed, they come only once⁸. Reliance on one-time fees and taxes such as these means that local revenues will at best be unstable and at worst inadequate to provide a foundation for the fiscal needs of local governments. On the other hand, one-time revenues can be an important source of capital for community improvements, especially as investment capital flows into a community from outside.

3.2 LAND RENTS AND LAND LEASES

In those countries where all land is publically owned, governments enter into long-term rental or leasing agreements which grant to private individuals the right to occupy, improve and

⁸ Betterment taxes also cannot capture the increased value resulting from broader changes in the community such as general population growth, since they are tied to specific government investments or actions.

use land for a specific period of time. These leasehold interests are frequently transferable to other parties and can thus be bought and sold. In exchange for the right to occupy and use the land, the lessee makes periodic payments to the government. While these rental or lease payments are recurring, it is important to distinguish them from a tax. These are payments made for the privilege of occupying and using the land, and they do not reflect the service burden placed on the community. Whatever use the lessee makes of the land, that lessee will also use public infrastructure and public services and the cost of that public usage is not reflected in the land rents. This does not in any way suggest that land rents and leases are unimportant sources of revenue in communities where they are used. The resulting revenue can provide important capital for urban development. The point here is simply that paying ground rent and paying a tax based on land are not incompatible and such an arrangement does not represent double taxation.

3.3 ANNUAL LPT

The only regularly recurring tax based on land and improvements paid by landowners or occupants to support public infrastructure and public services is the annual LPT. While the discussion here focuses on an “annual” tax, there are numerous instances where the tax is levied once a year, but paid either quarterly or monthly. The annual LPT has been designed and implemented in a variety of ways around the world, and has existed in some places for centuries.

All too often, however, it is not a strong contributor to the resources available for urban improvement in developing countries. The annual LPT can be administratively complex and may stress the capacity of local governments. The annual LPT requires attention to both policy and administration. The annual LPT represents the subject of most of the rest of the present publication.

3.4 SUMMARY

This section has outlined the principal methods for levying taxes on land and property in the world. To be sure, labels change and implementation nuances are many, some of which will be highlighted in the examples which follow. But the basic concepts of LPTs are fairly straightforward. Land and property can be taxed effectively when something about it changes, whether that be ownership or use. Taxes related to changes in ownership include transfer taxes, estate and inheritance taxes, and capital gains taxes. Taxes and fees related to changes in land use include development fees, betterment taxes and levies, and the special case of severance taxes.

Land and property can also be effectively taxed if there is no change in ownership or use. In fact it is important to consider such a tax since most land will not see a change in either ownership or use in any given year. An annually recurring tax on land and/or improvements can make a stable contribution to public revenues if it is adapted to local conditions and capacities.



Residents of an informal settlement in Colombo, Sri Lanka. Photo © UN-HABITAT/Suzi Mutter

4. RELATIONSHIP BETWEEN LOCAL PRACTICES, CAPACITY AND THE ANNUAL LPT

The structure of the LPT in a given context should reflect actual practices and local capacities along four dimensions. First, the LPT system should reflect and be sensitive to the local institutions and traditions related to land and property rights. Second, the LPT system will need to accommodate the extent to which such land and property rights are publicly recorded and actively enforced by the judiciary. Third, different design options exist depending on the extent to which land and property rights are actively traded in reasonably efficient markets. Finally, policy and practice will be influenced by the administrative capacity of government entities. Since each of these four dimensions plays such an important part in determining the best options for designing and implementing the LPT, each merits a more complete description here. The section concludes with a discussion of corruption and its impact on LPT.

4.1 LAND AND PROPERTY RIGHTS

UN-HABITAT has produced a very useful discussion of land rights and land right security in their publication *Secure Land Rights for All* (2008), and the reader is referred to that publication for a more complete discussion of the points only summarized here. It is generally agreed that property rights are most productively seen as a combination of various elements, including the right to:

- Occupy, enjoy and use
- Cultivate and use productively
- Restrict or exclude others
- Transfer, sell, purchase, grant or loan
- Inherit or bequeath
- Develop or improve
- Rent or sublet
- Benefit from increased property value or rental income

Documented land rights may also facilitate other rights and opportunities, such as the right to security of tenure, civic participation, access to basic services or to bank credit. This “bundle of sticks” approach to property rights is useful because it becomes immediately clear that the entire bundle may not be possessed by a single group or individual. Different parties may hold different rights regarding the same parcel of land. The most obvious case is land that is rented or leased. The lessee holds the right to occupy and use the land for a specified use and often for a specific period of time. While the lessee may have the right to sublet to another party, she does not have the right to sell the land and may not have the right to change how the land is used.

There are also cases when countries recognize different combinations of property rights. For example, in Thailand there are a range of legally recognized and recorded bundles of rights. At one end of the continuum is the “title deed” which is a registration of freehold ownership including all of the rights listed above. Other properties may be held in perpetual use by a family and may be inherited by their descendants, but the land may not be sold in the open market. In addition, some public lands may be occupied through a temporary “right to use” which may not be transferred or inherited. In addition, Thailand has provided a number of intermediate titling stages that allow occupants to pursue a full title deed. The result in Thailand is a legally recognized array of arrangements recognizing different rights obtained through different channels and representing different combinations of property rights. The point is simply that what is meant by property rights will depend on the particular historical, cultural and political context.

For purposes of the LPT, two views are particularly important regarding property rights, and which dominates in a particular community will have important implications

for the design of the LPT. One view sees land as most fundamentally an economic commodity, and land rights in terms of economic potential⁹. In this view, governments should seek to regularize and record land rights, especially the complete bundle of rights represented by freehold ownership, so that land owners will have improved access to credit markets. While access to credit markets is an important consideration, it is at least as important to recognize that “rights to land” differs markedly from “land rights” Increasingly, rights to land and property are seen as essential to the achievement of human rights. Access to land and security of tenure are regarded as an important “means to achieve human rights, as defined by international conventions.” The *EU Land Policy Guidelines* further argues that “land titling is not always the best way of increasing tenure security, and nor does it automatically lead to greater investment and productivity.” (EU, 2004, p 6)¹⁰ Access to land is an inseparable ingredient in a poor household’s ability to survive, earn, thrive and lift itself out of poverty¹¹.

[Secure land tenure and rights to property] are fundamental to shelter and livelihoods; as such, they are an important foundation for the realisation of human rights and for poverty reduction. Secure land rights are particularly important in helping to reverse three types of phenomena: gender discrimination; social exclusion of vulnerable groups; and wider social and economic inequalities linked to inequitable and insecure rights to land (UN-HABITAT, 2008a, p 3).

Importantly, tenure security in this context is in the first place “the right of all individuals and groups to effective government protection against forced evictions” (UN-HABITAT, 2008a, p 5).

⁹ See Assies (2009), Borrás and Franco (2010) and Payne (2001) for a more detailed discussion of the two main perspectives being debated.

¹⁰ See also FAO (2002)

¹¹ UN-HABITAT, 2008b, *Housing the Urban Poor in Asian Cities*, Quick Guide 3, United Nations Human Settlements Programme

Clearly, it is beyond the scope of this guide to attempt to resolve or even enter into this discussion. The perspectives are pointed out here solely to make two points which are central to the functioning of the LPT. First, whichever view is adopted does not affect the potential of an effective LPT to enable government officials and community leaders to raise revenues needed for public services and public investment. Second, the view taken on rights related to land and property will affect how the LPT is designed and particularly how it is administered.

To give just one quick example here which will be explained more fully below in section 8.2, if land is seen as an economic commodity, then if a household does not pay the LPT, the ultimate collection sanction is to seize the land and sell it at auction as happens (though rarely) in many western countries. But if land is fundamental to achieving basic human rights such as shelter, livelihood or food, then seizing land for non-payment of taxes is probably not an option and other sanctions and incentives must be incorporated in the design of the LPT.

So in designing the LPT for a given community, consideration should be given to how the community historically and currently views land-related rights.

- Which rights are held by whom will affect who bears the tax obligation
- Whether or not seizing land for nonpayment of taxes is acceptable under the adopted view of land rights will affect the design of collection efforts

4.2 LAND AND PROPERTY RIGHTS AND TENURE REGISTRATION

Secure Land Rights for All (2008a) also appropriately describes land rights as a continuum ranging from informal land rights at one end to formal and registered rights at the other. In between fall a variety of different socially recognized bundles of land rights such as customary rights, group tenure and leasehold rights. The same publication describes a continuum of tenure arrangements. Land tenure can range from freehold tenure which bestows

ownership in perpetuity with full rights to use or dispose of the land, all the way to a variety of non-formal tenure systems. And there are many different tenure arrangements that fall in between the two ends of the continuum.

In practice most of these tenure forms can be found in any given society. For example, there may be private residences and farms, communally owned grazing lands and state owned forests. In many contexts, communal rights may include rights to graze in the common pasture and exclusive rights to a plot of agricultural land and a residential parcel.

The key issue for purposes of the LPT is where and how these tenure rights are recorded, if at all. The presence of customary tenure arrangements in a community may result in what some have termed “extra-legal” tenure. These are properties held not against the law, but the tenure is not protected or recognized by the law. Local *de facto* tenure regulations are simply ignored by national law. Such extra-legal tenure can happen in societies that also have formally recognized or statutory tenure rights and illegal tenure, meaning that the properties are held in violation of the law¹². These are issues of importance for the LPT because tax policy must define who owes the tax, tax officials must be able to deliver the tax bill to the appropriate party, and they must be able to follow up in the collection process. In Jamaica, for example, 48 percent of all land parcels do not have a registered owner. In some parishes the figure is as high as 69 percent (Land Valuation Division, Jamaica National Land Agency, 2010). This is not to say that the land is abandoned. Many people in the immediate neighborhood know exactly who owns a given parcel. But that ownership has not been recorded with the national government’s land registry. To be sure, there are ways to design and implement the LPT in countries like Jamaica, but the methods must be adapted to the current property registration system. An on-going challenge that Jamaica faces is the difficulty of delivering tax bills and collecting on taxes due when the land is vacant and the owner is unregistered.



Ways of harnessing land property value in Sao Paulo, Brazil. Photo © UN-HABITAT/Malcolm Boorer

The lack of formal registration can emerge for a variety of reasons related to local history and policies. In Egypt, for example, prior to their most recent LPT reform, 85 percent of the land parcels were not on the property tax rolls, yet they have had LPT since the Ottoman Empire. But in the 1950s, the national government limited the LPT to urban areas, and created maps that defined those areas. Much of the development that has happened since has occurred outside those defined urban areas with the result that the LPT was never applied to new development.

In Latvia, the process of de-nationalizing land that had been confiscated during the Soviet occupation and privatizing buildings constructed during the same period has never been fully completed. The result is that a large number of parcels do not have a registered title.

The reasons for not formally registering titles are often the same across countries: complexity, cost and failure to see the need. The registration process in places like Jamaica and Latvia requires that the land be described precisely, often requiring the services of a land surveyor. Documentation of ownership interest must be provided, often difficult to provide if the original

¹² It should be further noted that this simple distinction between legal, extra-legal and illegal tenure oversimplifies the range of legal, religious and social arrangements found around the world.

acquisition was handled informally. In many instances, legal assistance is required to complete the necessary paperwork. When all is ready, a registration fee and stamp duty must often be paid before final approval and registration.

And many land owners do not feel the need to go through the process. If the customary tenure right is acknowledged by the community, they argue, what is the value in registering with a government agency? Generally the response is that a registered title provides greater access to formal credit markets. Access to credit could provide land owners with resources to improve their property or invest elsewhere, it is often argued. While this is sometimes true, and assuming there is sufficient stable income to service the debt, the idea of risking the family land and livelihood by pledging it as collateral to a bank is quite foreign in some cultures. Even if the idea of borrowing against family property is not objectionable, until a property owner actually feels a need to complete the registration process, they are likely to defer going through the complex and expensive process of land registration.

In some countries, such as Jamaica, it is also common to bequeath land to the family as a whole rather than specific individuals in the family. In such a case, registering all the ownership interests may result in literally dozens of registered owners for a given parcel. In countries that are transitioning from state ownership to private ownership, such as Latvia, de-nationalizing land and privatizing buildings often results in a land parcel and the buildings on that parcel being owned by different parties.

The point of this discussion is that in many developing and transitioning countries formal land registration systems are incomplete. In such a case, an effective LPT should consider what informal or customary tenure processes exist and how these might be employed in the design and implementation of the LPT. Careful consideration of the land and property registration systems will influence decisions about:

- Who owes and who pays the LPT;
- How the billing and collection systems will function.



Woman collects and records savings from members of a saving group in Mumbai, India.

Photo © UN-HABITAT

4.3 THE MARKET FOR LAND AND PROPERTY RIGHTS

Defining what it is that will be subject to the LPT is also a function of how developed the land and property markets are in a country or region. In many countries, the LPT is applied to the market value of land or to land and the immovable improvements attached to the land. Market value is defined as the price agreed to by a knowledgeable and willing buyer and a knowledgeable and willing seller, neither of whom are acting under duress. The annual tax is then calculated as a percentage of the market value thus defined.

Such a market-derived standard makes strong assumptions about the existence and functioning of real estate markets. It assumes that:

- Capital markets also function reasonably well to finance real estate purchases;
- There are an adequate number and quality of supporting trades such as valuers (appraisers), estate agents, advertising outlets, etc., to assure the adequacy of information for buyers and sellers;
- Property rights and titles are well-defined, well documented and marketable; and
- There are enough market transactions for all classes of property in various locations to be able to reliably establish an estimate of market value.

In many developing countries, such markets simply do not exist. In some instances, such markets may exist in major urban areas or for certain classes of property, but not for all properties or not in smaller communities. For example, the real estate market for upper income properties in Cairo or Alexandria may be fairly strong, but there may be no formal market for low income properties in those same cities.

And in some instances, markets may be active but informal. Land or housing are often bought and sold in an informal settlement without registering those transactions or seeking funding through formal credit markets.

If there are active formal real estate markets in a given area, then it is possible and often desirable to tie the LPT to the market value of the land and improvements. But without active land and property markets attempting to base the LPT on non-existent or non-observable market prices will simply lead to frustration and failure. On the other hand, there are very reasonable approaches to establishing LPTs that are not based on market value, and many countries use them. Thus, one key consideration in designing the LPT is whether there are active real estate markets in the community.

- If there are active real estate markets, the LPT should be tied to market value;
- Lacking reasonably efficient real estate markets, the LPT should be based on one of the non-market approaches described more fully in section 7.1.

4.4 THE CAPACITY OF GOVERNMENT AGENCIES

The final consideration that government officials and community leaders must evaluate in developing or improving the LPT is the capacity of the entities that will be charged with implementing the LPT system. Depending on the design choices made, an LPT can be administratively complex. Because the system often involves administrative discretion, the system can be fall prey to corruption and abuse as discussed more fully in section 4.5. Consequently, the ability of taxing authorities to efficiently and fairly administer the LPT should be weighed carefully. Often the best systems involve shared responsibility between two or more levels of government, each bringing to the LPT system their own strengths. The importance of administrative capacity shows up most clearly in four areas: monitoring land use, valuation, billing and collection, and appeals.

4.4.1 MONITORING TAXABLE LAND AND PROPERTY

One of the great strengths of the LPT is that the base (land) is difficult to hide and impossible to move. Income can be hidden and those who earn it can relocate. Retail sales can shift to lower tax jurisdictions. Land by its nature is immovable, and buildings constructed on that land are difficult to hide. But these very desirable features do not mean that the tax base is obvious and unchanging. Consider just a few simple examples:

- Outside of Cairo, Egypt, a parcel of land previously used for farming is converted to residential use. Because authorization for the conversion in type of use requires the approval of the Ministry of Agriculture, the new construction is non-conforming and technically illegal. No construction permits are requested or issued.
- The ground floor of a residential building in a suburb of Porto Alegre, Brazil is converted to a retail shop. The owner of the building still lives above the shop, but no city permit for the conversion was obtained.
- A family has a large residential parcel of land in a smaller community in Jamaica. It has been the family home for years. Now the oldest son needs his own home. The family allows the son to build a new home next to the family home. No approval is sought from the city and no construction permit is obtained.
- Alternatively, rather than allowing the son to build a separate structure, the family decides to add on to the existing structure, doubling the size of the current home.

These are simple examples, but they are typical of similar developments in many countries. In each case it is assumed that there is an approval process in place to authorize the action taken, but that because of cost or bureaucratic delays, the landowner has elected to go ahead without formal approval. Ignoring the question of enforcing land use regulation, the question for the LPT is how the tax authority will learn of the change in land use or building structure? This is the problem of discovery, and it is an ongoing

task in every jurisdiction that implements the LPT.

Discovering new construction or changes in land use is particularly difficult if the public agency responsible for determining the tax bill is a central government authority, as it is in Egypt, Jamaica, Latvia, Cambodia, Ukraine and many other countries. The task of monitoring changes in the local community is best left to local government officials, because local government officials live and work in the general area and can most readily detect changes as they occur. But assigning discovery to local governments implies that local governments have the capacity and the incentive to effectively carry out the task.

4.4.2 VALUATION OF THE BASE

Whether the LPT is based on the market value of real estate, physical attributes and location of the property, or some other model of value, someone must determine the taxable value of each parcel. Unlike the income tax or a value added tax where the taxable value is determined by something potentially directly observable, determining the taxable value of land and improvements inevitably requires an administrative judgment. Even if valuation is by formula, assembling the formula inputs requires gathering and managing information, assessing the relevance and accuracy of that information, and actually applying the formula. And when the valuation of a given parcel is multiplied by the number of parcels in a community, province or nation, the task becomes daunting indeed. Computerization can help immensely, but that too adds a layer of required technical capacity and expertise that may strain local resources.

It is frequently the case that higher levels of government are better able to attract, train and retain the human capital necessary for the more technical aspects of valuing property. For example, in both Latvia and Jamaica, property valuation is carried out by national government agencies. In Colombia, with the exception of the capitol Bogotá and three other large urban areas, the property valuation task is assigned to a national Geographic Institute (IGAC). Even in countries with large urban centers



Surveying of properties in Freetown, Sierra Leone. Photo © UN-HABITAT/Malcolm Boorer

and substantial local capacity, the valuation of specialized properties such as railroads, pipelines, electric utilities, ports and airports is frequently assigned to a higher level of government.

Even if valuation is assigned to the local government, there is often still an important training and oversight role for a more centralized agency.¹³ Precisely because valuation often involves judgment, and the exercise of discretion can result in mistakes or corruption, many of the best LPT systems involve training, support and quality reviews from a central agency. Which agencies should fill this oversight role will depend on the structure of government in a given country. The national government should only retain this responsibility in relatively small countries which do not have sub-national governments that organizationally fall between municipalities and the national government. In federal systems involving states, provinces or a similar level of government, the role of oversight and training will be most effectively carried out by agencies at that level (see below for further explanation). The valuation tasks which can

appropriately be assigned to local government officials will depend on the administrative capacity of those local governments.

4.4.3 BILLING AND COLLECTING THE TAX

Administrative capacity also influences tax billing and collection procedures. In Latvia, for example, the tax due is calculated by the central government agency, but the local government prepares the tax bill, mails it to the taxpayer and collects the tax. This arrangement can create some confusion if the records of the central authority and the local authority do not agree. Clearly, strong cooperation and good communication are required.

If local mail delivery is unavailable or unreliable, other means of delivering the tax bill must be pursued. In some instances, local government agents go door to door delivering tax notices. It may also be possible to contract with a local utility company for delivery of the tax notice. And emerging technologies can make payment of the tax much more convenient. In Kenya, for example, the LPT can be paid using cell phones. Whatever the challenge in administering the LPT, there is generally a practical approach that will meet the local need. The key is to anticipate

¹³ See section 6.0 for a discussion of what is meant by a centralized agency and for a more complete discussion of the points raised in this paragraph

the need, evaluate the resources available to meet the need, and to deploy all resources to best advantage.

4.4.4 APPEALS

No tax system is perfect in either design or implementation. The LPT is no exception. Errors will creep into the best databases. Clerks will transpose numbers. Administrators will misinterpret data. Mistakes will happen. Even if there is no error in a given instance, the taxpayer may feel that she is not being treated fairly for a variety of reasons. The design of the LPT needs to include provision for taxpayers to appeal the amount of tax due, and the government administration therefore must provide sufficient capacity for such appeals. Ultimately of course, the taxpayer can appeal to the courts, but formal judicial proceedings are nearly always very slow and very expensive for all parties. And if on careful review there is an obvious error, it is much better to resolve the discrepancy through an administrative process rather than through the judiciary.

One of the ways for resolving LPT appeals is to involve an independent panel of local residents who are taxpayers but who are not employed by the local government. Such panels can objectively evaluate the claims of the taxpayer and the evidence of the tax authority. Of course the decisions of the local panel should also be appealable to the judiciary if either party so chooses.

The appeals process requires that local governments be prepared to receive appeals in an orderly manner, schedule hearings before the appeals panel, and record and act on the decisions taken by the panel.

While the administrative tasks associated with the LPT are substantial, in a well-functioning LPT they should not require the expenditure of more than 3 to 4 percent of the revenue collected. The percentage may be higher if some of the administrative tasks are contracted to private entities. But if such contracting can

improve the efficiency, fairness or collection of the LPT, it may well be worth the additional cost. For more discussion on the appeal process, please see section 8.2.

4.5 CORRUPTION

Corruption, or the misuse of public office for private gain, is a pervasive problem in many countries.¹⁴ Corruption in a government's revenue system is particularly corrosive because it reduces net revenues collected, undermines public confidence in government and ultimately compromises the legitimacy of government. Public confidence and belief in the legitimacy of government are key factors in securing tax compliance. Fauvelle-Aymar examined political and tax capacity in 86 developing countries and concluded:

The more the government is legitimate, efficient and credible, the higher is its political capacity to ensure tax compliance. A legitimate government is one that can count on willing compliance or, at least, assent to its directives¹⁵.

This conclusion applies quite directly to LPT as well. The overall relationship between control of corruption and LPT revenues is highlighted in Figure 4.1. This figure summarizes IMF-reported LPT revenues from 78 countries. The countries are divided into four equally-sized groups based on their control of corruption index as developed by Kaufman, Kraay and Mastruzzi¹⁶. "Control of corruption" in this case means "measuring the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as 'capture' of the state by elites and private interests" (pg 3-4).

It is clear from the figure that countries that are most successful at controlling corruption realize, on average, about four times the LPT revenue

¹⁴ Fisher, 2006; Klitgaard et al., 2000.

¹⁵ Fauvelle-Aymar, C. (1999). The political and tax capacity of government in developing countries. *Kyklos*, 52(3), 391-413, page 410.

¹⁶ Kaufman, D., Kraay, A., & Mastruzzi, M. (2007). *Governance matters VI: Aggregate and individual governance indicators, 1996-2006*. Washington, DC: The World Bank.

(as percent of GDP) as countries with the worst corruption records.

Corruption can enter the LPT system at several points. Land parcels may simply be left off the fiscal cadastre. Values can be falsified as demonstrated in the adjacent box. Property can be deliberately misclassified to avoid higher effective tax rates. And collection efforts can be strategically overlooked in exchange for compensation.

LPT systems often involve numerous opportunities for administrative discretion on the part of government officials. Each such opportunity also affords an opportunity for corruption. If the LPT system is to operate with integrity and legitimacy, it must be based on four key characteristics.

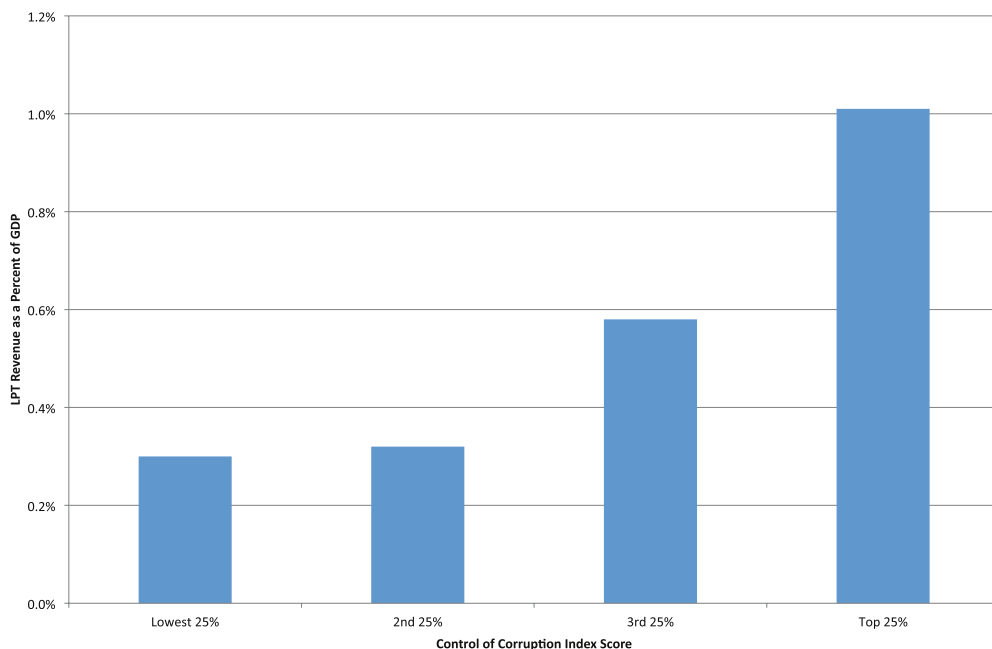
1. *Transparency*—all the processes described in this guide should be open and understandable to the public. The fiscal cadastre should be available for public inspection. The methods used to arrive at taxable value should be clear and open. Tax bills should be open to the public so that any taxpayer can compare their tax bill with other similar properties. Tax delinquencies should be publically exposed.
2. *Limited discretion*—the discretion of tax officials should be limited. To the extent possible, systems should be standardized and automated. As described elsewhere in this guide, land use classifications should be avoided and the number of tax rates should be minimized. Simple systems with minimal opportunities to exercise discretion will result in more uniform compliance.

Valuating corruption

One theatre owner in Mumbai was paying the equivalent of €2,135 per year in LPT. One year the property inspector arbitrarily raised the valuation resulting in a tax bill of €9,760, and then demanded a bribe of €3,050 to lower the valuation. The theatre owner appealed to the municipal commissioner who overruled the inspector. But when the commissioner was transferred, the inspector again demanded the bribe.

3. *Oversight*—multiple levels of government and multiple agencies should be given responsibility for administering the LPT system. Agencies responsible for generating values should have their procedures reviewed by the governments which will receive the revenue. Agencies that prepare the tax bill and collect the tax should be subject to audit by an office with oversight responsibility. Section 8 discusses in more detail how to handle multiple levels of responsibilities.
4. *Accountability*—tax officials responsible for administering the LPT should be held accountable for the accuracy, efficiency, effectiveness and fairness of their procedures and outcomes.

FIGURE 4.1: CONTROL OF CORRUPTION AND LPT REVENUES



4.6 SUMMARY

This section has stressed that government officials and community leaders seeking to design or reform an LPT should bear in mind four factors:

- How land and property rights are conceptualized and recognized in the community,
- The extent to which those rights are formally registered with recognized agencies and enforced by the local judiciary,
- The extent to which land and property rights are actively traded in reasonably efficient markets, and
- The administrative capacity of local and other government agencies.

How a society conceptualizes and recognizes land and property rights will affect both the design and the collection strategies for the LPT:

- Which land and property rights are held by whom will affect who bears the tax obligation

- Whether or not seizing land for nonpayment of taxes is acceptable under the adopted view of land rights will affect the design of collection efforts

The extent to which land and property rights are formally registered with recognized agencies and enforced by the judiciary will influence:

- Who owes and who pays the LPT
- How the billing and collection systems will function

The extent to which land and property rights are actively traded in reasonably efficient markets should directly determine how the base for the LPT is defined and valued.

- If there are active real estate markets, the LPT should be tied to market value
- Without reasonably efficient real estate markets, the LPT should be based on one of the non-market approaches described more fully in section 7.1.



A society's recognition of land and property rights affects the design and collection strategies for land and property taxation. Madagascar. Photo © UN-HABITAT/Mamy Mahenintiana

Finally, the administrative capacity of government agencies and potential for corruption should be carefully assessed in designing the implementation of the LPT.

- Multiple levels of government should be engaged in administering the LPT to minimize errors and abuse, and to assure that the system is meeting policy objectives.
- The administrative tasks of monitoring and managing the fiscal cadastre, valuing the tax base, preparing and delivering tax bills, responding to taxpayer inquiries and appeals and collecting the tax should be assigned to the level of government and the agencies best suited to efficiently and effectively carry out those tasks.
- Anti-corruption provisions should be built into the LPT system to assure transparency, appropriate levels of administrative discretion, effective oversight and accountability.

An evaluation of these four factors in a given community should guide the choices made by policy leaders as they confront the policy and administrative design choices in implementing or reforming LPT. In the next section, these choices are described more fully.



Women participating in a planning process in Nepal. Photo © UN-HABITAT

5. THE LPT REVENUE IDENTITY

In most cases the revenue from a tax is calculated as the product of the value of the tax base times the tax rate. Thus, if a given product is sold for the equivalent of €10 and the VAT is 10 percent, then the tax will be simply €10 times 10 percent or €1. In the case of the LPT, administration plays such an important role that the actual revenue realized must be adjusted to reflect the administrative practices. The revenue generated by the LPT will depend on two policy variables and three administrative factors as follows:

Revenue = Base X Rate X Coverage X Valuation X Collection

Each of these items is discussed in detail separately below.

The relationship between these factors is known as the revenue identity because it identifies the amount of revenue that will actually be collected. Consider a case in which the legally defined base is the market value of all land and buildings, and the rate is set at one percent of that value annually. But for a variety of reasons, only 80 percent of the taxable land parcels have been identified and are included on the tax rolls. In addition, the valuations are several years out of date with the result that properties are valued at only 90 percent of their current market value. The jurisdiction works hard at collections but is only able to collect 85 percent of the taxes as billed. In such a case, the revenue collected will be:

Revenue = Base X 0.01 X 0.8 X 0.9 X 0.85

or just over 61 percent ($0.8 \times 0.9 \times 0.85 = 0.612$) of the revenue expected by simply looking at the base and the rate.

The LPT Revenue Identity

Revenue collected is a function of two policy variables:

- The value of LPT base as legally defined (Base)
- The LPT rate as set by law and policy (Rate)

And three administrative factors:

- The proportion of all land that should legally appear on the tax rolls that actually is included in the fiscal cadastre (Coverage)
- The proportion of taxable value that is identified by the valuation process (Valuation)
- The proportion of the tax levied that is actually collected (Collection)

The total revenue collected will be the product of all these factors:

Revenue = Base X Rate X Coverage X Valuation X Collection

Defining the tax base and setting the tax rate are policy decisions. Managing the coverage, valuation and collection processes are administrative factors. The example presented shows that each is important if the overall revenue goals are to be met. Designing an effective LPT will require that careful attention be given to both the policy and the administrative questions relating to these five elements of the revenue identity.

5.1 DEFINING THE BASE FOR THE LPT

The base of the LPT is the value that will ultimately be used to allocate the tax burden to individuals, households and businesses. The important policy questions in designing the base for the LPT (for which some answers are supplied in later sections of this report) include:

- What should be included in the base? It can include land only, land and immovable improvements, just the improvements, or different combinations of land and improvements for different types of land use.
- How should value be determined, and how often should it be updated? As noted the LPT can be based on the market value of the real estate, proxies for market value or selected physical and locational attributes.
- Who will owe the tax? Part of defining the base includes determining who will owe the LPT. Will it be assigned to the owners of land or those who actually use the land?
- Should these decisions regarding general approach and incidence be uniform throughout a country or should they vary within a country depending on local conditions such as the quality of real estate markets or the nature of recognized property rights?
- Which types of property or ownership classes should be exempted from the LPT, if any, and why? One of the issues confronting every jurisdiction implementing an LPT is exemptions. For example, it is common, though not necessary, to exempt government-owned property. Temporary exemptions have also been granted in some cases because of natural disasters.
- Which level of government and which agency should determine which properties are exempt?

How property rights are defined and registered and the maturity of real estate markets will have a strong impact on how the base is defined for the LPT.

5.2 SETTING THE TAX RATE

The policy questions around rate setting include:

- Should all property be taxed at the same rate? If some property or some property owners are exempted from the LPT, not all property will be taxed at the same rate. But beyond exemptions, should rural farm land and urban residences be taxed at the same rate? Should businesses and households be taxed the same? Should poor households and better off households face the same tax rate?
- Which level of government and which agency should set the tax rate? Setting the rate at the national or regional level assures uniformity and avoids tax competition. Allowing local governments to set the rate empowers local officials and fosters local autonomy. In some cases the national or provincial government establishes a range for the rate, and the local governments are allowed to determine the final rate within that range.

Both the administrative capacity of different levels of government and broader policy objectives will influence LPT rate setting policies.

5.3 COVERAGE

When the base has been defined in law it establishes a standard for which properties and which taxpayers should be included on the tax roll or fiscal cadastre. Coverage is the proportion of all such properties that actually appear on the cadastre and have tax bills generated for them. While it is most fundamentally a product of administrative quality, there are nonetheless important questions to consider in the design and initial implementation.

- How will information be shared between agencies controlling land ownership and occupancy records, construction records and tax records? In many instances, there is very poor communication and cooperation between these agencies. But each controls some of the information required to manage an accurate cadastre and other land records. Pooling of all information related

to land and land use is an important step in achieving high coverage ratios.

- Will it be necessary to change other laws in order to assure that the required sharing takes place?
- Will one agency be responsible for “discovering” new property? Can this responsibility be shared?
- Who will provide the technical and financial resources to establish and maintain accurate land and property records? The assistance of donor agencies may prove very helpful in initiating an up-to-date cadastre, but maintaining the cadastre over time will require resources.

Successful management of the land and property coverage system will be influenced by the types of land and property rights recognized in a community, how those rights are registered or otherwise publicly acknowledged, the administrative capacity of government and the political will of community leaders.

5.4 VALUATION

Here again the definition in law for the LPT base sets the standard for how land and property should be valued for tax purposes. But such laws almost never identify the procedures which should be followed in determining value. They may specify that market value should be used, but they do not stipulate how market value is to be estimated. The law may specify that values are to be updated every ten years, but not address the question of who will pay for updating the values. Given that valuation ratios of less than one mean that legally owed taxes are not being billed and collected, the administrative design questions around valuation are very important. In Argentina, for example, Rezk (2004) reports that taxable values are generally 60 to 70 percent of market value. This suggests that if the legal standard is market value, municipalities in Argentina are billing for 30 to 40 percent less tax than contemplated in the law. This situation can be regressive if the proportion of undervaluation is greater for expensive than for more modest properties.



Valuation of property in Cotonou, Benin.

Photo © UN-HABITAT/Malcolm Boorer

To be clear, in some countries land and property values are ultimately fixed by legislative or presidential decree (e.g., Senegal). Such decrees are the end result of a valuation process that begins with the legal framework defining what value standard will be used (market value, annual rental value, etc.). Administrative staff are then tasked with implementing that standard and arriving at a value for each taxable parcel. The result of their effort is then formally ratified by decree. The process begins with law and ends with the force of law. In between are important administrative questions.

- What staff skills and training will be required in order to maintain values at legally required levels?
- Which level of government and which agency should be responsible for maintaining accurate taxable values?
- Who will provide the technical and financial resources to establish and maintain acceptable valuation practices?
- Will valuation practices be monitored and evaluated regularly to assure fairness and accuracy? If so, by whom?

How value is defined in the law will of course be very important for valuation practice, but the administrative capacity of government agencies will be just as important. Without solid valuation practices and committed, qualified staff, taxable values quickly become outdated and bear little resemblance to the legally defined standard.

5.5 COLLECTION

The collection ratio is the proportion of billed taxes actually collected. Collection success requires political will, judicial support and sound administrative practices. The key administrative questions in this area include the following.

- Which agency will be responsible for collecting the LPT?
- How will tax bills be distributed?
- Where and how will taxes be collected? This is an important point because it affects the compliance costs for taxpayers. If taxpayers must travel some distance to a central tax office to pay their LPT, compliance will be lower than if paying the tax is more convenient.
- What process will be used to handle appeals?
- What sanctions will be used in cases of nonpayment of taxes?
- Will there be oversight by other agencies or other levels of government?

When all is said and done, collecting taxes requires political will. Without it, tax officials will be unwilling to aggressively pursue tax avoiders, and courts will be unwilling to impose legally available sanctions. That being said, how property rights are articulated and the administrative capacity of government will strongly influence the design of appropriate collection processes.

Perhaps equally important to collection efforts are clarity and transparency in how the taxes collected will be used. If taxpayers see that their taxes will be used for meaningful urban improvements, infrastructure, better services and the like, they will be much more willing to comply with the tax. To the extent that they perceive little or no improvement in their community, they will tend to resist and avoid the tax.

5.6 EVALUATION OF THE LPT SYSTEM

One of the keys to success for any program is ongoing evaluation to assess progress, direction and impact. From that perspective it is also useful to consider how the LPT will be evaluated. Best practice suggests that the LPT should be evaluated from three perspectives: the taxpayer, tax administration and broader public goals.

5.6.1 THE TAXPAYER'S PERSPECTIVE

Evaluating the LPT from the taxpayer's perspective will focus on the overall tax burden, fairness in the distribution of that burden across households, and the cost incurred by taxpayers in complying with the tax. Tax fairness is assessed by comparing households in similar circumstances. The LPT is considered fair firstly if households controlling similar land and property pay a similar tax. Since the base of the LPT is land and immovable improvements, fairness is assessed by comparing the taxes paid on similar properties. While full or partial tax forgiveness may be granted for specific policy reasons, the LPT is considered fair if, in the absence of such specific exemptions, two identical properties bear the same tax burden.

A second type of tax fairness often considered in evaluating the LPT compares the taxes due on properties that are quite different. Here the argument is that just as similar properties should pay a similar tax, properties that differ in important ways should pay a different tax. The application of this standard in assessing the fairness of the LPT will depend on whether quite different properties are assumed to place a different burden on public services, or

Equity in taxation

Horizontal equity: Very similar properties should be subject to approximately the same tax obligation.

Vertical equity: Very different properties, especially in terms of market value, should have very different tax obligations.

whether such differences are assumed to reflect differences in the ability of property owners and occupants to pay the tax. One view is that the taxes associated with a given property should be proportional to the public services utilized by those who possess the property. The alternative view is that more valuable properties tend to be controlled by people with higher incomes and greater capacity to pay taxes. In either case, tax fairness is assessed by determining if the taxes paid by households in differing circumstances differ and are consistent with stated policy goals regarding the distribution of the tax burden.

A second important consideration from the taxpayer's perspective is the cost of complying with the LPT. Compliance costs differ from the actual amount of tax due, and reflect the cost incurred by the taxpayer in determining the tax obligation and actually delivering the tax payment. These costs include the time and expense necessary to complete any tax forms as well as the time and expense required to actually pay the tax. For example, if the taxpayer is required to complete a complex form with a detailed description of the property, tax identification numbers, etc., the cost of compliance is significantly higher than if the taxpayer simply receives a tax notice either through the mail or delivered in some other manner. Likewise, if the tax must be paid in person at a central location and the taxpayer must travel some distance through a congested city to arrive at that location, the compliance cost is higher than if the tax can be paid on-line, through the mail or at decentralized locations throughout the city. The evidence is quite clear that keeping compliance costs low is an important component of increasing the overall level of compliance.

5.6.2 TAX ADMINISTRATION

From an administrative perspective evaluation of the LPT requires assessment of the overall compliance level and the cost of administering the LPT. Compliance can be viewed both as the proportion of potential taxpayers who actually pay all or part of their taxes, and as the proportion of taxes levied that are actually collected. Clearly, administrators should strive to keep these ratios

close to 100 percent, and significant variations from that standard should prompt systematic administrative review.

Monitoring administrative costs is somewhat more ambiguous. One study has suggested that the cost of administering the LPT should not exceed four percent of the revenue collected (Gallagher, 2004), however there is a good deal of variation in how such ratios are calculated across countries (OECD, 2004). It is probably more important to adopt a consistent method for a given context and monitor the ratio over time.

Ultimately any tax is intended to raise sufficient revenue for a government to deliver needed public services. Hence one measure of the effectiveness of a tax on land and property is whether it raises sufficient revenue to fund the intended share of public services. What that share should be is clearly a matter of policy and will depend both on the adequacy of alternative revenue sources and the mix of services delivered.

5.7 SUMMARY

This section has described the relationship between policy and administration as it relates to the revenue collected through a tax on land and (potentially) improvements. The case has been made that in addition to policies that define the tax base and set the tax rate, the revenue collected will be strongly influenced by the completeness of the tax roll, the quality of valuation practices and the adequacy of collection procedures. It has often been the case that revenues have been significantly enhanced without changing either the law or the legally defined tax rate, but by strengthening administrative procedures and practices.

The section has also described some of the metrics that can be used to evaluate the performance of the LPT system. Such measures include the administrative burden placed on taxpayers, the cost of administering the system relative to the revenues collected, the fairness of the system in distributing the tax burden, and the compliance rate within the community. The next section provides an introduction to the options available to decision makers as they consider answers to the questions raised here.



An overview of Mathare slum in Nairobi, Kenya. Photo © UN-HABITAT/Julius Mwelu

6. DEFINING WHAT IS TAXED AND WHO MUST PAY

The policy options involved in the design of any tax on land and/or improvements should address four important questions.

- Who will be obligated to pay the tax?
- What precisely will be taxable?
- How will the taxable value of the land and property be determined?
- How will tax rates be established?

This section discusses the principal options often followed in addressing the first two questions. The next section will take up the questions of valuing the tax base and establishing the rates. The way forward in any given setting must of course be consistent with the broader legal framework, and it is the requirements for the enabling law that is first considered before turning to a more detailed discussion of the policy options.

6.1 DRAFTING THE LPT LAW

The enabling law for the LPT must be adopted by the same legal authority that authorizes other taxes. Government structures vary widely around the world and therefore the placement of the LPT within that structure will vary as well. In some countries, municipal governments have no independent revenue collecting authority. In others, they are granted substantial autonomy.

Some countries have one or more levels of government between the national government and municipal governments. Such systems that divide governmental authority between the national government and constituent political units are often referred to as federal systems. These political sub-units are known by different names including states, provinces, districts, parishes. For purposes of the LPT, the key point is that municipal, town and village governments will tend to be governed directly by laws and policies established at this intermediate level of government. For example, India is subdivided into 28 states. The national government has

granted each state substantial autonomy over LPTs within that state. States on the other hand vary in the amount of autonomy they have granted local municipalities. The result is that there is wide variance in the implementation of LPTs across India.

On the other hand, many countries either do not have this type of federal system or they have not elected to extend this degree of autonomy to subnational governments. In such cases, the LPT may be a national tax. In others, the LPT may be administered by the national government with funds earmarked partially for local governments. This diversity can make discussions of how LPTs are structured and administered confusing.

The position taken throughout this guide is that LPTs work best when there is a division of administrative responsibility between multiple levels of government. How this division should be made in a given country will depend in part on how the national and sub-national governments are structured. In the case of a federal system, the national government may need to adopt an overarching law to authorize the LPT, but the majority of legal and administrative framework will be established at the state, province or equivalent level. In such an environment, when this guide refers to a central authority it means the state, province, etc., unless explicitly stated otherwise.

In a more unitary government in which there are few or no intermediate levels of government between municipalities and the national government, references to a central authority can be taken to mean the national government or perhaps a regional agency established by the national government to carry out certain administrative and oversight functions. The relationship between governmental entities and the definition of their roles should be described in the enabling law. Drafting the law will undoubtedly require legal assistance, however there are some general guidelines that can be summarized here.

6.1.1 DEFINE WHAT IS TAXABLE¹⁷

The law authorizing the LPT should embody and reflect the cultural understanding of land and property rights. The law must

- Articulate precisely what is taxable. Will only land be taxed, or will the tax cover land and immovable improvements, or just the improvements?
- State whether the land and improvements are to be taxed as separate objects or in combination as a single unit.
- Define what constitutes an improvement, if such improvements are subject to the LPT. For example, are trees and other long-lived plants to be considered improvements? Or are improvements limited to immovable man-made structures?

In addition to describing precisely what will be subject to the tax, the law must set out the standard of value that is to be used. As is explained in greater detail in section 7.1, land and property can be taxed based on its capital market value, annual rental value, or based on property attributes. The law should stipulate which standard is to be used, but only in fairly general terms. Specific procedures for determining value are generally best left to administrative rules.

For example, the law might stipulate that the LPT is to be based on land area, location, land fertility, land use and building area, but leave the determination of how these factors are to be calculated and used to arrive at the tax bill to administrative rules. Administrative rules tend to be more easily updated than laws and can therefore be more readily adapted to changing standards and evolving agency capacity.

Since land values are not static, the law must also define the cycle for updating taxable values. In general shorter cycles (one to three years) are to be preferred since they tend to keep the fiscal cadastre more up-to-date. However revaluation of all properties can be expensive and the

revaluation cycle should therefore be practical in terms of administrative and financial resources. Cycles that are too long (e.g., ten years or more) reduce the equity of the LPT and can produce political turmoil when revaluations do occur. One compromise that is often employed is to index taxable values between revaluations based on the rate of price inflation, but that too must be expressly allowed in the law.

Part of defining taxable property in the law will involve setting the tax calendar, since valuation must take place as of a specific date. Typically, the tax law stipulates the calendar date on which the LPT is effective. Administrators determine taxable value as of that date and prepare tax bills accordingly. In many instances, the law will also stipulate when tax bills are to be sent out and when the tax is due. For example, the law may specify that values are to be determined as of 1 April of each year, and that tax bills based on those values are to be delivered to taxpayers by 1 October. Taxpayers might then be given until 1 December to actually pay the tax or make arrangements for its payment.

The establishment of these dates is important because it creates certainty for taxpayers and government budgets, and because the calendar establishes cutoff dates for changes in activity. Suppose for example that a building is under construction, but not yet completed. In the definition of immovable improvements, the tax status of such work-in-progress will be laid out and the status on the effective date will influence the tax bill for that property. Continuing the example, assume the valuation date is 1 April and the law stipulates that construction work-in-progress is to be taxed based on the percent completed. If the building is 50 percent complete on 1 April, it is taxed at 50 percent of its value, even if it will be finished and occupied by 1 October. Similarly, if a building is damaged by fire or natural disaster after the effective valuation date, the valuation will still apply unless provision is made in the law for some adjustment process.

¹⁷The remainder of this section draws heavily on Youngman (1996).

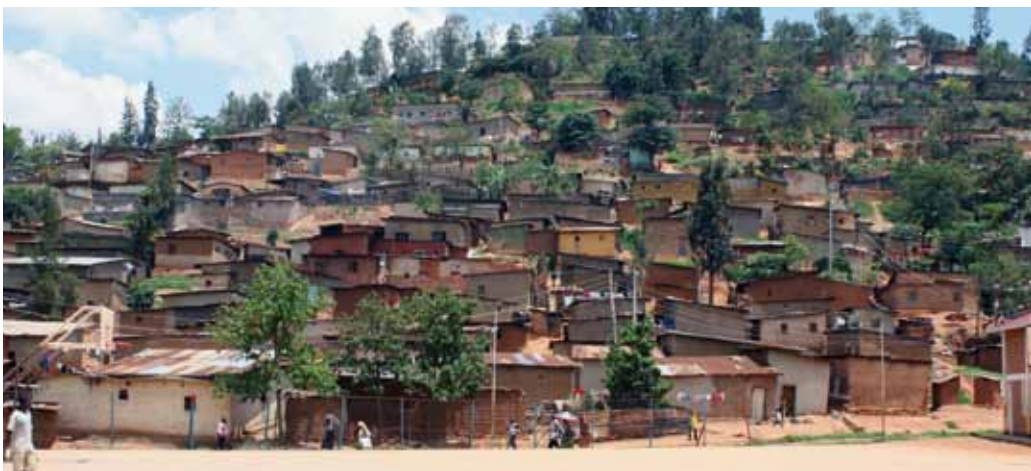
6.1.2 IDENTIFY WHO IS RESPONSIBLE FOR PAYING THE LPT

Land and property rights are nearly always subject to some restrictions and the law should stipulate when such restrictions affect the tax status of land. In addition, the bundle of rights associated with land is frequently divided between different individuals and groups. Section 4.1 described briefly the range of rights often associated with land, and it is common in most societies that arrangements are made between private individuals to divide these rights. Holders of freehold title both public and private may elect to lease their land to others. And in some instances land and the buildings on the land are owned by different parties. The law should be clear that what is being taxed is a set of rights related to land, and that the holders of those rights are therefore subject to the LPT.

At the same time, even though the rights may be divided between different parties, the law should not attempt nor allow the tax authority to allocate the LPT between interests. Any such allocation should be the responsibility of the private parties involved. All interests in the land should be at risk for the entire tax due. Thus, for example, if two sisters have inherited a home from their parents, both should be equally liable for the entire LPT due. Youngman (1996) suggests that the tax liability should fall on all persons “owning, claiming, possessing or controlling” an interest in the property as of the effective date.

The law should also be clear on when a partial interest in an otherwise exempt property becomes a taxable interest. Suppose for example that a private firm leases space from a nonprofit hospital to operate a gift shop within the hospital. The hospital may be exempt from the LPT but should the gift shop be exempt? The answer to this question will likely depend on judgments regarding the administrative capacity of the relevant governmental entities.

One of the challenges facing developing countries in administering the LPT is the standard for adequate notification of taxpayers. In countries with reliable mail systems, LPT-related notices are generally sent by certified mail. But if the mail is not reliable, and especially if the fiscal cadastre does not include current contact information for a given property, the LPT law should stipulate what will constitute notification of taxpayers. For example, it is common practice to have a single point of contact with taxpayers, even if there are multiple interests involved. Notification to other interested parties may be satisfied by publication in a newspaper or posting in a public place if the tax is not paid promptly. Similarly, in some instances posting a notice on the property may be deemed adequate notification. Whatever the standard that is appropriate and reasonable for both administrators and taxpayers, the law should be clear on what qualifies as notification so that any claim that notice was not given can be dealt with later on.



Residential houses in Kigali, Rwanda. Photo © UN-HABITAT/Julius Mwelu

The law must also be clear on what land and property is to be fully or partially exempt from the LPT. Such exemptions should be kept to a minimum as explained in section 6.5, but any that are granted should be spelled out in the law. Some exemptions may be granted on the basis of who holds the rights, such as government properties. Some may be based on the nature of the land use, such as mosques, churches, charities, etc. Whatever the reason for granting the exemption, full and partial exemptions should require an application from the taxpayer and should require periodic review to assure ongoing eligibility.

The final point to be made with regard to exemptions and the legal determination of who bears the tax liability is that as with other taxes, the LPT can affect taxpayer incentives. For example, suppose that the law grants an exemption on the first 50 m² of land area owned or occupied by the taxpayer. In order to maximize the exemption, a taxpayer might consider subdividing her property and dividing “ownership” between family members. A similar incentive can exist if the LPT rate is progressive, taxing larger or more valuable properties more heavily. It is important therefore that the LPT law be clear on which contiguous or related parcels will be considered as a single unit for tax purposes.

6.1.3 DETERMINE THE PROCESS FOR SETTING THE LPT RATE

The LPT law should address two issues with regard to LPT rates. First, any land and property classifications should be spelled out in the law. Thus, if commercial land is to be taxed at a different effective rate than residential land, these property classes should be identified and defined in the law. As discussed in section 7.2, the number of land classifications should be minimized to reduce the chance for innocent or deliberate errors by tax administrators and in the interest of tax fairness. One distinction that should be considered, however, is whether land and immovable improvements should be taxed at different rates, as described in section 7.2.2.

The second rate issue that should be addressed in the LPT law is the process for determining the final tax rate. The options are described more fully in section 7.2, but the essential question

for the legal environment is which government entity will be responsible for setting the rate or rates? Best practice suggests that a range of LPT rates should be set by a central government authority but local cities and towns should have some say in determining the final rate within their community. In some cases the range of rates is set in the law itself. In other cases the law merely defines the process and time schedule for determining the range of rates.

6.1.4 ASSIGN THE ADMINISTRATIVE FUNCTIONS

As suggested in section 4.5 and described more fully in section 8, this guide takes the position that LPT systems work best when administrative responsibilities are shared between governmental entities. The LPT law should stipulate which functions are assigned to which agencies, and which entity will have responsibility for establishing the rules, regulations and guidelines for implementing the LPT.¹⁸ In particular, some entity should be designated to have general oversight responsibility to assure that the LPT system is working as intended. This entity should have the authority to require procedural changes by local governments or other agencies if the performance of the LPT fails to meet articulated standards.

The administrative tasks which must be carried out in managing the LPT are described more fully in section 8, but they include:

- Maintenance of the fiscal cadastre
- Determination of taxable values (this task can be divided between agencies based on nature of property being valued)
- Generation and delivery of tax bills
- Collection of tax payments
- Responding to taxpayer questions and concerns
- Processing valuation appeals
- Follow up on delinquent tax payments

¹⁸ Even with enabling legal authority, many important policy details are generally left to administrative rules.

In addition, the LPT law should establish the administrative process through which taxpayers can appeal if they feel an error has been made. Ultimately, appeals can be made to the judiciary, but there should also be an administrative appeals process that is simpler, faster and less expensive for taxpayers seeking to correct errors. The law should be clear that the actual tax bill cannot be appealed, but errors in describing the property and information used to calculate taxable value can be appealed. The time period during which appeals can be filed should also be stipulated.

The final administrative actions that should be clearly spelled out in the LPT law are the sanctions to be used by tax officials in the event of non-payment of the LPT. These normally include a fixed penalty if the LPT is not paid by the due date and an interest rate to be applied to unpaid balances. In addition, if culturally appropriate, the law may stipulate that the LPT obligation will constitute an enforceable lien on the property, and that failure to pay may lead to the property being seized and sold at auction. As explained in section 8.2, such action is rarely taken even when legally possible, and depending on the view of property rights, it may not be appropriate in some settings.

Whether or not property can be sold to recover back taxes, other sanctions should also be considered and stipulated in the law. These might include public exposure, the ability to seize other assets or cutting off public services for nonpayment of taxes. Whatever combination is elected, the available sanctions should be spelled out in the law along with the waiting periods before they are imposed, and the entities authorized to carry them out.

6.1.5 ASSIGN THE TAX REVENUE

Finally, the LPT law should be clear on which levels of government will receive the revenue from the LPT, and whether it will be earmarked for specific purposes. In many settings, there are overlapping levels of government. A given property may benefit from government programs at the national, state/province, district and city level. In addition, it may be included in one or more special districts (see section 10.1). It is

not uncommon to have LPT revenues divided between these overlapping layers of government. This can be done by granting each governmental entity the power to impose a separate tax rate¹⁹, or it can be done through a revenue sharing scheme. To the extent that administrative responsibilities are shared, sufficient revenues should be shared to at least cover the administrative costs.

This subsection has provided a brief description of what should be included in the LPT enabling law. But there are many options available under the headings described here. The remainder of this guide provides a more complete discussion of those options.

6.2 DEFINING THE FREQUENCY AND CLASSES OF TAXABLE LAND AND PROPERTY

The first question which must be addressed in designing the taxable base for the LPT is whether the intent is to generate one-time revenues or revenues which will continue each year. The advantage of one-time revenues is that the tax is most often applied at the time possession or land use is changing. In such circumstances, taxpayers generally have a strong incentive to proceed with the change and the tax cost can often be shifted to or shared with other parties. For example, Ukraine levies a one percent transfer tax on the contract price in all real estate sales transactions, but the law does not specify whether the tax should be paid by the buyer or the seller. In practice, it is usually divided between the two parties. Development fees can also often be shifted forward to those who will ultimately acquire the developed property.

It should be remembered however that whether the tax is the result of changes in possession (transfer levies, capital gains taxes, estate taxes are examples) or changes in land use (betterment levies and development fees), such changes may occur only rarely for any given

¹⁹ If employed, the rates should be consolidated on a single tax bill. The taxpayer then pays one bill and the revenues are divided between the relevant entities.

Using betterment levies to finance public works in Colombia

The betterment levy or special assessment (as it is known in the United States) is a “compulsory charge imposed by a government on the owners of a selected group of properties to defray, in whole or in part, the cost of a specific improvement or services that is presumed to be of general benefit to the public and of special benefit to the owners of such properties”[...]. In Colombia this levy, called *Contribución de Valorización (CV)*, has been collected since 1921. The betterment levy is addressed in the legislation of most Latin American countries, although its implementation often meets resistance. The main arguments against it claim it is impractical, technically cumbersome, beyond local capacity to implement, and unpopular. Colombia’s experience, however, seems to contradict these allegations, suggesting that the resistance is grounded more on prejudice, ideology, or lack of information. This instrument not only has a long history of continued (albeit irregular) application, but also a record of raising substantive revenues to fund public works.

Bogotá currently has about \$1 billion worth of investment in public works from this levy, and eight other smaller cities combined have another \$1 billion. More importantly, based on recent levies on 1.5 million properties in Bogotá, its collection has been generally accepted by taxpayers with relatively low default rates—in fact lower than for the property tax. Although its legitimacy is not questioned, even among the business community, controversies continue over how the charge is assessed and distributed among properties.

Colombia’s experience with the betterment levy during the past 70 years demonstrates that it is a viable instrument to finance urban development and is capable of raising substantial revenues, even though the methodology to assess and distribute the levy is complex and can be perfected. Among the lessons to draw from that experience, the most important is the clear link between the provision of public benefits and the property owners’ willingness to pay the levy. Success depends on the legitimacy of the project and the institutional capacity and ethical standards of the agency administering the levy. To generate trust among citizens, success is also predicated on ensuring affordability, applying a fair distribution model, publicizing the social value of the project, and promoting participation during implementation.

Source: Ochoa, O.B (2011), Betterment Levy in Colombia: Relevance, Procedures, and Social Acceptability, Land Lines 23 (2) • Lincoln Institute of Land Policy, pp14-19

parcel of land, and it may be decades between such transactions. In good economic times, when many properties are being developed and property trades occur frequently, these one-time levies can be very important sources of local revenue. But governments that rely too heavily on such revenues to fund on-going operations often encounter severe fiscal challenges when economic conditions slow as they have in many countries in recent years.

The annual LPT offers the advantage of a more predictable ongoing source of revenue. In

addition, the tax rate can generally be much lower than rates associated with one-time levies because the annual LPT is most commonly applied to a much broader base (all properties rather than just those being transferred or developed). On the other hand, including all properties in the base creates both political and administrative challenges. The administrative issues will be discussed more fully in the next section. The political issues to bear in mind relate to location, land use and the practical implementation of a theoretical consideration.

6.2.1 LOCATION

One of the important considerations in defining the LPT base is location. Should land in rural areas be taxed in the same manner as land in urban areas? Land in rural areas is most often agricultural or forest land. As such it may be somewhat remote from the public infrastructure and services intended to be funded through the LPT. On the other hand, the case can be made that rural communities need improved roads, reliable electricity and water systems as much as urban areas need roads, sanitation and other urban investments.

Perhaps the most compelling location issue that should influence the design of the LPT is the maturity of real estate markets in rural versus urban areas. As noted earlier, it is not uncommon for urban areas to have reasonably well-developed real estate markets complete with the institutional infrastructure necessary to support the efficient functioning of such markets. It is also common for rural areas and even for segments of urban areas to have markets which are not as well-developed. Real estate financing may be difficult to obtain, or the network of institutions that facilitates the availability of real estate information may be lacking. If such a dichotomy exists, it is reasonable to ask whether a single approach in designing the LPT is advisable.

In areas with active, well-functioning real estate markets, defining the LPT base as current market value or some variation on market value is generally to be preferred. In areas with less mature real estate markets, defining the base in terms of physical attributes such as area or volume may be more practical. The key point is that markets are often related to location, and the extent and maturity of real estate markets are important factors to consider in defining the LPT base. It is certainly possible to design a tax system that relies on market values in areas with active markets, while relying on physical property attributes in other areas as long as the distinction is carefully reviewed on a regular basis. In Ukraine, for example, land is valued based on market value if such a value can be identified. If not, land is taxed based on the land area, the size of the community and the location within the settlement.

6.2.2 LAND USE

Land use differences often emerge as an important political consideration in defining the LPT base. There is often a tendency to tax commercial and industrial activity more heavily while minimizing or even excluding agricultural activity. This is especially true at the urban fringe in areas that as a matter of policy the community would like to preserve as agricultural land or open space. Agricultural land at a city's edge is often more valuable for its development potential than for its agricultural production. If the land is taxed at its "market value," meaning its value as developable land, farmers may not be able to continue farming because of high taxes. While many countries simply exclude agricultural land from the LPT base, many others design a system which taxes agricultural land at its agricultural value rather than full market value. Thailand, for example, has established a panel of agricultural experts that assesses the level of agricultural potential for land in different sections of the country. Agricultural land in each area is then taxed based on its estimated agricultural potential rather than full market value.

Whether agricultural land or forest land should be taxed and at what rate is obviously a politically sensitive topic. Public finance experts argue that a broader, more inclusive tax base means that tax rates for everyone can be lower. In addition, rural areas are often in need of substantial public infrastructure investment. On the other hand, farmers as a group are often politically sensitive, as is evidenced by the fact that farm land is often either excluded altogether or is taxed at a much lower rate than other property.

6.2.3 THEORY AND PRACTICE

Land and improvements are often also classified based on residential, commercial or industrial usage, and often with the intent of applying different effective tax rates to different classes of property. An important point to bear in mind in this regard is that the more distinctions made in the tax law, the greater the potential for both honest errors and deliberate abuse in administering the LPT. When does a property cease to be agricultural and become urban in

use? When does a residential property become commercial? Such distinctions may seem clear in the abstract, but practice around the world suggests that the application of a specific distinction requires an official at some level to make a judgment regarding the applicability of articulated standards. Such judgments are susceptible to error and in many instances to inappropriate influences. Thus, maintaining simplicity and clarity in the definition of the LPT base will greatly enhance the administrative consistency and fairness of the final implemented system.

6.3 DEFINING WHO MUST PAY THE TAX

An important practical consideration in designing the base of the LPT is deciding whether the owners of property will be obligated to pay any tax that is due, whether the tax will fall on the occupant or user of the property, or whether the tax burden will be shared by owners and occupants of the land²⁰. In most countries where private ownership of land is recognized and recorded, LPTs are the obligation of property owners. In cases where property registration is not complete or where other types of ownership are recognized, it is often the case that occupants or users of property can be more readily identified. In such cases it may be more practical to assign the tax to those who actually use the land. And in some instances, LPTs are levied on both owners and occupants. In France, for example, *the taxe foncière* is payable by the property owner, while the *taxe d'habitation* is payable by the occupier of the property. (If the property is occupied by the owner, the owner is responsible for paying both taxes.)

The principal criterion for determining who must pay the tax is likely to be the extent to which property rights are registered and the administrative capacity of the agency responsible for billing and collection of the tax. If landowners

are known and can be readily contacted, it will be administratively easier to enforce the tax on landowners. Landowners do not generally relocate without leaving a forwarding address. If however landownership is not recorded or landowners are not easily located, it is likely to be administratively more practical to assess occupiers or users of the land. A similar strategy can be employed in the case of informal settlements. The tax notice can be delivered to the property, and subsequent enforcement efforts can be focused on the location. Several countries have found that a mixed strategy can be effective: define the tax as the obligation of the landowner, but if the landowner fails to pay the tax in full, require the occupier of the land to pay the tax and deduct that payment from any amount due to the landowner.

6.4 DEFINING WHAT IS INCLUDED IN TAXABLE LAND AND PROPERTY

One of the central policy questions that must be addressed in designing any LPT is the specification of precisely what will be considered taxable property. The question comes down to whether the tax should be applied to land only, to immovable improvements such as buildings only or to both²¹. Public finance specialists around the world argue that land provides the most economically efficient tax base. The supply of land is relatively fixed and land is immovable so applying a tax to land will promote its efficient use and will minimize economic distortions in the larger economy. If the tax rate is high enough, taxing land will tend to discourage land hoarding and speculation and could actually make land more affordable. In addition the impact of public infrastructure investment on private real estate is most often on the value of land. Better access and enhanced public services increase the demand for the land being serviced, thus increasing its value. If the LPT is intended to capture part of the increment in value, taxing land is essential. At

²⁰ One other option is to assign the tax obligation to the land. This approach, known as in rem property tax, makes it easier for tax administrators to satisfy notification requirements by simply publishing the tax notice in the local press. Unfortunately, it can make collections more difficult since the only remedy for non-payment is seizing and selling the land.

²¹ It is also possible to include equipment, vehicles and other movable personal property under the general heading of property taxes, but this Guide focuses solely on land and immovable improvements.

Benefit Tax: One principle of public finance is that people should pay taxes for public services roughly in proportion to the benefits they receive from those services. Those who receive more benefit should pay more in taxes. Thus, the tax approximates a “price” for the services received.

the same time, the data required to administer the LPT will focus on land and the beneficiaries of land with no requirement to collect or store information on improvements.

On the other hand, it can be very attractive to tax immovable improvements to land. After all, the demand placed on public services by land is minimal. It is the use to which the land is put that creates the demand for public services. People living in homes and businesses carrying on activities that use roads, water, sanitation, etc., create the demand for public services. If there were no improvements on the land, there would likely be little need for the services that must be funded through taxes. Further, to the extent that extensive improvements require more public services, a tax tied to the value of improvements more closely approximates a benefit tax in that the taxes paid are roughly proportional to the benefits received. At the same time, taxing improvements may tend to discourage investment. Land owners who think their taxes will increase if they improve their

property may think twice before making the investment.

In many industrialized countries, both land and improvements are taxed (but not always at the same rate). There are strong arguments related to tax transparency in favor of taxing both land and improvements. When real estate transactions involving improved property take place in the private sector, there is generally very little effort to distinguish between the price of land and the price of improvements. Negotiations take place around the combined price, especially for residential properties. Thus, when the land owner or occupant receives a tax bill, the taxpayer is generally able to compare his or her personal knowledge of the market value, construction cost or rental value of the property with the tax assessor’s estimated value if the value concepts are the same. But if the local authority is taxing just land or just improvements, the taxpayer may be unable to judge the accuracy or fairness of the tax being assessed. And quality tax administration is enhanced if taxpayers understand how their bill is being calculated and can check its accuracy for themselves.

A further argument in favor of taxing both land and improvements is the availability of market data. Precisely because most real estate transactions involve both land and improvements, the details of such transactions are more readily available to tax administrators than are transaction details involving just land or just buildings.

TABLE 6.1: LPT BASE AND RATE EXAMPLE

	Market value	Tax on Land Only (3% rate)	Tax on Improvements Only (1.5% rate)	Tax on Land & Improvements (1% rate)
Unimproved Land	\$ 2,000	\$ 60	0	\$ 20
Current improvements	0	0	0	0
New improvements	\$ 4,000	0	\$ 60	\$ 40
Total	\$ 6,000	\$ 60	\$ 60	\$ 60

The best LPT design will be based on the specific local context created by the combination of current property rights, land registration systems, property markets and administrative capacities. In many instances the theoretically preferable may need to give way to the administratively practical. Table 6.1 illustrates that the same revenue can be generated from a tax on land only, improvements only or a combination of both. Clearly, the rates will vary depending on what is included in the base. Just as clearly, the tax will fall more heavily on land owners or extensively improved property, depending on how the base is defined. But as the table illustrates, a given property could be charged the same amount of tax under any definition. Which property to include in the base should be a function of culture and capacities.

The table also illustrates how the design of the base can affect the incentives taxpayers face. Consider first the owner of a parcel of unimproved land in a regime in which land is taxed but improvements are not. If the current value is as shown in the table and the current tax rate is three percent of value each year, holding the land without improving it is relatively expensive for the landowner. Thus, there is an incentive for the landowner to either improve the land or sell it to someone who will improve it. And once improved, the total tax due does not change. The result is a system which strongly encourages making land available for development.

Now consider the case where the annual LPT is applied only to improvements. Since the land is initially unimproved, it is not subject to the LPT. A developer considering improving the land will take into consideration the increased taxes that will be due each year after the improvements are installed. The result is a system which will tend to discourage investment at the margin. Landowners suffer no penalty for holding land indefinitely, while developers face the prospect of higher taxes as land is improved or renovated.

Finally, consider the case of an annual LPT applied to both land and improvements. In this instance, the landowner is again faced with a tax on unimproved land, but at a lower rate so that the positive incentive to develop is reduced

Tax Incidence: Incidence refers to how the tax is divided among potential taxpayers.

Statutory incidence refers to who is legally obligated to pay the tax.

Economic incidence refers to who actually incurs the cost of the tax. Thus, the statutory incidence may fall on landowners, but the economic incidence may fall on those who occupy or benefit from the land. For owner-occupied property, both the statutory and the economic incidence fall on the possessor of the land.

compared to the land-tax only scenario. As new improvements are installed, the tax obligation will increase, but again at a lower rate so the cost of development is lower than under the improvement-tax only scenario. So while in all three scenarios the same amount of revenue is due from the same parcel, the landowner's incentives are quite different depending on what is included as taxable property. In the larger community these differences in incentives will combine with shifts in the incidence of the LPT as well.

6.5 EXEMPTIONS

In every country that employs an LPT, some property is exempted from the obligation to pay the tax. These exemptions may be granted based on the entity that owns the property such as religious institutions, charitable groups, universities and schools, governmental organizations or cultural groups. In other instances, the exemption is based on how land is used, with agricultural land being a prime example. In some cases, exemptions are granted because of the nature of the service provided by the entity, including such services as hospitals, museums and parks. There are also exemptions granted based on the social or economic characteristics of the property holder. Common examples include the aged, low income households, householders with



Should elderly and low-income residents, like this lady in Madagascar, be exempted from land and property taxation? Photo © UN-HABITAT

disabilities and military veterans. And in some instances exemptions are granted to encourage economic development, including enterprise zones, redevelopment areas, and the like. Despite the prevalence of exemptions from LPT, there are important policy issues that should be carefully considered before granting or continuing such exemptions.

As discussed in section 6.1, exemptions from LPT are most commonly granted by the same governmental entity that creates the legal framework for the tax system. In some instances exemptions may also be granted by local governments, or local governments may be given authority to grant temporary relief from LPT. It is often politically appealing to grant an exemption, but in all cases, granting an exemption reduces the revenue potential of LPT. The resulting narrowing of the tax base means that either other taxpayers must face higher taxes or public services must be reduced.

Consequently, LPT exemptions should only be granted when there are compelling reasons to do so, and they should be reviewed periodically to assure that the purpose for which they were originally granted is still relevant.

A fundamental principle of good tax policy can be simply stated as “**broad base, low rates.**” In the case of the LPT this means that including all land in the tax will mean that the overall rate can be lower and the burden on each taxpayer lighter. With each exemption granted, the base is narrowed and the rate necessary to reach the same revenue target will of necessity be higher for those who remain subject to the tax.

It should be remembered that exempt property still creates a demand for local services. Consider for example an office building owned by the national government. It seems unlikely that the burden placed on local services by such a building will differ in any appreciable way from the burden created by any other similar office building. Hospitals, churches and universities still require roads for access, street lighting, and other urban services. Thus, granting an exemption reduces revenue without reducing the demand for services by a similar amount.

Care must also be taken not to disadvantage some property holders relative to other similar activities. For example, if nonprofit hospitals are granted an exemption, such hospitals then have a competitive advantage over similar for-profit medical facilities. Generally, communities should avoid tax policies that favor some businesses at the expense of other competing ventures.

Exemptions can also influence land use decisions and development patterns. For example, the property tax is one of the oldest taxes in Egypt, coming into effect in 1884. The law underwent a major reform in 1954 which exempted all property outside defined urban areas from the property tax. One result is that over the years, a major portion of the development in Egypt has been on the urban fringe, just outside the taxable areas.²²

²² Egypt has recently initiated another reform to bring a larger percentage of the land area into the LPT system.

Exemptions also complicate the LPT system and create the potential for fraud and abuse. For example, if schools are exempted from the tax, what constitutes a school must be carefully defined in law, tax administrators must understand the definition and must administer the exemption fairly and uniformly in making judgments regarding which property is eligible for the exemption and which is not. Without such care in both design and administration, inappropriate exemptions will inevitably enter the LPT system. This is especially true with exemptions granted on the basis of social or economic conditions. Judging whether or not an individual meets some age or income requirement for exemption places a substantial burden on local tax administrators, and again introduces the opportunity for errors in judgment.

The legal system of many countries does not permit local governments to tax the other levels of government. However, national governments can recognize that national facilities create demand for local government services such as roads, parking, police, fire protection, etc. In recognition of this local burden, some central governments make payments to local governments to help offset the cost of such services. These “**payments in lieu of taxes**”²³ are negotiated or simply set by the central government and rarely approximate the taxes that would have been due.

It should be recognized also that the degree of exemption can vary significantly. Exemptions may be complete as for property owned by international organizations. They may be partial resulting in a lower effective tax rate, but not a complete exemption. They may also be in the form of a deferral of tax payments due. For example, in urban areas with rapidly rising real estate values, long-time residents on fixed incomes may be unable to pay the LPT if it is rising in step with real estate values. In such cases, some countries have deferred payment of the tax until the property is either transferred to an heir or sold. Grants and credits against other taxes or fees can also be used to offset the cost of the LPT without adding to the burden of the LPT administrators.

It is likely that even after careful review, some exemptions will be incorporated into the LPT system. Every effort should be made to keep such exemptions to a minimum, to review them regularly and to keep the property involved in the cadastral and valuation system so that the cost of such exemptions can be tracked.

6.6 SUMMARY

In determining how best to define the base for the LPT, the following questions need to be answered:

- Should the base include land only, improvements only, or land and immovable improvements? There are strong theoretical and policy arguments for taxing land only. And there are good practical reasons to tax both land and improvements.
- Should the tax be levied on land owners, occupants of the land or both? The answer will depend on land rights registration systems, administrative capacity and potentially other policy considerations (e.g., the French example).
- Should certain classes of land use or certain types of owners/occupants be exempted from the tax? Such exemptions should be limited.
- Do the alternatives change with the nature of land ownership (freehold, leased, communal, state owned, informal, other)? If so, how? The nature of land rights will mostly influence the choice of who will be obligated to pay the tax.
- How are land use classifications used and are they desirable (agricultural, residential, commercial, industrial, publicly owned, non-profit, foreign)? Such classifications are generally used if there is a desire to tax different land uses at different rates, but from an administrative perspective, the number of classifications should be minimal.
- What are the political, administrative and economic implications of these choices? The issues raised in this subsection strongly affect administration, compliance and taxpayer incentives.

²³In many developing countries, a large share of local revenues is often in the form of transfers from the national government. In such cases, a “payment in lieu of taxes” system may develop only as the national government reduces subsidies over time.

7. OPTIONS FOR DETERMINING TAXABLE VALUE AND SETTING RATES

7.1 VALUING THE TAX BASE

As noted earlier in this guide, LPTs differ from many other taxes in that the value of the tax base is often not immediately clear. With a Value Added Tax (VAT) or a Goods and Services Tax (GST), the taxable base is determined by the value of a transaction. With an income tax, the taxable base is derived from the taxpayer's gross income. With some LPT such as transfer or capital gains taxes, there is also an underlying transaction to establish the taxable base. But with many LPT, either the tax is assessed before a transaction takes place as in betterment levies and development fees, or there is no transaction as in the case of the annual LPT for most properties (since most land and property is not traded in any given year). The challenge is to establish policy guidelines for determining taxable values which are both fair and sufficient to raise needed revenues.

The policy options for LPT valuation can be arranged along a continuum, with market-driven approaches based on capital market value on one end and non-market approaches based on purely physical property characteristics on the other. The best policy along this continuum for a given community will depend on two principal factors:

- The economic and social infrastructure supporting markets for real property
- The administrative infrastructure available to implement the tax

Most LPT is tied directly or indirectly to the capital market value of land and immovable improvements. While some countries have accepted development fees or betterment levies “in kind” (meaning the fees were paid by transferring part of the land developed to the local government), by far the more common approach is to assess the tax or fee as a percentage of market value. In the case of development



Valuation of property in Aceh, Indonesia.

Photo © UN-HABITAT

fees, the percentage may be relatively modest and may be tied to other calculations of the expected cost to government of servicing the new development. Betterment levies are often a much higher percentage of the incremental value resulting from the public investment or the permitted change in land use. Ecuador continues to have a law that permits local municipalities to assess betterment levies at a progressive rate of up to 42 percent of the gain in land value, while in Peru the law permits assessments of between 20 and 50 percent of land-value gain, though in neither case has the law been applied in recent years. (Peterson, 2009, page 64) India in recent years has also experimented with betterment levies as high as 50 percent of land-value gain²⁴, but with considerable controversy and unevenness of administration. Other types of LPT such as capital gains taxes, transfer taxes and estate taxes are nearly always expressed as a percentage of market value, contract value or some other capital market concept.

²⁴ See for example The Karnataka Irrigation (Levy of Betterment Contribution and Water Rate) Act, 1957 as amended.

But to base any LPT on capital market value presumes that there is a functioning market for land and improvements in which parcels of land trade regularly, that information on the capital value of land is publicly available and that reasonable estimates of the value of all taxable land can be obtained from available information. These are strong assumptions and are unrealistic in many contexts. When the market for real property is immature or non-existent, it is still possible to have a well-functioning LPT system, but it must be based on land and property attributes other than capital market value. To illustrate the policy alternatives available, the following discussion will focus on the annual LPT, but similar concepts could be applied to one-time taxes and fees as well.

7.1.1 CAPITAL MARKET VALUE

The first alternative is the capital market value of land or of land and improvements. Capital market value is defined as the price that a knowledgeable buyer would be willing to pay, and a knowledgeable seller would be willing to accept, if both parties wanted to make the trade but it was not essential for either. The assumption is also that the two parties are not connected through family or other ties. The central idea is to estimate how the market would actually function if there were no unusual conditions or constraints. The only way to make such an estimate is to observe actual markets and obtain information on real land and property sales. Without such sales, the concept of capital market value has little meaning.

The capital market approach is the approach taken in many advanced economies. In such countries, the economic infrastructure to support real property markets is well established. Included under the heading of economic infrastructure are those institutions that facilitate market transactions in real property such as banks and other institutions to provide mortgages and other financing instruments, real estate professionals to facilitate the buying and selling process, valuation experts to provide accurate valuation information to all parties, and some mechanism for recording and making public the transfer of property from one party to another.

One distinct advantage of capital market value as the base for the LPT is that as communities grow and develop, land values generally increase and the capital market approach has the capacity to identify such increases and build them into the tax base. The result is a tax base that tends to grow with the local economy.

The techniques for using market information to estimate the capital market value of properties that have not actually traded in the market in the recent past are well developed. A summary of these techniques is presented here, with more details and numerical examples in adjacent boxes. The techniques involve using well established analytical approaches to assessing value in the market place.

The first is the **comparable sales approach**, used very widely with residential properties largely because of the general availability of data. In the comparable sales approach, the analyst gathers data on similar homes that have sold in the recent past, and makes appropriate adjustments for any remaining differences that might affect value. The fundamental logic behind the approach argues that no one would pay more for a home than what similar homes are actually selling for in the current market. If a seller demanded a higher price, the buyer would simply purchase one of the other homes.

The second approach to value is the **cost approach**, used very widely for commercial properties. Here the argument is that no informed buyer would pay more for a property than would be required to acquire the land and construct the improvements. There are several technical variations on the cost approach, but the reasoning is essentially the same. Determine the cost of all the components (for example, land, buildings and other site improvements), make adjustments for age and obsolescence, and the result is an estimate of what it would cost to reproduce or replace the land and property. While applying the cost approach to complex properties may require substantial engineering expertise, most jurisdictions simply use (hopefully, current) construction cost indices to estimate structure values.

Valuation Example: Capital Market Value based on comparable sales

Taxable value is determined by the capital market value of the property. In this example, capital market value is estimated using the comparable sales approach. The premise of the comparable sales approach is that no buyer would pay more for a property than what other similar properties are selling for.

Step 1: Gather market sales data for properties that have recently sold. Include sales price and property attributes. Verify that sales data is for “arm’s length” transactions and that no special conditions applied.

Step 2: Collect land area, building area and building attribute data for each land parcel.

Step 3: For each property to be valued, identify a set of similar properties that have recently sold.

Step 4: Adjust the sales data for any remaining differences between the property being valued and the comparable properties.

Step 5: Estimate the market value of the property being evaluated.

Step 6: Calculate the taxable value from the market value, if the two differ by policy.

Step 7: Apply the approved tax rate to the taxable value to obtain the tax due.

Example: Analysis of the property in question (the subject property) and the available sales data indicates three comparable properties in the neighborhood that have recently sold (see the table). They vary somewhat from the subject property but are fairly close. The valuer uses these comparable properties to make a judgment regarding the likely sales price of the subject property. In this case, because the subject property has a somewhat newer home, a slightly larger than average building area and a parking garage, the valuer estimates the sales price to be 60,000. If the tax rate is 1 percent of value, the tax will be 600.

	Property Attribute			Subject Property
	Property A	Property B	Property C	
Lot Size (m2)	800	750	770	750
Building Area (m2)	100	105	125	110
Age (years)	50	45	47	40
Parking garage	No	Yes	No	Yes
Sales Price	45,400	55,600	57,000	??

Valuation Example: Capital Market Value based on the cost approach

Taxable value is determined by the capital market value of the property. In this example, capital market value is estimated using the cost approach. The premise of the cost approach is that no buyer would pay more for a property than the cost of buying similar raw land and constructing the improvements.

Step 1: Gather construction cost data for buildings and land sales prices for recently sold parcels of land.

There are typically three different cost concepts that can be used. **Historical cost less depreciation** is the cost of the land and buildings when the building was first constructed. From this amount, depreciation is deducted to reflect the aging of the building. **Replacement cost** calculates the cost of replace the functionality of the building using current construction standards and methods. **Reproduction cost** calculates the cost of reproducing the building as it is, if it had to be reproduced in the current market. Most commonly historical cost less depreciation or replacement cost is used.

Step 2: Collect land area, building area and building attribute data for each land parcel.

Step 3: For each property to be valued, estimate the capital market value as the cost of land and buildings.

Step 4: Calculate the taxable value from the market value, if the two differ by policy.

Step 5: Apply the approved tax rate to the taxable value to obtain the tax due.

Example: Analysis of current construction costs and market land values has been completed by the valuation staff. The subject property has a building which is ten years old and an expected total life of 50 years. There are other on-site improvements. Data collected on the subject property when combined with the construction cost information yields the estimates shown in the table. The valuer must judge which is the more reasonable estimate of overall cost. If the replacement cost value is selected, and the tax rate is 1 percent, the tax due will be 495.

	Historical Cost less Depreciation	Replacement Cost
Cost of Land	10,000	13,500
Cost of building	50,000	35,000
10 years of depreciation	(10,000)	(7,000)
Other improvements	15,000	10,000
Less depreciation	(5,000)	(2,000)
Total	60,000	49,500

The third approach to value is used largely with commercial and industrial properties, though it could in principle be applied to any property. The approach is known as the **income approach**, and the logic underlying it argues that people purchase property because of the benefits they receive from the property. In particular investors buy commercial property because of the income potential of the property. An investor's willingness to pay for a property will not exceed the value of the income that

can be realized from the investment. Thus, with a reasonable estimate of the cash flow likely to result from the property and an estimate of current investment discount rates, the value of the property can be determined. Again, additional detail and numerical examples are provided in the adjacent boxes. The point here is this approach is a standard technique in the financial analyst's toolkit, and tax administrators can use it as well with appropriate training and access to the necessary data.

Valuation Example: Capital Market Value based on the income approach

Taxable value is determined by the capital market value of the property. In this example, capital market value is estimated using the income approach. The premise of the income approach is that all property, but especially commercial and industrial properties, represents an investment, and investors expect some positive return on their investment. Therefore, no buyer would pay more for a property than the present value of the free cash flow the property will generate, discounted at the investor's required rate of return.

Step 1: Gather market data on the rate of return required by property investors.

Step 2: Collect expected cash flows on properties to be evaluated. This can be done either by requiring the taxpayer to submit a property tax return that includes historical and perhaps estimated future cash flows, or it can be done by collecting market rents for similar properties.

Step 3: For each property to be valued, estimate the expected cash flow after operating and maintenance expenses, but excluding financing costs and any taxes.

Step 4: Calculate the market value as the present value of the expected cash flow using the appropriate estimate of required rate of return.

Step 5: Calculate the taxable value from the market value, if the two differ by policy.

Step 6: Apply the approved tax rate to the taxable value to obtain the tax due.

Example: An industrial property generates an annual cash flow after expenses of €28,000. Careful review of market information indicates that investors in this type of property require an annual rate of return of 15 percent. At that rate the property can be maintained and renewed in perpetuity. The market value of the cash flow is therefore calculated as $\text{€}28,000 / 0.15$ or €186,667. If the tax rate is 1 percent, the tax due is €1,867.

All three approaches (comparable sales, cost and income) are used routinely by professional real estate valuers (also called appraisers in some countries) around the world. But it is clear that all three rely heavily on the availability of data on real market transactions, that is, on the ability to observe local markets in action. Building any LPT system based on capital market value concepts without ready access to market-based data will likely result in frustrated tax administrators and either angry taxpayers or wholly inadequate revenues.

Many of the requirements for active real estate markets also exist in major urban areas in less developed countries, though there may be important gaps in the market support infrastructure. For example, secondary mortgage markets may be immature and consequently financing for real estate purchases may have to rely on family members and other less formal arrangements. Mechanisms for publicly recording sales transactions may fall short of capturing all relevant sales either because some segments of the market remain informal or because of other challenges with the land titling system. It may also be that individual private ownership is a concept that is foreign to the local culture. In some instances the market for real property may be fairly well developed for some segments of the market, and less mature for others. Whatever the reason, if the market for real property is not complete and active, it is worth considering less data-intensive and administratively expensive approaches to valuing land and improvements for the LPT.

7.1.2 ANNUAL RENTAL VALUE

One of the criticisms of the capital market approach to value is that LPT based on capital market value tax unrealized gains in property value. The concept of capital market value is not concerned with what a landowner actually paid for a property or how long it has been in the owner's possession. The standard it seeks to find is what the property would sell for on the open market on the designated tax date. But with urban growth, public investment and other changing urban conditions, the property may be worth

much more than the possessors actually paid for the property. An annual LPT based on capital market value, if well administered, will identify and tax all of the property value, including the incremental value that the landowner can only realize if the property is sold. This can result in taxpayer resentment.

An alternative approach to value that avoids this political challenge is known as Annual Rental Value, referred to as Rates in some countries (e.g., Kenya). Jurisdictions that have an historical tie to some European countries often employ this approach to value. The definition of value under this approach is the typical rent or lease payment that would be required to obtain the exclusive right to occupy and benefit from a property. For example, the Bermuda Government Land Valuation Department defines annual rental value as:

The rent at which a valuation unit might reasonably be expected to let from year to year if the tenant undertook to bear the cost of internal repairs, and the landlord to bear all other reasonable expenses necessary to maintain the valuation unit in a state to command that rent, but excluding any element attributable to any tax payable under the Act²⁵.

Annual rental value is thus clearly related to market conditions, but it reflects current land use rather than how the property might be used if sold on the open market. Suppose for example that a particular property is currently used for a residential purpose, but if it were sold on the open market, it would most likely be converted to a commercial use. In such a case the capital market approach would value the property for its commercial potential, since that is what a likely buyer would be planning. The annual rental value approach would value the property at its current rental value, based on the current residential usage.

Implementation of the annual rental value approach has many of the same information, technical and administrative requirements

²⁵The Land Valuation and Tax Act 1967, Land Valuation Department, Bermuda Government

as the capital market approach. It requires active markets for rental properties, access to information on those markets and up-to-date information on who is in possession of the property. But the annual rental value approach has been successfully applied to all types of property, and LPTs based on annual rental value can potentially raise the same revenue as a system based on capital market value.

Both the capital market and the annual rental valuation approaches require substantial

expertise on the part of tax administrators. Understanding and being able to appropriately apply the techniques used by markets to estimate current value requires specialized training. Even then, the value estimates are often subject to dispute by taxpayers who challenge the data and the judgments employed in assessing taxable value. To minimize both the expertise required and the number of potential appeals, some countries have employed a less precise valuation concept known as banding.

Valuation Example: Value based on annual rental value

Taxable value is determined by the annual rental value of the property. Annual rental value is defined as the typical rent for similar properties.

Step 1: Gather rental market data for different classes of property (flats, houses, retail commercial, office buildings, industrial land, etc.).

Step 2: Calculate typical rental values per square meter for each class of property.

Step 3: Collect land or building area and occupancy data for each land parcel.

Step 4: Calculate the gross rental value of each property using the area data and appropriate rental rate.

Step 5: Adjust the gross rental value for rent-related expenses to obtain net rental value.

Step 6: Multiply the tax rate by the adjusted net rental value to obtain the tax due.

Example: Analysis of market data indicates that flats in a given neighborhood rent for €6/m² per year and that typical rental expense for landlords is 12 percent of gross rent. A particular flat is 75 m² in size. The gross annual rental value is calculated as 75 m² multiplied by €6/m² or €450. The net rent is €450 less the allowed expenses of €54 (12% of €450) or €396. If the tax rate is 15 percent, the tax due is €59.40.

7.1.3 VALUATION BANDS²⁶

The annual LPT on residential property in the United Kingdom (UK) is known as the council tax and since 1993 it has been based on valuation bands. (Commercial and industrial property in the UK continues to be valued using annual rental value.) The logic of banding is simple enough. Rather than estimate the actual market value of each residential property, all homes are placed in one of eight value clusters called bands based on a judgment of the approximate value of the home as of 1991. Table 7.1 shows the eight value bands that have now been used in England and Scotland for nearly two decades.

All homes in the same value band within a given local municipality pay the same annual tax. Homes in the same value band in different localities may face a different tax since the tax rate is set by the local government. Homes which undergo extensive renovation may be moved to a new band. Absent structural improvements, homes do not change bands based solely on changing market conditions unless there is a total revaluation which has not happened since the system was put in place in 1993.

Valuation bands have a number of advantages. They require less information and less expertise on the part of tax administrators. Consequently they are less expensive to implement and maintain than either capital market or annual rental value systems. Because there is less precision in the valuation, there is less reason or grounds to dispute the valuation therefore fewer taxpayer appeals.

There are also certain inherent fairness questions about valuation banding that should be considered. “Fairness” in land and property taxation as noted earlier refers to horizontal and vertical equity. Both horizontal and vertical equity are difficult to achieve with valuation banding. To see this, consider two properties in the same community in England, one (property X) whose market value in 1991 was £119,500 and a neighboring property (property Y) valued at £120,500. Property X would fall in valuation band E while property Y would be placed in valuation band F. Now suppose the local municipality assesses a tax of one percent of the average value within each band. Even though property X and property Y are separated by less than one percent in market value, because they are in different valuation bands they would face very different tax obligations. Property Y would owe almost 35 percent more tax than property X (£1,400 compared to £1,040).

Vertical equity can also be a problem with valuation bands. To continue the example, add to the situation just described property Z in the same community with a market value of £159,000. It too falls in valuation band F with property Y, and consequently would be obligated to pay the same tax as property Y even though it is over 30 percent more valuable.

The only way to completely overcome these equity issues is to adopt a capital market valuation standard, which in many cases is simply not practical. While the problem can be reduced by increasing the number of value

TABLE 7.1: VALUATION BANDS USED IN ENGLAND AND SCOTLAND

Valuation band	Range of values
Band A	Not exceeding £40,000
Band B	Exceeding £40,000 but not exceeding £52,000
Band C	Exceeding £52,000 but not exceeding £68,000
Band D	Exceeding £68,000 but not exceeding £88,000
Band E	Exceeding £88,000 but not exceeding £120,000
Band F	Exceeding £120,000 but not exceeding £160,000
Band G	Exceeding £160,000 but not exceeding £320,000
Band H	Exceeding £320,000

²⁶ This section draws heavily on Plimmer, McCluskey and Connellan (2002).

bands, it cannot be eliminated completely. And the other advantages of valuation banding may outweigh equity issues. Valuation systems should be selected because they are simple enough to be implemented and fairly administered, and transparent enough to be explained and understood by taxpayers. In this regard valuation bands are certainly attractive even though they may bear little connection to capital market values.

7.1.4 CADASTRAL OR FORMULA VALUE

Another approach which has been used successfully in countries such as Latvia and Argentina is based on a cadastral or formula value. This approach provides an intermediate step between systems based on physical property attributes and those based on capital market value. The method uses property attributes in a mathematical formula to arrive at a taxable or cadastral value. The approach offers significant potential as a practical step in the transition from a non-market approach to a more market-based approach to valuing land and property.

The cadastral value approach begins by gathering as much information as is available on market conditions throughout the jurisdiction. The information may come from the personal knowledge of tax administrators, public sources, interviews with residents or private sources that make the information available for a price. Using the best information available, tax administrators divide the jurisdiction into what are believed to be fairly homogeneous geographic zones. “Homogeneous” in this sense means that similar properties in the same zone will generally be valued similarly in the market place. The system of zones will likely include several overlapping but very different zones for different land uses (residential, commercial, etc.).



Residential housing in Pristina, Kosovo.
Photo © UN-HABITAT/Malcolm Boorer

Information is also assembled on property attributes such as the total land area, the floor area of any buildings or flats within buildings, number of flats in a building and any other significant immovable improvements. Estimates of average or typical market values are assigned to each unit of property attribute. For example suppose that a careful review of the available information in a given community indicates that typical sales prices for land and buildings in three zones are as shown in Table 7.2. This information could then be used to value all residential property in these zones.

TABLE 7.2: AN EXAMPLE OF RESIDENTIAL LAND AND BUILDING VALUES

Property Attribute	Average value per square meter		
	Zone 1	Zone 2	Zone 3
Land	15	30	10
Buildings	40	75	20

TABLE 7.3: AN EXAMPLE APPLYING ESTIMATED VALUES TO INDIVIDUAL PROPERTIES

Location of property	Zone 1	Zone 2	Zone 3
Property Identifier	AAA	BBB	CCC
Property description	Single-family residence	One flat in a building of 40 flats	Single-family residence
Land area (square meters)	700	7,000	500
Building floor area (square meters)	100	50	50
Cadastral value			
Property	15 X 700 = 10,500	30 X 7000/40 = 5,250	10 X 500 = 5,000
Building	40 X 100 = 4,000	75 X 50 = 3,750	20 X 50 = 1,000
Total cadastral value	14,500	9,000	6,000

Continuing the example to demonstrate how typical values such as those shown in Table 7.2 can be used to value individual properties, consider the three properties shown in table 7.3. Property AAA is a single-family residence in a comfortable neighborhood of similar homes. Property BBB is a flat or apartment in a building that includes a total of 40 such flats. Property CCC is also a single-family residence but in a much poorer zone of the city. In each case, the typical values specific to each zone are applied to the particular characteristics of the individual property to arrive at a cadastral taxable value. Note that in the case of the flat, the land value is divided between all the dwelling units that share the land.

There is no assumption that the resulting cadastral values reflect the actual market value of properties valued under this approach. But if implemented with care, the cadastral values will result in an equitable distribution of the tax burden and will roughly correlate with market values. The advantage of this approach is that as a country's data systems become more sophisticated over time, the system can readily be converted to a capital market approach. And the system can be adapted to the amount of detailed property information available to tax administrators. Initially, there may be little more than land area and gross building area data which

can be obtained from physical inspections or aerial photos. As additional information is added to the cadastral system, it can be incorporated into the valuation system.

Implementation of a cadastral value approach does imply both the capacity and the commitment to computerize property records or it is unlikely the system will be sustainable. But such computerization will facilitate both property registration and the ability to update taxable values quickly as market conditions change.

7.1.5 AREA AND LOCATION

The final approach to valuation to be discussed here is perhaps the least demanding in terms of data and expertise, and it makes the fewest assumptions about the maturity of local real estate markets. There are several variations, but all involve defining the base for the LPT in terms of the physical attributes of the property. If only land is to be taxed, then some combination of land area (m²), location and land use will define the base. If improvements are to be included as well, the building area or volume is added to the list of defining characteristics. Connolly and Bell (2009) report that 38 countries tax property using this approach, as shown in Table 7.4.

TABLE 7.4: COUNTRIES EMPLOYING AREA-BASED PROPERTY TAX FOR AT LEAST SOME AREAS AND/OR SOME TYPES OF PROPERTY²⁷

Country	Area-based tax used for		Types of taxable property	
	Land	Buildings	Land	Buildings
Albania	Yes	Yes	Agricultural	All
Azerbaijan	Yes	No	All	Inventoried value
Belarus	Yes	No	All	Value based
Bulgaria	Yes	Yes	Non-agricultural, non-forest land, developed agricultural land	All non-agriculture
Burundi	Yes	Yes	Undeveloped land in designated municipalities and all developed land	All
Cameroon	Yes	Yes	All	All
Chile	Yes	Yes	All	All
Croatia	Yes	Yes	Idle agricultural land, idle enterprise real estate, idle construction land; communal fees on all land	Vacation house; communal fees on all buildings
Czech Republic	Yes	Yes	All	All
Dominica	Yes	Yes	Roseau City	Roseau City
Eritrea	Yes	No	All	N/A
Ethiopia	Yes	No	All	N/A
Georgia	Yes	No	All	N/A
Hungary	Yes	Yes	Unimproved land on plots above the average area	All except Nyíregyháza
India (Delhi Municipal Corp)	Yes	Yes	All	All
Israel	Yes	Yes	Developed land, occupied undeveloped land, and agricultural land	All
Kazakhstan	Yes	No	All	Average annual net book value of the assets
Kenya	Yes	No	Registered land	N/A
Kyrgyz Republic	Yes	No	All	Value based
Lao	Yes	No	All	N/A
Lesotho	Yes	No	Rural land	N/A

²⁷ Based on Connolly and Bell (2009), Table 3.

TABLE 7.4: **COUNTRIES EMPLOYING AREA-BASED PROPERTY TAX FOR AT LEAST SOME AREAS AND/OR SOME TYPES OF PROPERTY(CONTINUED)**

Lithuania	Yes	No	All	Non-residential buildings assessed according to market value
Moldova	Yes	No	All	N/A
Namibia	Yes	Yes	Rural	Rural
Nigeria	Yes	Yes	All land with buildings valued less than 600 Naira	All valued less than 600 Naira
Poland	Yes	Yes	All	All
Romania	Yes	No	All	N/A
Rwanda	Yes	Yes	Undeveloped Land	Occupied buildings
Saint Lucia	Yes	No	Undeveloped land	Annual rental value
Saint Vincent and Grenadines	Yes	No	Undeveloped land outside urban areas	Annual rental value
Slovak Republic	Yes	Yes	All non-agriculture	All
Slovenia	Yes	No	Developed and undeveloped building land	Type and value of the premises
Tajikistan	Yes	Yes	All	All
Trinidad and Tobago	Yes	No	Land outside of cities	Annual rental value for property within the city boundary
Tunisia	Yes	Yes	Unbuilt land	All
Ukraine	Yes	No	All	N/A
Uzbekistan	Yes	No	All	Inventory cost or depreciated cost
Zimbabwe	Yes	No	Rural land	value based in urban areas

Under the area-based approach to LPT, the tax due is calculated by multiplying the measured land area (and often the building area) by a per unit assessment rate. For example, in Chile, non-agricultural land is assigned a value per square meter based on the zone in which the land is located (*ZCS, zona características similares*). The zones are determined by a national agency, the Chilean Internal Tax Service (SII, *Servicio de Impuestos Internos*), and reflect location and land use. The taxable value of the land, known as the fiscal value in Chile, is then determined by multiplying the area of the land and the base value per square meter in that zone.

The Chilean approach to taxing immovable improvements is only slightly more complicated. Buildings are divided into six general classes and 33 sub-classes based on type of construction. Construction type and building quality are combined in national tables that establish a base fiscal value per square meter for each category of building. These base values are then multiplied by the area (m²) of each building, and standard adjustments for location, special construction features, degree of commercialization and age are applied to arrive at the fiscal value of the building.

Since the taxable value is based on physical characteristics of the property such as location and size, the data requirements for administering the system are much lower. Chile makes adjustments for building quality and age, but these are embellishments that could be added later if the data is not available. For example, in the Czech Republic, taxable value is based on the floor space of buildings and a locally determined coefficient that varies with the population of the city. These coefficients range from 0.3 for cities with less than 300 residents to 3.5 for cities over 50,000 in population, and local governments are authorized to adjust their coefficient down three levels or up one level to account for building type and location within the municipality.

Thus, the area based approach to value still requires land records that accurately report land and building area at a minimum. If additional property characteristics are available they can be incorporated in adjustment factors. Over time these adjustment factors can become quite extensive as data on land and buildings is expanded and refined. Eventually the entire area-based system can be converted to one of the other valuation approaches as appropriate. The principal advantage of the area-based approach is that it can be used with minimal property information while still providing a foundation for a tax system that can be elaborated over time.

One variation on the area-based approach simplifies information needs even further by simply applying a flat fee or parcel tax to each parcel of land regardless of value, size or location. The argument for such an approach is that all property represents at least a minimal cost to the community to provide basic services. The state of Victoria in Australia uses this approach to raise 20 percent of its property tax revenue, with the balance collected based on a capital market value levy. In other instances in which a minimum tax is imposed, the rate is often so low as to yield very little revenue while creating significant administrative costs to prepare bills and monitor collections. The point here is simply that as a starting point, a single flat-rate tax could be applied to all properties, and the system could then be augmented over time as additional information and local capacity are acquired.

Revenue Buoyancy: Buoyancy or elasticity refers to the relationship between the revenues collected and broader economic trends in society. If the revenue collected from a tax tends to increase without changing the tax rate as fast as or faster than growth in the economy, the tax is said to be more buoyant than a tax that does not keep pace with economic growth. In general it is considered good tax policy to have a tax system that yields revenue growth that keeps pace with but does not exceed growth in the broader economy.

There are two main shortcomings to the area-based approach. First, the more limited the data underlying the system, the greater the likelihood that there will be inherent inequities. If all that is known about two properties is their similar size and the fact that they are in the same city zone, both will be charged about the same amount of tax when in fact they may differ markedly in desirability. It is this potential for inequity that prompts tax authorities to strive to expand the data collected and develop appropriate adjustment factors. Even with these efforts, there remain potential inequities in the way properties are taxed.

The second shortcoming of the area-based approach to value is the lack of inherent buoyancy in the resulting revenue collections. Ideally an annual LPT increases as the local community grows and develops economically. Revenues from the LPT increase without explicit action on the part of decision-makers in response to public and private investment and increased demand for land. Such increases are a feature of well-run market-based valuation systems, but they do not occur automatically with an area-based approach. Since the taxable value under the area approach is based on physical attributes, the taxable value will change only if property attributes change or if the tax authority explicitly adjusts the rating factors.

Valuation Example: Value based on property attributes

Taxable value is determined by the physical attributes of the property such as land or building area.

Step 1: Determine which characteristics will be used to determine taxable value. (Examples include land area, building area, construction materials, access to infrastructure, etc.)

Step 2: Collect the identified data items for each land parcel.

Step 3 (Optional): Divide the city into districts of roughly comparable desirability. (Different districts are used for residential and commercial land.)

Step 4: Within each district, establish a rating factor to be applied to each characteristic in determining taxable value

Example: City officials determine that a city consists of four districts based on land use patterns: the central business district, an industrial district, an exclusive residential district and all other land. Land area and building area will be used to determine taxable value. The rating factors are set as shown in the table, and the tax is calculated by multiplying the rating factors by the property attributes.

Example properties in each District	If the property attributes are		And the rating factors are		Then the tax due is		
	Building Area (m ²)	Land Area (m ²)	Building area	Land Area	Building	Land	Total
Exclusive residential	100	230	2/m ²	0.5/m ²	200	115	315
Industrial	1000	2300	1.5/m ²	0.6/m ²	1,500	1,380	2,880
Central business district	100	100	1.5/m ²	2/m ²	150	200	350
All other	50	150	0.2/m ²	0.05/m ²	10	8	18

7.1.6 SUMMARY OF VALUATION OPTIONS AND THE WAY FORWARD

As noted above, the options for valuing the base for any LPT vary along a continuum ranging from approaches based on the capital market value of the land and improvements to approaches based solely on the physical attributes of the property. Capital market value represents the approach taken in many advanced economies. Annual rental value is widely used by countries that have historical ties to parts of Europe. Valuation bands are currently used in the United Kingdom to value residential property and valuation approaches tied closely to the size and location of land parcels and buildings are used in 38 countries. All represent viable approaches to determining the taxable value of property. Which is best in any given context will depend heavily on answers to the following questions:

1. **Is there an historical reason to prefer one approach to the others?** As mentioned, countries with historical ties to some European countries tend to employ the annual rental value approach. If both the public and tax administrators are familiar with this approach, there is little reason to change. Similarly in other countries, there may be a greater comfort level with one approach for historical reasons. Since all can be employed effectively if other conditions are met, public familiarity and acceptance are important.
2. **Is there an active real estate market in the community?** The same valuation approach does not have to be employed everywhere in any country. In areas with active real estate markets, a capital market approach might be employed, while in other areas valuation could be based on size and location. Active mature real estate markets include the financial, professional and information infrastructure to support such markets. What is key is the recognition that if the real estate markets in a given area are immature or non-existent, attempting to base the LPT on a variation of capital market value will in all likelihood lead to frustration for both tax administrators and taxpayers.

3. **What is the administrative capacity of the government to administer the LPT?**

Capital market approaches to value require substantial human and financial resources to acquire and maintain current property and market information. In addition, the techniques used to estimate capital market value under a capital market approach require significant expertise on the part of tax administrators. Both the personnel and the budgets must be available to support a system based on capital market value. On the other hand approaches based on property attributes such as size and location are much less demanding both in terms of expertise and resources. While it is still necessary to maintain quality property records under any approach to value, the information demands and the level professional expertise are both lower with valuation approaches not tied closely to capital market value.

7.2 RATE SETTING

Once the value of real property has been established for tax purposes, the calculation of the tax due involves applying the appropriate rate to the defined base. While the final calculation may be a simple matter of arithmetic, there are two important policy considerations in rate setting: How may tax rates will there be and who will set them? Even countries that appear to have only one tax rate in practice have multiple rates, but the number of rates varies widely. In addition, there are good arguments for both centralized rate setting and local rate setting, but the most effective way forward appears to involve both.

Before discussing the two central questions in greater detail, it should be noted that little can be learned by looking at a countries LPT rate unless the definition of the LPT base is also considered. For example, rates of ten, twenty and even forty percent are not uncommon in countries that tax annual rental value. But in countries that value land based on capital market value, rates typically fall in the one to three percent range. The actual final rate will thus depend heavily on how the LPT base is defined and what the revenue target is.

7.2.1 FIXING THE NUMBER OF LPT RATES

Multiple LPT rates are justified on a variety of grounds. In some cases, certain properties may represent a greater burden on local government services, and thus it is argued they should pay higher taxes based on the “benefit” principle. In other instances higher taxes are rationalized on the basis of ability to pay: those with more means are asked to pay more. Finally in some countries (e.g., Brazil and Singapore) there is a very explicit effort to redistribute wealth through the LPT resulting in much higher rates on higher valued property.

Countries can also implement multiple LPT rates through one of several mechanisms. Perhaps the most common approach is to classify property based on land use. Such a system may be as simple as distinguishing between agricultural, residential and other non-residential property. In other cases, the number of property classes easily exceeds one hundred. Each property class could conceivably have a different LPT rate. Clearly the greater the number of land use classifications, the greater the administrative challenge of keeping land use information up to date, and the greater the opportunity for errors in classification.

A second system of property classification that yields multiple LPT rates is to distinguish between properties based on ownership. It is quite common, for example, to exempt certain classes of owners such as mosques, churches, charities and schools from the LPT altogether, a subject that will be discussed more fully in the next section. Finally, property can be classified based on taxable value and different rates applied to different value classes. For example, Morocco defines the LPT base as annual rental value, and divides residential properties into four value classes, each with a different LPT rate (See box for details).²⁸

A number of countries seek to implement a policy goal of redistributing society’s resources through multiple and progressive LPT rates. In announcing Singapore’s shift to a more progressive LPT system in 2010, for example, the government made it clear that redistribution was a central policy goal. The new Singapore LPT for owner-occupied property replaces an old rate of 4 percent of annual rental value with three tiers, again based on annual rental value. The first S\$6,000 (€ 3,458) is exempt from the annual LPT. The next S\$59,000 (€ 34,000) is taxed at a rate of four percent, while all rental value over S\$65,000 (€37,458) is taxed at six

Multiple annual LPT rates based on property value: The case of Morocco *(Taxe d’habitation)*

New residential construction in Morocco is exempt from the annual LPT for five years. After this period, housing is taxed based on its annual rental value at the following rates:

Owner-occupied homes receive a 75 percent reduction in these rates.

Annual Rental Value (Euros)	LPT rate
Less than 5,000 dh (446)	0%
Between 5,001 and 20,000 dh (1,782)	10%
Between 20,001 and 40,000 dh (3,565)	20%
More than 40,000 dh (3,565)	30%

²⁸Ministry of Economy and Finance, 2009, Resume du Systeme Fiscal Marocain, Kingdom of Morocco.

percent. Thus, for example, an owner-occupied property with an annual rental value of S\$24,000 (€13,830) would owe S\$720 (€415) in property tax (nothing on the first S\$6,000 and 4 percent of the next S\$18,000). All residential property that is not owner-occupied and all other property is taxed at 10 percent of the annual rental value.²⁹

The Government of Namibia has also recently implemented a policy to promote redistribution of land ownership in that country. Under the Namibian Land Valuation and Taxation Regulations of 2001, land is to be valued at market value, though in practice this has translated into sixty-one valuation zones which were used to arrive at a cadastral or taxable value as described above. One interesting feature of the Namibian case is that the policy objective is to discourage ownership of multiple farms. Consequently, the LPT rate increases based on the number of properties owned. A Namibian national owning a single farm faces a tax rate of 0.75 percent (1.75 percent for foreign nationals). The rate increases by 0.25 percent for each additional farm owned. Thus, the tax assessment sent to owners lists all farms owned by that registered owner. The property with the highest value is listed first and taxed at the lowest applicable rate (for example, 0.75 percent). The second highest valued property is listed second and is taxed at the next rate (1.0 percent), and so on for all properties (Directorate of Valuation and Estate Management, ND). Bird and Slack (2007) argue that similar efforts in other countries have not been very successful largely because the additional administrative burdens involved in tracking owners of multiple parcels have proven to be quite substantial.

What should be clear from these examples is that it is quite possible to adjust LPT rates for the presumed ability to pay the tax and to create a system which is quite progressive in rate structure. Rates can be based on location as well as land use. For example, land in the urban center can be taxed at a higher rate than land

on the urban fringe or rural land. Or industrial property might be taxed at a higher rate than other property in an effort to export part of the tax burden to non-residents. What is less clear is the extent to which such multiple rate systems are desirable.

When it comes to designing LPT rates, there is great virtue in simplicity, especially in environments where administering an annual LPT strains public agency capacity. Simplicity in this case means few land use classifications, uniform assessment rates and very few LPT rates. In general, the evidence from past practice strongly suggests that neither equity nor efficiency is enhanced through a complex rate structure.

In terms of equity, reducing the effective tax rate for some property holders simply means that others will face higher taxes if the same revenue target is to be met. It is somewhat like a balloon filled with water. Squeeze one end to make it smaller and the other end must expand. So it is with reducing LPT rates for selected groups. If the community must raise a certain amount of revenue in order to fund necessary services, reducing the rate on some properties means that other property holders will face higher taxes in order to collect the same overall revenue.

In terms of efficiency, both economic and administrative efficiency should be considered. Bird and Slack (2004), for example, review the property tax in twenty-five countries, and conclude that there is little or no economic justification for the common practice of taxing non-residential property more heavily than residential property. Residential property in general represents a greater burden on local services. In addition, differential tax rates for residential and non-residential property can distort land use decisions. They conclude that while taxing residential property more lightly than other property is politically popular, it is economically inefficient.

²⁹ IRAS e-Tax Guide, 2010, Property Tax: Budget 2010, New Progressive Property Tax Regime (PPTR) for Owner-Occupied Residential Properties with effect from 1 January 2011, Inland Revenue Authority of Singapore.

Multiple LPT rates can also represent an unwarranted administrative burden that increases costs and the potential for errors in administration. If different rates are applied to different land use classifications, then clearly accurate information on current land use must be maintained and regularly updated. Even a distinction as apparently simple as residential versus non-residential increases the information requirements and therefore the cost of maintaining the system. Suppose for example that a particular property serves as both residence and commercial store-front. Such mixed use is common in many urban areas and requires that the tax administrator record both the mixed use and the allocation of the total building area between the two uses. The taxpayer will surely have an incentive to encourage the tax administrator to under estimate the amount of area allocated to the commercial usage if such usage is taxed at a higher rate. If the LPT system includes different rates for different types of non-residential usage, the task becomes even more information intensive and therefore more expensive and error prone.

The same holds true for graded or progressive LPT rates within a single land use classification. Consider again the case of Morocco described above, and a property with an annual rental value of €3,600. Based on the published rates, such a property should incur a tax obligation of thirty percent of the annual rental value, or €1,080 per year. However, if the tax administrator, either intentionally or inadvertently, mistakenly records the rental value at €3,550, just €50 per year less, the tax obligation will fall to €710, nearly a 35 percent reduction in the total tax bill. The taxpayer in possession of a high value property in a community with progressive LPT rates has an incentive to try and influence local administrators. Even without pressure from taxpayers, multiple classifications require more property information and more judgment on the part of local officials, and therefore there is more opportunity for error. Decision makers should evaluate carefully the administrative feasibility and practicality of any multiple rate system.

7.2.2 DIFFERENTIAL RATES ON LAND AND IMMOVABLE IMPROVEMENTS

At least since the late 19th century economists have argued that land and improvements should be taxed at different rates. The claim manifests itself on one hand in the argument that land should be taxed, but the rate on immovable improvements should be zero. The economic argument is that since the supply of land is fixed, a tax on land does not have the same distortionary effect on the local economy that virtually any other tax would have. Taxing improvements, it is argued, discourages investment in real estate improvements.

Two examples serve to show how the land-only tax can be implemented. Ukraine charges an annual land tax that depends on the land use classification and location of the land. If the land has an estimated market value then the tax is one percent of the estimated value. All other land is taxed based on land area, with rates varying from €0.0014 per square meter to €0.0192 per square meter depending on property location. In regional centers the rate is increased by as much as three times. Thus a 5,000 square meter parcel could have an annual land tax of between €7 and €288, depending on location and how the land is classified.

Jamaica converted their capital value tax on land and improvements to a tax strictly on the unimproved value of land in 1957. As noted above, the current rate is 0.5 percent of land value above J\$300,000 (about €2,570). Thus, a fairly typical parcel valued at J\$1,000,000 (about €8,600) would have an annual tax bill of J\$3,500 (about €30).

Another option employed by some countries is to tax land and improvements, but at different rates. Such systems are commonly called split rate property tax systems. For example, for a period of time, the city of Pittsburgh, Pennsylvania in the USA taxed buildings at the rate of 1 percent of capital market value while taxing land at the rate of 4 percent of capital value. The result some have argued was an accelerated redevelopment of the city compared to other cities in the region.

TABLE 7.5 COUNTRIES USING SOME FORM OF LAND VALUE TAX OR SPLIT RATE TAX

Africa	Kenya, Namibia, Swaziland, Zimbabwe
Asia	Japan, South Korea, Taiwan, Thailand
Australasia and the South Pacific	Australia, Fiji, New Zealand, Papua New Guinea, Solomon Islands, Vanuatu
Caribbean and Latin America	Bahamas, Barbados, Belize, Grenada, Jamaica, Mexico
Europe	Denmark, Estonia, France, Ukraine
North America	Canada, United States

Source: Franzsen, 2009, Table 3.1.

(Oates and Schwab, 1997) Examples of other countries that tax land only or that tax land and improvements at different rates are shown in Table 7.6.

7.2.3 TAXING THE LEAST ADVANTAGED

One of the important challenges in designing LPT policies is the question of how to treat low income households in the community? On the one hand, it may be difficult to identify and collect the tax from such households and the revenue yield may be quite low. On the other hand, even a very modest tax can foster civic engagement and can reinforce a culture of community ownership among people who otherwise may feel quite disenfranchised.

In practice many jurisdictions take one of two approaches for minimizing the tax burden on low income households. The first approach reduces the rate for all homes by a specific percentage. Suppose for example that all property is valued at capital market value, but residential properties are taxed at one-half the rate of other property. This very broad approach has two disadvantages. First, as noted above, it shifts a significant portion of the overall tax burden to non-residential property without sound economic justification. Second, and perhaps even more important, most of the benefit from the lower tax rate will go to higher income households since they will tend to own the more valuable property in a community. The reduced tax rate approach is illustrated in Scenarios 1 and 2 in the box. In this illustration, if all properties are taxed at the same rate (Scenario 1), the resulting revenue totals €2,110. But if

residential property is taxed at one-half the rate of non-residential property (Scenario 2), in order to collect the same revenue, the rate on non-residential property must be increased by over 50 percent. At the same time, the vast majority of the “benefit” to residential property holders flows to those with the most valuable property, and the more valuable the property the greater the benefit. Thus, while it is true that tax relief is granted to holders of the lowest valued property, that relief comes at a very high price in terms of either foregone revenue, reduced equity or both.

A second and more effective approach is to exempt a specific amount of residential value from the LPT. Under this approach, policy makers establish a specific threshold taxable value. All residential property receives a reduction in taxable value by (up to) that amount. Consider the illustration in Scenario 3 shown in the box. Under this scenario, it is assumed that an exemption of €1,000 is granted to all residential property. The result is that holders of the lowest valued property would have no tax obligation at all. The relative importance of the exemption would decline with increasing property values. While it is still the case that in order to collect the same revenue as the no-relief case, the tax rate will be higher, the net increase in the rate with a specific exemption will be much lower than under the “lower rate” scenario. And the burden will be more uniformly spread through the community.

7.2.4 OTHER RATE-RELATED ISSUES

Other options are also used to shift the burden of the LPT or to pursue specific land use objectives.

Lowering the tax burden through reduced tax rates: An illustration

In this illustrative example, under Scenario 1, all property is taxed at the same rate and a total of €2,110 is collected. Under Scenario 2, all residential property is taxed at one-half the rate of non-residential property. Under Scenario 3, the first €1,000 of taxable value is exempt from the LPT for all residential property.

Property	A	B	C	D	
Land use	Residential	Residential	Residential	Commercial	Total
Taxable Value	€1,000	€10,000	€100,000	€100,000	€211,000
Scenario 1: No tax relief					
Tax Rate	1%	1%	1%	1%	
Tax obligation	€10	€100	€1,000	€1,000	€2,110
Scenario 2: Lower residential rate					
Tax Rate	0.5%	0.5%	0.5%	1.555%	
Tax obligation	€ 5	€ 50	€ 500	€ 1,555	€ 2,110
Tax savings or increase	€ 5	€ 50	€ 500	-€ 555	
Scenario 3: Specific value exemption					
Exempt value	€1,000	€1,000	€1,000	€0	
Adjusted taxable value	€0	€9,000	€99,000	€100,000	€208,000
Tax Rate	1.0144%	1.0144%	1.0144%	1.0144%	
Tax obligation	€0	€91	€1,004	€1,014	€2,110
Tax savings or increase	€10	€9	-€4	-€14	

As noted above, both Morocco and Singapore tax properties that are not occupied by the owner at a different rate, and this practice is fairly common in those countries that maintain records on housing tenure. In many instances the practice is intended to export part of the tax burden to non-residents. But again it requires information on the ownership status of property possessors and can lead to misrepresentation of that status.

In some countries all property holders are assessed a minimum LPT. In Latvia, for example, a residential exemption is extended to those earning less than half the minimum wage, but all property holders are required to pay a minimum LPT of L5 (about €1.50) per year. Such a practice is more about maintaining accurate land and occupancy records and encouraging civic engagement than it is about revenue. In other cases, the minimum tax may attempt to reflect the cost of providing urban services and

resembles a minimum fee for services. (Fischel, 1992) For example, the minimum LPT in Honolulu, Hawaii (USA) was recently increased from \$100 to \$300 per year to reduce local government budget pressures.³⁰

In Jamaica the approach is slightly different but has a similar effect. The Jamaican LPT is J\$600 (about €5) on the first J\$300,000 (about €2,600) of (capital market) value, while the tax rate is 0.5 percent on values above J\$300,000. The effect is to create a minimum tax of about €5 on all land holders. Probably the most important issue around a minimum LPT is whether the capacity and political will exist to actually collect the tax.

One of the land-use issues that many communities have faced over the years is how to minimize land speculation. Speculation in

³⁰ City and County of Honolulu, 2010, Ordinance 10-9, Adopted 9 June 2010.

this context refers to those parties who have no intention to develop land but acquire it solely as a relatively short-term investment in anticipation that growth and changing demand will drive the price of land up. They acquire land, hold it until the price increases and then sell. In some regions of south eastern China, for example, local governments took advantage of relaxed national requirements and attempted to encourage outside investment by creating special industrial zones. After extensive investment in infrastructure by the local government, it was frequently the case that land speculators acquired the land through long-term leases (since all land in China is owned by the state). When development did not immediately follow, there was little local officials could do.

In some countries, the LPT has been used in an attempt to discourage this type of speculation. Latvia, for example, taxes unused land at twice the rate applied to developed land. Taiwan also imposed an additional tax on vacant land until 1985, at which point the tax was suspended because of deteriorating real estate market conditions. However, in January, 2011, the vacant land tax was re-instated with the explicit intent to discourage land speculation and hoarding. Local governments have the discretion to set the vacant land tax rate at from two to five times the standard land tax rate.

7.2.4 RATE SETTING AUTHORITY

As noted at the beginning of this section on rate setting, there are two important policy considerations related to LPT rates: what the rate or rates will be and who will set them? The principal consideration in determining who will set the LPT rate is the degree of local autonomy that will be granted to local governments. There are strong arguments in favor of a national (or state/provincial) role in rate setting, just as there are strong arguments in favor of local autonomy in rate setting. In the end, best practice indicates that both levels should be involved in determining the final LPT rate or rates.

The trade-off appears to be a desire to promote uniformity and avoid tax competition on the one hand, and a need to support local autonomy and

responsiveness to local needs on the other hand. Economists and international organizations like the OECD and the European Union argue that tax competition between countries or between localities within a country undermines government capacity to provide necessary public services.³¹

If a local community seeks to attract private investment in the community by lowering its tax rate, the argument goes, that community runs the risk of not having sufficient resources to provide adequate public services. If an adjacent community responds by lowering its tax rates even further, then there emerges a “race to the bottom” with the result that the fiscal integrity of both communities is seriously impaired.

To be sure, there are groups that argue this type of tax competition provides a useful check on the growth of government, but the more common response is to advocate tax harmonization across jurisdictions. Such harmonization in the case of LPTs amounts to national (or state/provincial) LPT rate setting.

The alternative view argues forcefully for local autonomy in LPT rate setting. Local officials, it is argued, are closer to the people they serve and are more aware of local needs. If they are to be held accountable by local citizens, local governments need the flexibility that comes with having a revenue source over which they have some control. Consequently, there will be greater responsiveness to local needs, better accountability and improved public services if local governments can control the LPT rates.

The compromise position between these two views is to set the range of rates at the national (state/provincial) level and allow the local government to select the final rate within that range. For example, in Japan the Local Tax Law stipulates the local taxes that prefectures and municipalities can levy. The “standard tax rate”

³¹ Evidence that such competition takes place is found in Feld and Reulier (2009), Hauptmeier et al (2009) and Brueckner and Saavedra (2001).

for the annual LPT is also set in the law and local governments are expected to adopt this rate in setting local taxes. The current standard rate is 1.4 percent of taxable value. The Tax Law also sets the maximum tax rate which gives local governments the power to levy a rate of up to 2.1 percent of taxable value. As of 2004, less than nine percent of local governments adopted a rate higher than the standard rate, but the option is there if local needs justify a higher rate. (Kitazato, 2004)

Another example of local autonomy within national limits can be found in the Philippines. (Guevara, 2004) The Local Government Code of 1991 grants taxing power to local governments and sets both the minimum and the maximum LPT rates. The minimum rate is set at 0.25 percent of taxable value (0.5 percent for cities) while the maximum rate is one percent for provinces and two percent for cities and municipalities in Metro Manila. In this instance, most local government units adopt the maximum rates allowed. Since the Philippines also employs a classification system and assessment ratios of less than full value, the effective LPT rates are lower than those set in law. But the principle is still well illustrated: local autonomy exercised within limits established by national policy. In their review of property tax practices in twenty-five countries, Bird and Slack (2004) report that local governments had some degree of autonomy in selecting the final LPT rate in sixteen of the twenty-five countries.³²

7.2.5 SUMMARY AND THE WAY FORWARD

As with every aspect of the LPT system, the way forward with regard to rate setting should be based on the specific context created by the current system of recognized property rights, the quality and extent of the land registration systems, the nature and maturity of property markets and the administrative capacities of those government agencies charged with implementing the LPT.

However, several guiding principles have been identified in rate setting practices from around the world and can be summarized as follows:

- Simplicity should rule the day, both for the sake of taxpayers and ease of administration. The best LPT systems are easy for taxpayers to understand and require few judgments by tax administrators. Complex rate structures increase the likelihood of errors and abuse.
- From the standpoint of simplicity, a single rate is best, or one rate for land and another (lower) rate for immovable improvements. Multiple rates encourage taxpayers to dispute which rate should apply to their property and create opportunities for errors in judgment by tax administrators.
- Few if any land use or property value classifications should be created if they result in different effective tax rates. Classification systems with different tax rates add substantially to the complexity of the LPT system and contribute significantly to inequity in both policy and administration.
- However, if the LPT system is based on the physical characteristics of the property rather than capital market value, LPT rates should be adjusted for location to reflect the fact that some properties are in higher demand than others.
- Exemptions for low valued properties should be carefully targeted and should be weighed against the increased administrative challenges they create.
- Local governments should be granted some degree of autonomy in setting local LPT rates. Many countries grant this autonomy within limits set by a higher level of government. Local autonomy is essential in order for local officials to respond appropriately to differing and changing local needs.

³²The countries reviewed include selections from the OECD (Australia, Canada, Germany, Japan and the United Kingdom), Asia (China, India, Indonesia, Philippines and Thailand), Africa (Guinea, Kenya, Tanzania, Tunisia and South Africa), Central and Eastern Europe (Hungary, Latvia, Poland, Russia and Ukraine) and Latin America (Argentina, Chile, Colombia, Mexico and Nicaragua).

7.3 SUMMARY

This section began by identifying four policy questions, the answers to which should determine how an LPT is designed in a given local context.

- Who will be obligated to pay the tax?
- What precisely will be taxable?
- How will the taxable value of the land and property be determined?
- How will tax rates be established?

The appropriate answers to these four guiding questions in a given context should be strongly influenced by the four dimensions of local practices and capacities described in section 4.

- The local institutions and traditions related to property rights
- The extent to which land and property rights are publicly recorded and actively enforced by the judiciary
- The extent to which land and property rights are actively traded in reasonably efficient markets
- The administrative capacity of government entities including the ability to make business processes transparent and accountable.

Often it will be the interplay of two or more of these dimensions that will determine the best local answer to the policy questions. For example, both the legal and practical incidence of the tax (who will be obligated to pay?) will depend on the quality of the land registry that publicly records ownership and/or possession and the administrative capacity of the local tax authority. Land holders must be identified if they are to be taxed.

Likewise, policies that define what should be taxable should be guided by the local institutions and traditions regarding property rights and by prevailing market conditions. Levying a tax based on capital market value in a community where an active market for real estate may not exist or where private ownership of land is not consistent with local culture will most likely



Explaining an urban housing scheme.

Photo © UN-HABITAT

lead to frustrated tax administrators and very low compliance by taxpayers. Better in such a circumstance to levy the tax based on the physical attributes of the property and require those who possess and benefit from the property to pay the tax.

Policies for determining taxable value should be guided by administrative capacity and by market conditions. It requires less expertise and less information to value property based on size and location than on capital market value. And again, it is pointless to impose a tax based on capital market value if such markets are not sufficiently active to yield the required information. Finally, policies to guide setting the final rate for the LPT will depend on the administrative capacity of both central and local governments and broader policies regarding decentralization and local government autonomy and accountability.

It should be clear from the discussion in this section that the administrative capacity and practices of local officials are key aspects of an effective LPT. Indeed, as Bird and Slack (2007, pg 223) put it, when it comes to the annual LPT “Tax administration is tax policy.” The next section discusses in greater detail the administrative options that are available to local governments in implementing the LPT.



The Dharavi informal settlement in Mumbai, India is with over 6 million inhabitants one of the largest slums in the world. Photo © UN-HABITAT/Malcolm Boorer

8. ADMINISTRATIVE POLICY ISSUES AND OPTIONS

The purpose of this section is to discuss the principal administrative policy options available to governments in implementing and managing LPTs, with particular emphasis on the annual LPT. The most effective strategy for addressing many of these issues is to recognize the comparative advantage that central (or regional, state or provincial) governments have for some tasks, and also the distinct administrative advantages that local governments often have for other tasks. Thus, the most effective administrative strategy is often to share administrative responsibilities between agencies and between levels of government and to assign a given task to that level or agency of government best suited to accomplish the task. However, care must be taken to consider the incentives motivating each level of government and to assure appropriate information sharing and oversight between government agencies.

Much of the literature on tax administration focuses on the question of which level of government should receive which tax revenue, known as the tax assignment question. (Bird, 2009) However the more salient question regarding LPTs is which level of government and which agencies within government are best suited and able to carry out the administrative tasks associated with the tax? The topic of administrative design in emerging economies is often linked to discussions of decentralization. For example, Ebel and Taliercio (2005, pg 924) point out that if decentralization is defined as the degree of local government revenue autonomy, there is evidence that fiscal decentralization “enhances macroeconomic growth and stability.”

However complete decentralization is not the only option. The position taken in this Guide is that some functions can be carried out more efficiently, more effectively or more equitably at one level of government than at another, and it is the overall quality of administration that should drive administrative policy decisions. Quality

of administration in this context is defined as reaching desired revenue targets while achieving acceptable levels of both administrative equity and public perceptions of tax fairness. Even in a setting in which there is a strong policy commitment to decentralization, such decentralization requires building administrative capacity at the local level. Shared administrative responsibilities can serve both to build local capacity and to provide ongoing quality control for necessary administrative functions.

Vehorn and Ahmad (1997) identify four basic conceptual models for tax administration among different levels of government.

- Central government tax administration only, with provision of revenue sharing and transfers;
- Central government tax administration only, with assignment of different taxes to different levels of government;
- Multilevel administration, with revenue sharing and transfers; and
- Each level of government administering the taxes assigned to it.

The first two reflect virtually no local involvement in the administration of a tax. The central authority is fully responsible for all of the functions identified above, from developing and maintaining the property registry to pursuing tax delinquencies. The annual LPT has generally not performed well in countries that have taken either of these approaches to its administration. Effective administration of the LPT requires too much local knowledge of changing land occupancy and use to be effectively administered by the central government. On the other hand, localities that have assumed full responsibility for administering the annual LPT also generally fall short of effective administration, especially in emerging economies with often limited local government capacity. Several of the administrative tasks involved in LPTs require

expertise and resources often lacking at the local level. Thus, the strongest conceptual approach for administering LPTs involves multiple levels of government and frequently multiple agencies within government.

8.1 SHARING RESPONSIBILITY AND DIVIDING TASKS

Even in settings in which there is strong support for decentralization and devolving governmental responsibility to local governments, there are strong arguments in favor of an on-going role for more centralized³³ administrative support for LPTs. Central authorities are likely to be more successful at assuring uniformity of policy and practice and harmonization of the overall tax system. Very often, the central authority has more technical expertise and better resources for carrying out technical tasks. Central government agencies can also improve transparency and taxpayer understanding by setting performance standards, and by standardizing some procedures and forms across jurisdictions. They can also facilitate training, the sharing of best practices and they can monitor the quality of local government practices.

On the other hand, there are certain functions that are best performed at the local level. Local tax officials are more in tune with local conditions and can identify changes in land use and possession more readily. Local officials are also in the best position to respond to inquiries and concerns from local property holders, and to provide initial processing of formal appeals. And one of the strengths of LPTs as a source of local revenue is the connection that local governments can make between taxes paid and services received.

The need for cooperation between government entities extends also to other departments at the same level of government. In many instances, different departments or agencies have administrative responsibilities for functions

that impact land, land use and land related information. For example, China is beginning to experiment with annual LPTs, but one of the challenges they face is the traditional communication barriers between the government agency that controls land, a different agency that regulates construction and the tax authority. Without cooperation and good communication between all three agencies, the difficulty of administering a LPT is greatly increased.

8.1.2 ROLE FOR CENTRAL OR REGIONAL AUTHORITY

Whether individuals or businesses, taxpayers seek stability, certainty, clarity and fairness in the tax system. One potential function of a centralized authority is to facilitate these attributes in the administration of the LPT. The first step along this road is taken when the law establishing the parameters of the LPT is created. Whether done by constitution or statute, or a combination of both, the enabling law should specify precisely what is taxable, who is obligated to pay the tax (including any exemptions), what the general standard is for determining taxable value³⁴, how frequently property will be revalued, which governmental entities are responsible for administering, levying and collecting the tax, which entities will receive the revenue from the tax, what rights of appeal taxpayers have regarding valuation decisions, and what the appeals process will be. Thus, it will generally be the central authority that creates the legal environment that governs the implementation of the LPT, though substantial latitude may be granted to local governments to adapt the LPT to local needs. For example, if real estate markets are more mature in major urban areas but much less mature in smaller municipalities, the enabling law may establish capital market value as the basis for taxable value in urban areas while property attributes such as size and location may be used in less developed areas.

³³ "Centralized" in this context can apply to the national central government in a unitary environment. In a more federal system it can also apply to states, provinces or a regional entity.

³⁴ Youngman and Malme (2004) recommend that the enabling law not mandate particular valuation techniques or procedures, since these methods change and evolve over time. Rather their recommendation is that valuation administration should be held responsible for a given result (such as market value) rather than adherence to rigid methods.

Some consider valuation to be the most difficult aspect of administering the LPT, at least in systems based on capital market value. A central government agency can play an important role in setting standards for valuation and other administrative practices. Several countries in Eastern Europe³⁵ and in Latin America (notably Colombia) have had success creating special central agencies to administer land valuation while maintaining other features of tax administration such as preparation of tax bills and managing tax collections at the local level.

Even if valuation is carried out at the local level, the central agency can provide guidelines for revaluation by local authorities and can review such efforts to assure reasonable quality and uniformity. Some of the tasks involved in valuation are fairly technical and a central agency can provide the following support services to local tax administrators:

- General advice and information sharing on best valuation practices;
- Professional development opportunities for local staff;
- Assistance with particularly difficult appraisals;
- Guidance and support with mapping and integrating geographic information systems;
- Cost schedules for use in the cost approach to value;
- Capitalization rates for use in the income approach to value;
- Legal advice;
- Technical advice;
- Computer processing and information management;
- Computer modeling development;
- Contract review if the local authority contracts with private entities for some tasks.

In addition to standardizing legal codes and other procedures, a central agency can facilitate

standardized information collection and linkage to a national taxpayer identification system. Such a system greatly facilitates local collection and enforcement efforts.

Central agencies have also been helpful in providing training to local authorities to assure uniformity and fairness in tax administration. This training can include legal and administrative rules, recent court actions, standard procedures and even credentialing of local officials. For example, in the United States, the property tax is a local government tax. Valuation is nearly always based on capital market value, and valuation estimates are carried out by local government officials. But in every state there is an agency of state government charged with overseeing the administration of the property tax. The strength of these agencies varies by state, but in many instances they play a vital role in the overall quality of the property tax system. In the state of Utah for instance, the Utah State Tax Commission administers the state tax system, but in addition is charged with overseeing the quality of the local property tax system. The Tax Commission staff receives reports from local jurisdictions each year on tax rates, taxes collected, and valuation changes. They also carry out the valuation of complex properties, conduct regular training sessions for local officials, and review the methods and accuracy of local valuation estimates. As a Commission, they have the legal authority to require a local government to change its administrative practices if the Commission judges them to be incorrect. Finally, the Commission acts as an appeals board if a taxpayer appeal cannot be resolved at the local level. As in other states, the Tax Commission has no responsibility in rate setting or tax collection, but it plays an important role in assuring that the overall property tax system is administered fairly.

Most writers argue that the LPT is most appropriately assigned to local governments because the base is immobile and because the revenue can be linked most readily to local services received. While these are strong arguments for tax assignment, they do not reduce the importance of having centralized support and oversight for many of the functions necessary to effectively administer the LPT. From

³⁵ Cadastral agencies in Lithuania, Russia and Slovenia and Land Services in Estonia and Latvia are responsible for developing land valuations for taxation. See Youngman and Malme (2004).



Cadastral maps are vital sources of information for the administration of land and property taxes as here in Pakistan. Photo © UN-HABITAT

establishing the legal environment, and setting minimum and maximum tax rates, to facilitating information sharing, establishing professional standards and guidelines and technical support, there is a compelling argument for a central or at least regional agency to support local tax officials.

these tasks in a given context will depend on the four context defining elements discussed previously: (1) the nature of local real property rights, (2) the institutions for recording and defending those property rights, (3) the maturity of local real estate markets and (4) government capacity.

8.2 ADMINISTRATIVE PRACTICE

The administrative tasks necessary to effectively administer an LPT can be summarized fairly succinctly based on the revenue identity. Governments must

- develop and maintain a list of taxable land and properties,
- identify and register the relevant taxpayers,
- determine the taxable value of all land and properties,
- determine the tax rate that applies to each property and calculate the tax due,
- prepare and deliver the tax bill,
- appropriately respond to inquiries, concerns and appeals from taxpayers,
- collect the revenue due, and
- appropriately follow through and resolve tax payment delinquencies.

The best administrative strategy for addressing

8.2.1 COVERAGE: LAND REGISTRIES AND CADASTRAL MANAGEMENT

A cadastre is an official property registry. There are at least three types of cadastres which can be integrated into a single set of property records but often are not. The physical cadastre contains a description of the physical property including boundaries and if the property has been developed, information on immovable improvements. The legal cadastre contains information on legal rights such as ownership of land and buildings, and in some instances it also contains information on occupants of the land. In some countries this is referred to as the “Land Book.” The fiscal cadastre contains tax information including valuation estimates.

As noted, these cadastres can be integrated into a single set of property records that support legal transfers of rights, land use planning and taxation, as well as other potential uses. In practice there may be good reasons to maintain separate cadastres. In Jamaica, for example, as

of 1998 the fiscal cadastre contained 590,000 parcels while the national legal cadastre included only about 300,000 parcels that had been legally registered. (Rosengard, 1998) By 2010 the picture had not improved dramatically, with just over 779,000 parcels on the fiscal cadastre but nearly half (nearly 371,000) still unregistered in the land registry.³⁶

While there are a number of important arguments to support a comprehensive and integrated land inventory and cadastre³⁷, such efforts can take years to fully realize. And the lack of such a cadastre should not be considered an insurmountable obstacle to implementing an LPT. The case of Hargeisa, Somaliland is very instructive. (UN-HABITAT, 2006) In 2001, development indicators placed Somaliland among the poorest and least developed regions in the world, with GDP per capita estimated to be US\$200. After years of conflict, the damage to the physical and institutional infrastructure meant that the land registration system was largely destroyed. Hargeisa is the capital of Somaliland with a population of about 396,000 in 2005. The city had in place a property tax but the revenue generated was US\$169,062 in 2005, far short of the revenue needed for essential municipal services.

With the assistance of UN-HABITAT, Hargeisa undertook a property survey intended to produce an improved fiscal cadastre. Beginning with satellite images of the city, staff produced digitized maps showing all buildings, roads, rivers, airports, etc. Field teams then went throughout the city to collect and record property attributes. The amount of data collected was kept to a minimum:

- physical characteristics of the property (dimensions, use, building materials and access to infrastructure),
- occupier, and
- the number of residents living in the building.

The entire process took about eight months (July, 2004 to March, 2005) and cost about US\$48,500 or US\$0.82 per property (excluding equipment³⁸). The end result was that the fiscal cadastre increased from 15,850 properties to 59,000 properties.

Hargeisa also put in place a new classification and rate system. Previously all buildings were taxed at the same rate per square meter. Under the new rate structure, buildings were placed into five property classes based on roof materials, wall materials and road type. This was still an area based system, but now reflected more accurately property value differences. The new rate system went into effect in 2007 and by 2008 revenue collected had risen by 248 percent to US\$588,754. (UN-HABITAT, 2009b)

The Hargeisa case provides several important lessons. First, local governments are best placed to improve and manage the fiscal cadastre. Satellite imagery was used as a starting point by Hargeisa staff, but field inspections were necessary to obtain even the most basic information. Local staff will also be in the best position to monitor land use changes and update the cadastre.

Second, the effort to build a fiscal cadastre is substantial but not overwhelming, certainly not as daunting as a complete inventory of all legal interests. The fiscal cadastre does not have to resolve boundary or ownership disputes. With the appropriate legal framework, it need only identify property attributes and who the property beneficiary is. It is important to note that the Hargeisa effort included some 9,000 informal properties which were included on the fiscal cadastre but granted an exemption. The point is that even though city leaders eventually decided to exempt informal properties, the process used to develop the fiscal cadastre identified and collected relevant data on the informal neighborhoods as well.

³⁶ Source: Land Valuation Division, National Land Agency of Jamaica as of 1 June 2010.

³⁷ See for example, UN-HABITAT, 2009.

³⁸ Equipment costs include hand-held PDAs, office computers and software, all of which are being used in other cities. Project costs were funded by UNDP.

Third, incremental effort is almost certainly needed. Somaliland has about 3.5 million inhabitants with about half that number living in cities. As the capital, Hargeisa was the starting point, but similar methods to build local cadastres are being extended to other communities, with Hargeisa staff providing technical support to other localities. And the effort cannot stop even when the entire country has been mapped. With a growth rate of over 3 percent, land use patterns will continue to evolve. Local resources will need to be deployed to keep each cadastre up-to-date. Over time, it is likely that additional information will be added to the cadastre and more refinements made. Maintaining a fiscal cadastre takes consistent effort and attention from local officials.

Fourth, investing in the cadastre is worth the cost and effort. In the Hargeisa case, the number of potential taxpayers went from 15,850 to 59,000 as a result of the land survey, over a 370 percent increase. And Hargeisa is not unique in this regard. As of 2006, 85 percent of the privately held land in Egypt was not on the fiscal cadastre. As of the late 1990s, somewhere between 30 and 70 percent of land was not included in the fiscal cadastres of Kenya. (Kelly, 2000) In 1999, the tax roll in Guinea covered about one-third of taxable property. (Bird and Slack, 2004 pg 42) The problem of incomplete fiscal cadastres is quite pervasive. But what the Hargeisa case demonstrates quite clearly is that LPT revenue can be enhanced quite substantially without changing property tax law or tax rates if the quality and completeness of the fiscal cadastre is improved.

Further, improvements in the fiscal cadastre can lead to improvements in other cadastres as well. In Indonesia, the fiscal cadastre for the land and building tax (*Pajak Bumi dan Bangunan*, or PBB) is more extensive than the legal cadastre under the National Land Agency. One result is that property holders often rely on the fiscal cadastre and a property tax receipt as proof of “indicative ownership” (*Hak Girik*). (Kelly, 2004) A similar practice exists in Latvia, Africa and Latin America. (Youngman and Malme, 2004) Over time it seems likely that fiscal cadastre information will be reflected in legal registries.

Fifth, if the legal cadastre is seriously incomplete, as in the case of Hargeisa, making occupants of the property liable (or jointly liable) for the tax may make the most administrative sense. Occupants or possessors of land and buildings tend to be easier to locate. Placing the tax obligation on occupants also allows communities to apply the LPT to occupants of publically owned land and buildings such as public housing.

Sixth, computerization can help even very poor communities efficiently manage and update their cadastres and tax administration systems, but local staff will need to be trained and assigned to support the system. Donor support was essential to getting the Hargeisa effort underway, but if it is to be sustained, local officials will need to commit the resources and people to keep the system up-to-date. This investment in human capital can be leveraged as staff from the capital train fiscal cadastre managers in other cities, or perhaps contract with those cities for data processing services.

Seventh, the Hargeisa case points out there is more to the administration of a property tax system than improving the fiscal cadastre. The revenue under the updated cadastre and revised rates was forecasted to be over US\$1 million in 2008 while actual revenue was less than US\$589,000, a shortfall of over 40 percent. The other administrative factors in the revenue identity must also be strengthened if the full potential of the LPT is to be realized.

8.2.2 SELF-ASSESSMENT

Between 2000 and 2003, Bangalore, India doubled their property tax collections through administrative changes at the local level. In the late 1990s, property tax collections in Bangalore were low. Nearly half of all properties were not included on the fiscal cadastre, and only about half of the taxes levied were actually being collected. Assessments were made by local tax officials who visited each property on the fiscal cadastre and subjectively valued the property. It was considered impractical to attempt to change the tax rate or redefine the base. After consulting with international experts, the decision was made to implement a system of self-reporting

Discovering properties to be added to the fiscal cadastre

It is difficult to overstate the importance of local knowledge in the discovery process. People on the ground who know and understand the neighborhoods are vital in the detection of changing land use and new development. At the same time, new technologies can be used to good advantage by cadastre managers.

- Aerial photos and satellite images are especially useful in preparing initial land surveys and spot checking data records
- Geographic information systems (GIS) are very valuable as a database for tracking land and improvements and can be used in the valuation process as well. GIS systems may require cooperation with other government entities in order to share expense and expertise.
- Land surveys with physical inventories of land, land use and improvements are important but can be time consuming and expensive. One option is to partition the city into zones and work systematically through each zone over an extended period of time. Each property in the city should be visited at least every five to seven years.
- Self-declaration can be a valuable tool in many instances. To be effective, they require a simple process, well designed and easy to understand forms, multiple points of access for taxpayers to receive help in completing the forms, and sound audit procedures to assure compliance.
- Any list of properties, households or businesses can be used to augment information in the fiscal cadastre. Utility and business license records can be checked for customers that might not be on the cadastre.
- The impact of past policy decisions that exempted property should also be evaluated.

Discovering new properties and adding them to the cadastre is an ongoing task. Left neglected for any length of time and the fiscal cadastre can become seriously outdated. Egypt, for example, conducted an evaluation of their fiscal cadastre in 2005. At the time, a recent census indicated that there were just over 19 million property units in the country. A field survey was conducted in two areas that suggested the census number was about 10 percent too low, so the total property units was thought to be about 21 million. Of these, only 3.5 million were paying the annual property tax. Of the remainder, 6.5 million had been exempted by previous laws, 1.9 million had been missed and 9 million were outside the long established tax zones. Thus, 83 percent of the potential property units were not included in the fiscal cadastre.

of data. Land owners were asked to voluntarily report the location of their property, the type and area of the structure, how the property was used (residential or commercial), and estimated depreciation. Taxpayers were asked to calculate the rental value of their property from schedules provided by the city. These schedules were based on location (six zones within the city), usage (16 property classifications), type of construction (three bands of construction cost) and age of

the structure. Taxpayers then calculated the tax due and were asked to pay the tax at designated banks.

This self-assessed taxable value was then fixed for five years. The city did impose both minimum and maximum capitalization rates for arriving at rental values, and importantly, five percent of all self-declarations were audited for accuracy.

The city government made concerted efforts to educate the public on how the self-declaration should be done. They produced brochures, provided question and answer columns in newspapers, made public presentations, sponsored payment clinics and ran numerous advertisements. The entire system was made voluntary to avoid any potential legal challenge, and land owners who chose not to participate were told they would be treated as they had in the past.

The first year the system was put in place, revenue collection increased 33 percent. By the third year, collections had increased 65 percent. Remarkably, 90 percent of residential properties and 60 percent of commercial properties opted to participate in the program.

The remarkable success of the Bangalore self-assessment program can be attributed largely to two factors. First, the system was carefully designed and carefully implemented. Great pains were taken to educate taxpayers and provide necessary assistance in completing the required forms. Second, and certainly equally important, taxpayers saw the new self-assessment system as providing a level of certainty that did not exist previously. The prior system involved inconvenient assessment inspections by often corrupt local officials. The new system made the tax calculation more transparent and certain.

To be sure, the audits and data checks carried out by municipal officials were essential to maintain the integrity of the system. But the fact that the program received such strong public support indicates the importance of certainty and transparency to taxpayers. Self-assessment approaches have since been implemented in other major cities in India including Delhi, Hyderabad, Patna and Ahmedabad.

Self-assessment can also be employed to launch a campaign to expand and update a fiscal cadastre. Not all potential taxpayers will choose to voluntarily submit property data, and certainly the submitted information needs to be verified. But self-assessment should be a consideration in areas employing non-market approaches to value, especially if it is linked to a program designed to increase tenure security and regularize informal

settlements. In such cases, residents anxious to establish and document an ownership interest in occupied property are often willing to step forward and register their property interest.

Self-assessment systems have also been employed in other countries, with varying degrees of success. Hungary employs self-assessment, but lacks the personnel necessary to audit and follow up on non-filers. Self-assessment in Bogotá, Colombia has been much more successful. (Bird and Slack, 2004) Bogotá implemented self-assessment in 1993. Taxpayers were required to declare the capital market value of their property. After the first year of the program, the tax base doubled, the number of properties paying taxes doubled as well and collections more than doubled. (Piza, 2000)

Some countries have attempted a self-assessment system that stipulates that if the government thinks the self-assessed value is too low, the government itself reserves the right to purchase the property at the self-declared value. But such a system can only work if the government has the resources and the will to actually purchase properties. In practice this has rarely happened.

8.2.3 VALUATION

While the basis for establishing the taxable value of land and improvements is defined in the law establishing the LPT, it is generally considered best practice if the enabling legislation does not specify the techniques to be used in making the determination of final taxable value. Specific techniques may change and evolve as the level of technical expertise and the quality of available data improve over time. As a result, the exact procedures and responsibilities for valuation are often established by administrative rule.

One important valuation consideration is the placement of the valuation (also called assessment) function within the administrative machinery of government. As noted previously, the information necessary to make valuation decisions may be spread across a number of agencies and even levels of government, and it may be necessary to take into consideration the entrenched interests of those agencies.

The options that have been used by central and eastern European countries include placing the assessment function in the:

- Ministry of Finance
- Ministry of Local Government
- Ministry of Agriculture
- Ministry of the Environment

In addition, the assessment function can be found in specialized national land valuation agencies as in Latvia and Ukraine, and in local governments as in Hungary. Elsewhere in the world, a similar range of options have been employed. In India, for example, some states assign the task to local governments, while in others a state assessment authority is used. In Indonesia, a central tax department is responsible for valuations.

There is not as much confusion on this issue as may first appear. Taking into consideration local conditions, the guiding questions for a given country should be:

- Is the basis of value to be market value or a non-market approach? If capital market value or annual rental value is the basis for value, a more centralized authority may be more likely to have or be able to develop the necessary data and expertise to maintain values based on market value, using information provided by land holders and local governments. If a non-market approach to value is used, the local authority may be better able to collect and maintain physical property attributes.
- Is there already in existence an agency that has information that can serve as the basis for a fiscal cadastre? If so, the most cost-effective approach may be to build on the system already in place.

Acknowledging the importance of these questions, it is not impossible for local governments to effectively manage a valuation system based on market values. But it should be recognized that such a system requires more expertise, more information and is more expensive than other approaches to value. One option if local governments have the valuation assignment is to contract with private sector

entities or even with another local government for assessment services. Such an approach does not totally remove the need for local expertise since the local government is ultimately responsible for the quality of the assessment and must respond to inquiries and appeals from taxpayers. But contracting out with a private entity or with another local government can substantially reduce the need for dedicated local resources.

Whether done at the local or more centralized level, administering LPTs based on market value concepts requires access to specialized information and expertise. Such systems can only function well in areas with reasonably mature and efficient property markets. Valuation managers need access to information on real estate market transactions and changing market conditions if they are to do their jobs well. They also need training as professional valuers (known as appraisers in some countries). In many developing countries, there is a serious shortage of trained valuers even in the private sector which makes the challenge of attracting and retaining qualified staff especially difficult.

The administration of the valuation system is daunting but not as overwhelming as it might seem. Unlike private sector valuers conducting appraisals of single properties, the challenge of valuation for LPT purposes is to fairly assign a tax obligation. Thus, the major challenges for administering the LPT valuation system are to acquire accurate current information on each property and to use a consistent and fair system for assigning taxable value based on that information. "Mass appraisal" techniques become essential tools for efficiently carrying out the valuation task. While it is true that valuation lists of high quality have been compiled for literally thousands of years without the assistance of computers, information technology today can make the task much more efficient and timely. Mass appraisal involves computerizing relevant property (and taxpayer) information and then using that information to develop and apply rules for determining the taxable value of each property. The rules applied may be simply multiplying land or building area by a fixed tax rate for each land use classification, or they may

be the result of more sophisticated statistical analysis that incorporates market trends and detailed location information (if the data support such analysis). The key concept is to automate the rules to assure they are uniformly and consistently applied in generating what will likely be thousands of taxable values with limited human resources.

It should be stressed that information technology (IT) will not solve all valuation problems. IT will not improve the quality of the final product, though it can reduce clerical errors. More or better IT is not a substitute for valuation or organizational skills, and will not necessarily yield better valuation results. (Keith, 2002) However, well-planned use of IT is likely to reduce overall costs, increase accuracy and consistency of the data used, and will certainly save time, especially when it becomes necessary to update values.

Revaluation or the updating of property valuations is an essential part of valuation administration. The law establishing the annual LPT should specify how frequently such revaluations should occur. The international consensus is that such updates should occur at least every five years, but more frequently in dynamic urban areas with rapidly changing market conditions. The rationale for such revaluations is clear. Urban conditions change frequently and sometimes quite rapidly. Cities grow in population and land use patterns change with the result that the demand for land changes. The LPT system needs to reflect these changes in a timely manner to the extent possible. Failure to keep values up-to-date often results in two failures of the overall LPT system. First, revenue buoyancy is lost. It is generally considered desirable by public finance experts to have a tax system which yields revenue increases that keep pace with growth in the community. Dated property values make it practically much more difficult to increase LPT revenues fairly as any increase in tax rates will not reflect the changing property dynamics within the community as some areas appreciate in value more rapidly than others.

Second, when property is eventually revalued, the result is often a major shift in taxable value

which leads to taxpayer shock and anger. For example, a recent review of land values in Jamaica carried out by the Land Valuation Division of the National Land Agency indicated that between 2002 and 2010, residential land values had increased by between 100 and 300 percent depending on the parish, while commercial land values had increased by as much as 1,500 percent in some areas. Such increases put community leaders in a very difficult position. Either they must reduce the overall effectiveness of the LPT by substantially reducing tax rates, or they will likely incur the wrath of stunned taxpayers who face a doubling or tripling of their tax bill in a single year. By far the better strategy is to revalue property regularly and thus incorporate changing values into the LPT system on a more incremental basis.

There is no question, however, that revaluations take resources. One of the reasons many countries fail to follow their legal requirements for periodic revaluations is that they are expensive. The other reason of course is that any increase in value can be difficult for political leaders. One response that has been employed in a number of countries is to adjust taxable values between formal revaluations using an index. Colombia and Mexico, for example, annually adjust taxable values using an index tied to the consumer price index in those countries. Indexing values is a reasonable and effective strategy but it cannot substitute for periodic formal revaluations. Adjusting all property values by the same index fails to capture changing relative values within a community as land prices in some areas rise more rapidly than in others. Thus the strongest strategy is clearly to revalue property on an annual basis as is done in some advanced economies though not many. Short of annual revaluations, formal revaluations should be undertaken about every five years or less, and values should be indexed each year in between revaluations. Ideally, the adjustment index used should be based on changing real estate values rather than a broader index such as the consumer price index.

Of course, revaluation is not as critical with non-market approaches to value. Even in such cases periodic land surveys should be undertaken to assure that accurate and up-to-date property

Valuation Example: Capital Market Value based on mass appraisal

Taxable value is determined by the capital market value of the property. In this example, capital market value is estimated using computer assisted mass appraisal techniques. Such techniques assume that average or typical pricing patterns and relationships can be estimated using samples of recently sold properties. These patterns and relationships can then be used to estimate the market value of all other properties in the same property class.

Step 1: Gather market sales data for properties that have recently sold. Include sales price and property attributes. Verify that sales data is for “arm’s length” transactions and that no special conditions applied.

Step 2: Using the sample of recently sold properties, estimate the relationship between property attributes and sales price using standard statistical methods (some form of regression analysis).

Step 3: Collect land area, building area and building attribute data for each land parcel.

Step 4: Using the estimated relationships from Step 2, calculate the estimated sales price of all properties.

Step 5: Calculate the taxable value from the estimated market value, if the two differ by policy.

Step 6: Apply the approved tax rate to the taxable value to obtain the tax due.

Example: Fairhaven City has 100,000 homes. In the last two years, 2,000 homes have sold in arm’s length sales. Using data for these 2,000 homes and regression analysis, the valuation staff estimate that the market value of each of the 100,000 homes can be estimated to be:

Market value = $18,670 + 10.6(\text{lot size}) + 554.4(\text{building area}) + 5,033(\text{if garage}) - 747(\text{age in years})$.

Thus the estimated market value of a property that is 40 years old with lot size 750 m², building area of 110 m², and a parking garage is given by:

$18,670 + 10.6(750) + 554.4(110) + 5,033 - 747(40)$, Or 62,757

If the tax rate is 1 percent, the tax is 628.

information is maintained. Such surveys need not include an entire city in a given budget cycle. The cost of the survey can be spread across several years by dividing the city into districts and surveying a limited number of districts each year. Satellite imagery can be used effectively to facilitate such surveys as well. How frequently each parcel is reviewed will depend on how dynamic the conditions are in a city. In areas with more rapid growth and development, the frequency of parcel review should be increased. With each survey, past data collected should be verified and careful consideration should be given to the value added by collecting new data.

Whether the LPT is based on property characteristics or some concept of market value, it is important to consider the data requirements necessary to maintain and improve the system. In this regard, perhaps the most important question to ask is, what determines the attractiveness and value of real property in a given area? As described previously in the case of the Municipality of Hargeisa, the value classification was ultimately determined by roofing materials, wall materials and road type, and the final taxable value within a class was determined by building area. In other instances, value is influenced by location. Agricultural land is frequently valued based

on soil fertility and most common agricultural practices in an area. Other factors that may be considered include building materials, current land use, potential land use, proximity to infrastructure, proximity to undesirable activities or influences in the community, and the area of both land and buildings. The fiscal cadastre should include at least the minimal set of factors that are considered important indicators of relative value. This minimal set can be augmented in future land surveys as resources permit and changes in the community warrant. Mass appraisal techniques can then be used to generate the tax due from each taxpayer.

8.2.4 BILLING

In most countries that employ LPTs, the billing and collection functions take place at the local level.³⁹ Even in cases where the tax is a national rather than a local tax, billing and collection are generally through local offices. While the costs to administer an annual LPT are fairly high, compliance costs are quite low if local governments make it easy for taxpayers to pay their bill. Appropriate collection procedures are an important component in keeping compliance costs low, which in turn encourages compliance. In countries or regions where mobile phone penetration is fairly high, billing can be done using such enabling technology as is done in Kenya.

Procedures for preparing and delivering tax bills will depend on local conditions. Local mail systems can be used to deliver tax bills if reliable. If not, local utilities are generally able to deliver bills and can be contracted to deliver tax bills as well. It may even be possible to contract with the utility operation for both billing and collection, in which case the tax obligation can simply appear as a separate item on the utility bill. In some cases communities deliver the tax bill by hand, going door to door.

A key question from both a legal and administrative standpoint is the notification standard employed: When have tax administrators satisfied requirements that the taxpayer be notified of the tax obligation? In nearly all cases there is no requirement that the taxpayer acknowledges receipt of the tax notice, but in some instances taxpayer appeals of subsequent legal action have been based on the argument that the tax notice was never received. The general pattern has been to deliver the original tax notice through some reasonably certain method such as the mails or by hand, and then if payment is not made within a specified time period, to deliver follow-up notices by a method that requires taxpayers to acknowledge receipt of the notice.

Whether the tax obligations of all taxpayers are made public can be an issue of some controversy. On the one hand, advocates argue that the only way to assure fairness in the assessment of LPTs is to make all assessments public so that any given taxpayer can compare their obligation with that of their neighbors. The concept of horizontal equity explained earlier requires that similar properties bear a similar tax burden, and taxpayers require sufficient transparency in the system to assure that they are being treated the same as others who possess similar properties. Thus, in some countries, both the valuation assessment and the calculated tax obligation of all properties are a matter of public record. The public has the right to examine these records, and several jurisdictions have gone so far as to make this information available on the internet. In areas with less automated systems, it is common practice to publish the list of tax bills.

The opposing argument is that taxpayers have a right to privacy, and the government has a responsibility to protect that right to the extent possible. Property holders should not have their personal affairs made public simply because they possess property. Making property information, including taxable values and the final tax bill, public infringes on personal privacy and potentially personal safety.

³⁹ Ukraine, Chile, Guinea and Tunisia are examples of exceptions to the general pattern.

Balancing the right to privacy and the public's right to a transparent tax system is a sensitive issue. In most cases it is resolved by reference to the social norms in a community. However, neither argument should be dismissed lightly. People do have a right to some degree of privacy in their personal affairs. And a taxpayer does need to have enough information about the tax obligation of other property to be able to evaluate whether or not her own property is being fairly taxed.

In order for any tax to be acceptable to the public it must be perceived as fair, and meeting technical standards of fairness is not sufficient. The public must feel that the tax is fair. And a tax that fails to meet technical standards of fairness will be publicly acceptable if it is perceived by the public to be fair. It has been noted, for example, that the council tax in the United Kingdom falls into this category of a tax on property that fails to satisfy several important technical equity standards, but is perceived to be fair by the public and is therefore accepted by the public. (Doherty, 1999; see also Youngman and Malme, 2004)

8.2.5 APPEALS

An essential element in public acceptance of LPT fairness is the appeals process. Every tax system at any level of government can make mistakes. Information is entered into a computer incorrectly or it becomes outdated. Tax administrators make incorrect assumptions or judgments. Taxpayers themselves may make errors in reporting information. Whatever the source, errors can and will creep into the tax system. Given the volume of information and the number of land parcels in any community, the only practical way to correct errors in the LPT system is for taxpayers to bring such errors to the attention of tax administrators. And in many instances, there is no error in the record, but the taxpayer feels that they have been treated unfairly in some way and seeks redress. Whether it is to correct errors or respond to perceived unfairness, there must be a process available to taxpayers to appeal their treatment by the tax system.



Mix of high-rise commercial property and low-rise residential housing in Singapore.
 Photo © UN-HABITAT/Madanmohan Rao

The best appeals process should meet several important criteria.

- The process should be seen as objective by taxpayers. Taxpayers need to feel that their concerns will be heard by competent hearing officers who do not have a vested interest in defending prior decisions and actions by tax administrators.
- The process should be accessible to taxpayers. Taxpayers should not have to travel long distances or incur substantial expense to file an initial appeal.
- The process should be timely. Most taxpayer concerns can be resolved fairly quickly once heard and the initial appeal process should therefore convene soon after an appeal is filed. Taxpayers should have sufficient but not unlimited time in which to file an appeal.
- The burden of proof should fall on the taxpayer. The appeals process should presume initially that the tax system is correct, unless the taxpayer can produce solid evidence to the contrary.
- Decisions of the appeals process should be appealable. Taxpayers who do not feel that the initial hearing adequately resolved their concerns should be able to appeal the decision to a higher body, and ultimately to the court system.

In combination these criteria are best satisfied by an administrative process that begins at the level responsible for determining taxable value and can on further appeal move into the court system. Taxpayers should be granted a specific period of time following notification of the tax bill in which to file an appeal. Generally, the time period varies from two to six months. The best approach for hearing the appeal is to convene a local appeals board consisting of three to five land holders (and therefore taxpayers) who are not employees of the tax authority or the local government. To the extent possible, these individuals should have or receive training in the methods used by the tax authority to arrive at taxable values. In countries where the LPT is not administered at the local level, it is still effective to have an appeals board that includes members

of the local community who are more familiar with conditions in the area.

It is common for the tax authority to manage the appeals process even though the appeals board determines the outcome of the appeal. Thus, taxpayers file their notice of appeal with the government office that is responsible for valuation, which then passes the necessary information to the appeals board. This board should plan on convening shortly after tax notices are sent out, and generally is required to respond to an appeal within a fixed time period. The board should have the authority to adjust the taxable values determined by tax administrators. The board should also have well defined procedures for taking testimony from taxpayers and tax administrators and for keeping records of and reporting their actions.

In most cases, the tax obligation itself is not appealable but the data used and the taxable value of the real property are. Since the tax due is the result of applying a predetermined rate to the taxable value of a particular property, and the rate is set by policy, only errors in fact or judgment about the property in question are subject to appeal. Thus, taxpayers who feel that their taxes are too high must argue that there is some error in how the property is described on the fiscal cadastre or that there is some error in judgment on the part of tax officials, and evidence must be presented to support their claim. The appeals board then can reach a conclusion based on the evidence and arguments presented. Their conclusion could be that there is not sufficient evidence to justify changing the taxable value, or that the taxpayer is correct and the taxable value should be adjusted. In some cases, the board may also conclude that the taxpayer is correct but that the adjustment requested is excessive, and they may make a smaller adjustment.

The appeals process should also include a clear path for further appeals. If the taxpayer is not satisfied with the ruling by the local appeals board, there should be a well-defined “next step” in the appeals process. Given that in many countries the judiciary is heavily burdened and delays in resolving land cases can be quite substantial, many countries have a second or

third level of administrative appeal before the appeal enters the court system. Thus, an appeal heard by a local appeals board may move next to a regional or provincial administrative board. If still not resolved, the case can be filed in the court system, though it is common in such cases to require the taxpayer to pay any tax due before filing with the courts. Should the courts rule in favor of the taxpayer, any taxes paid are refunded to the taxpayer.

8.2.6 COLLECTIONS

The single most important factor in actually collecting the LPT is political will. Much can be done to make the payment process easier for taxpayers, and to make nonpayment more painful. But unless the political leadership is strongly supportive of making the LPT effective, the evidence is that collections will be an ongoing problem.

Countries have been successful at improving compliance with the annual LPT by providing more methods for making tax payments. In many instances, payments can be mailed to the tax office. When Bangalore, India implemented their self-assessment system, they also expanded the number of locations by allowing taxpayers to pay the tax at designated banks. Other countries have successfully employed utility company offices as collection points as well, and more recently some countries are allowing tax payments to be made over the internet. Greater convenience for taxpayers very often translates into higher levels of compliance.

Many countries also allow taxpayers to pay their tax obligation over the course of the year rather than in a single annual payment. Care must be taken with this option not to unduly increase the administrative burden for tax administrators with an expectation of additional billings throughout the year, but it is possible to have effective systems that allow taxpayers to pay their tax in quarterly or monthly installments. Again, convenience is strongly related to compliance.

At the same time, there will be individuals and businesses that do not pay their taxes in a timely manner. Most systems establish a deadline

for payment of the tax in full or for finalizing agreements for periodic payments. Once the deadline passes, a fixed penalty is normally charged, generally a percentage of the taxes due. In addition, interest is charged and begins to accrue. Interest rates vary, but should be higher than what banks and other lenders charge otherwise nonpayment of taxes becomes a relatively inexpensive loan from the government.

It is also common practice to begin to publicize individuals and organizations that have failed to pay their taxes or make arrangements for payment by the deadline. Some jurisdictions publish a list of taxpayers and amounts owed in local newspapers or post the list in conspicuous public places, though again this can raise concerns among privacy advocates.

One effective strategy to enhance compliance is to restrict the taxpayer's ability to obtain government authorization to sell or further improve the property until proof of tax payment is provided. Thus, property transfers may require proof that LPT charges are current before processing the transfer. Building permits and changes in land use may not be authorized without proof of payment. South Africa has even linked continued electric service to full payment of the LPT which can be done in communities where electric service is provided through a public agency or where the tax authority has contracted with the electric utility to collect the tax.

And it is possible to contract with local private sector organizations for the collection of the LPT as well. In several Pakistani towns (*tehsils*), local governments specify the taxes and fees to be collected and request proposals from the private sector for collection. The winning bidder is contracted to collect the taxes according to the legal requirements, and is allowed to keep as the collection agent's fee collections that exceed the amount guaranteed in the contract. New requests for proposals are reissued every three years. Even if the initial tax payments are mostly collected by the tax authority directly, some jurisdictions have successfully employed private sector collection agents to collect late payments.

If the country has a national taxpayer identification system such as the Tax File Number in Australia or the *Cadastro de Pessoas Fisicas* in Brazil, the LPT can be linked to that system and it may be possible to pursue other taxpayer assets in response to nonpayment of property related taxes. Of course that assumes both the legal and administrative mechanisms are in place to fairly and responsibly implement this approach.

Ultimately, the final remedy available to governments for non-payment of the LPT is the seizure and sale of the property, if culturally appropriate. While this option is frequently written into enabling legislation, in practice it rarely happens. Even in countries that routinely exercise this option such as the United States and Canada, the process takes three to five years and there are multiple opportunities for the taxpayer to redeem the property by paying the tax. In many other countries, the option exists in principle but is never exercised. And the reasons

are clear. It is politically very difficult to seize a family home, business or farm. Further, such action generally requires approval by a court, and courts are often reticent to approve such action even if the law is clear if the political support for the LPT from the leadership of the country and community is uncertain.

Thus, the reality of LPT collections in many developing countries is that the tax is assessed but not paid, penalties and interest are charged but not collected, and the total amount owed in back taxes continues to accumulate. In the final analysis, the only way to break this cycle is for the senior leadership in the community to get behind the LPT, put in place the appropriate sanctions for nonpayment and insist that the tax be collected. This has proven difficult both because of the political pressure from those who would rather not pay the tax, and because the senior leaders themselves may find their own tax obligation significantly increased.



Residential houses in Cairo, Egypt. Photo © UN-HABITAT

8.3 SUMMARY

In summary, the administrative tasks that must be carried out to effectively manage the LPT system are tied to the revenue identity, and those tasks generate a set of key administrative questions. The following table summarizes both the tasks and the key questions.

The way forward regarding administration is based on current attitudes and values regarding property rights, the nature and quality of the property registration systems, the maturity of property markets and the administrative capacities of the various government agencies involved. The potential for leveraging resources through cooperation and shared responsibilities between agencies and levels of government should be carefully explored. The most effective LPT systems nearly always involve entities other than just the local tax authority. Centralized oversight and support can be very effective at improving overall quality and cooperative agreements can enhance efficiency and effectiveness.

As noted previously, tax administration is tax policy. But it might also be said that political will is the basis for both policy and administration, and this is particularly true with regard to the LPT. LPTs can be both fair and effective in generating the revenue necessary to fund key local services. As will be shown in the next section, LPTs will not generate all the resources that are needed to fund desired public services, but they will provide a stable and reliable foundation for a responsive government. LPTs will only provide this foundation in any meaningful way if they have the full support of the community. This means the system must be perceived as fair by taxpayers, taxpayers must see the connection between the taxes paid and the services received, and political leaders must be willing to support both the tax and those tax administrators charged with implementing and collecting the tax. Without perceived fairness and political support, design means little and implementation will be ineffectual.

TABLE 8.1 ADMINISTRATIVE TASKS AND GUIDING QUESTIONS

Governments must	Key Administrative Questions
Develop and maintain a list of taxable land and properties	Is the base adequately and appropriately defined?
Identify and register the relevant taxpayers	Are all properties included in the fiscal cadastre?
Determine the taxable value of all land and properties	Are all properties valued appropriately?
Determine the tax rate that applies to each property and calculate the tax due	Is valuation information linked appropriately to tax rate(s) and are the tax bills clear and accurate?
Prepare and deliver the tax bill Collect the revenue due	Are billing and collection functioning adequately?
Appropriately respond to inquiries, concerns and appeals from taxpayers	Do taxpayers feel that the system is fair?
Appropriately follow through and resolve tax payment delinquencies	Are the administrative mechanisms for dealing with delinquencies being used effectively, fairly and humanely?



A housing project at Xafuun Settlement in Somalia. Photo © UN-HABITAT

9. ESTIMATING REVENUE POTENTIAL

Changes in tax policy inevitably raise questions of fiscal impact. Whether the issue is creating a new tax on land and constructed improvements, reforming the current property tax system or merely fine tuning existing real estate tax practices, sooner or later the question of net revenue effect must be confronted. This is especially the case if there is no viable property tax in place. Decision makers must weigh the political costs of implementing a new tax, and generally will insist on some estimate of expected revenues and often the expected incidence of the proposed tax before making a final decision. Revenue potential is also very useful in assessing the effectiveness of property tax administration as actual revenue is compared to estimates of potential. This chapter addresses the question of assessing the revenue potential from the property tax.

9.1 ESTIMATING NATIONAL FISCAL POTENTIAL

It is important to recognize at the outset that the question of revenue potential is really a question of income and political will. To take only a minor liberty with a well-worn concept in public finance, land, and buildings do not pay taxes. Only people pay taxes. Thus, the revenue potential from the property tax is a function of aggregate income, the share of that income going to other taxes and the willingness of government decision makers to employ the ownership or use of property as a mechanism for allocating part of the overall tax burden.

From this perspective, it is helpful to understand how much of national income is collected through property taxes around the world. Table 9.1 reports property tax collections for selected countries. In advanced economies, LPT revenue (including all forms of property related taxes)

varied in the most recently available data from about 0.30 percent of GDP in Japan to 4.55 percent of GDP in France, with an average rate for the listed countries of just under 2 percent of GDP. Given that total collections for all types of taxes in these countries average over 28 percent of GDP, it can be seen that the property tax is typically a relatively small tax, averaging just 7.29 percent of total tax revenue. However, it should also be noted that in several countries, LPTs exceed 15 percent of total taxes, and they are an even more significant revenue source for local governments. In the United States, for example, the property tax represents over 27 percent of local government general revenues and nearly 73 percent of local government taxes.

In emerging and developing economies, tax rates in general tend to be lower than in advanced economies, and the property tax is no exception. The average property tax collection rate among the developing and emerging economies listed in Table 9.1 is about 0.78 percent of GDP, or about 40 percent of the rate in advanced economies, and rates below 0.5 percent of GDP are found in half the countries listed. Within this set of countries, the property tax represents about 4.5 percent of total taxes.

Thus, it would appear that a reasonable target range for LPTs in a national economy is between 1 and 2 percent of GDP. Higher rates are feasible, but they will in all likelihood require somewhat lower rates for other taxes. Collection rates well below 1 percent of GDP suggest that there is an opportunity to enhance revenues through a strengthening of LPTs. Rates in excess of 2 percent of GDP are found in some countries, but such rates will require some combination of a very broad base (such as extending the VAT tax to real property sales and rental income), comparatively high tax rates, and aggressive local tax administration.

TABLE 9.1: LPT REVENUE IN RELATION TO GDP AND OTHER TAX REVENUE BY COUNTRY

Country	Year	Taxes on Property (Percent of GDP)	Total Taxes (Percent of GDP)	Taxes on Property as Percent of Total Taxes
Advanced Economies				
Australia	2007	2.69	29.48	9.12
Austria	2007	0.58	27.63	2.10
Belgium	2006	3.17	30.24	10.48
Canada	2007	3.38	29.58	11.43
China, PR: Hong Kong	2006	2.80	12.72	22.01
Cyprus	2007	2.64	57.63	4.58
Denmark	2007	1.87	48.02	3.89
Finland	2007	1.12	30.81	3.64
France	2007	4.55	26.76	17.00
Germany	2007	0.85	23.96	3.55
Greece	2007	0.98	20.15	4.86
Iceland	2007	2.41	38.25	6.30
Ireland	2007	0.83	26.00	3.19
Israel	2007	2.89	30.72	9.41
Italy	2007	0.81	29.95	2.70
Japan	2006	0.30	18.16	1.65
Luxembourg	2007	1.60	26.20	6.11
Malta	2007	1.66	28.47	5.83
Netherlands	2007	1.71	24.88	6.87
New Zealand	2007	1.67	33.44	4.99
Norway	2007	1.19	34.33	3.47
Portugal	2007	1.21	24.85	4.87
San Marino	2002	1.18	23.52	5.02
Singapore	2007	1.06	14.38	7.37
Slovenia	2006	0.61	23.76	2.57
Spain	2007	3.01	25.07	12.01
Sweden	2007	1.16	35.88	3.23
Switzerland	2006	2.37	22.68	10.45
United Kingdom	2007	4.53	29.35	15.43
United States	2007	3.11	21.58	14.41
Group Average		1.93	28.28	7.29
Emerging and Developing Economies				
Africa				
Congo, Rep. of	2005	0.30	6.74	4.45
Lesotho	2006	0.66	58.34	1.13
Mauritius	2007	1.31	16.63	7.88
Morocco	2007	1.61	26.16	6.15
South Africa	2006	1.70	30.36	5.60
Swaziland	2003	0.54	27.72	1.95
Group Average		1.02	27.66	4.53
Developing Asia				
Bhutan	2000	0.04	10.73	0.37
China, P.R.: Macao	2007	0.82	24.82	3.30

TABLE 9.1: LPT REVENUE IN RELATION TO GDP AND OTHER TAX REVENUE BY COUNTRY(continued)

Maldives	2007	0.14	21.17	0.66
Thailand	2007	0.22	17.40	1.26
Vietnam	2003	0.42	20.72	2.03
Group Average		0.33	18.97	1.53
Central and Eastern Europe				
Bosnia and Herzegovina	2007	0.51	26.43	1.93
Bulgaria	2007	1.50	26.14	5.74
Croatia	2007	0.42	26.68	1.57
Czech Republic	2007	0.44	20.29	2.17
Estonia	2007	0.23	21.66	1.06
Hungary	2007	0.81	25.89	3.13
Latvia	2007	0.53	22.20	2.39
Lithuania	2007	0.29	20.91	1.39
Poland	2007	1.11	23.08	4.81
Romania	2006	0.74	18.93	3.91
Slovak Republic	2007	0.37	17.26	2.14
Group Average		0.63	22.68	2.75
CIS and Mongolia				
Armenia	2007	0.24	16.37	1.47
Belarus	2007	1.58	35.63	4.43
Georgia	2007	0.63	21.58	2.92
Kazakhstan	2007	0.65	18.13	3.59
Moldova	2007	0.43	25.66	1.68
Ukraine	2007	0.24	22.67	1.06
Group Average		0.63	23.34	2.52
Middle East				
Egypt	2007	0.24	15.64	1.53
Iran, I.R. of	2004	0.30	7.53	3.98
Kuwait	2007	0.04	0.09	44.44
Group Average		0.19	7.75	16.65
Western Hemisphere				
St. Kitts and Nevis	2006	3.00	22.22	13.50
St. Vincent and the Grenadines	2004	0.21	23.82	0.88
Argentina	2004	2.64	22.90	11.53
Barbados	2004	2.37	31.57	7.51
Bolivia	2007	2.89	24.52	11.79
Chile	2007	0.57	22.71	2.51
Costa Rica	2007	0.79	15.76	5.01
Honduras	2007	0.46	16.69	2.76
Jamaica	2005	0.20	24.19	0.83
Paraguay	2007	0.37	12.27	3.02
Peru	2007	0.20	15.89	1.26
Group Average		1.25	21.14	5.51
Average for emerging and developing economies		0.78	21.57	4.54
Overall average		1.26	24.37	5.68

Source: IMF Government Finance Yearbook, 2008, Table W4

9.2 ESTIMATING LOCAL REVENUE POTENTIAL

Equally important is the estimation of revenue potential for a given community. Three fairly straightforward methods can be employed to make rough estimates of potential revenue. The first method is based on the strong correlation between population and property values. If the national GDP per capita is known, and a reasonable estimate of the local population is available, an estimate of revenue potential can be obtained by multiplying GDP per capita by the population and taking one percent of the result. For example, in the Hargeisa case, national GDP per capita was known to be US\$200. As a by-product of the land survey, city population was determined to be 396,000. Multiplying these two figures and taking one percent of the result yields an estimated revenue potential of US\$792,000 per year.

A second approach is to divide the city population by the average number of people living in a household to obtain an estimate of the number of households in a city. Suppose, to continue the example from Hargeisa, that the average household size is estimated to be seven persons. Then the estimated number of dwellings in the city would be the city population divided by seven or $396,000 / 7 = 56,571$ dwellings. If the expected average tax per household is US\$15, then the revenue potential would be 56,571 multiplied by US\$15, or US\$849,000.

An estimate of the number of structures can also be obtained either from reasonably current satellite images or from a physical survey of a sample of properties. The survey approach would work by dividing the city into districts of approximately equal land area. The survey team would then randomly select some proportion of the districts. Each district selected would then be visited and a count of structures completed. The assumption is that the randomly selected districts are representative of the larger city, and that the counts found in the sample could be applied to other districts. Thus, if surveying a random sample of ten percent of the districts

yields a count of 5,000 structures, then the number of structures in the entire city would be estimated at 5,000 divided by 10 percent, or 50,000 structures. Again, if the estimated tax per structure is US\$15, then the estimated revenue potential would be US\$750,000.

Another approach to obtaining an estimate of the number of structures in a city is to request from local utility companies a count of the number of customers or meters they have on their records. This count of customers or meters can then be multiplied by the expected average tax bill per parcel as above to obtain an estimate of revenue potential. The best approach would apply several of these methods and compare the results. In the example used here, three estimates were generated:

- US\$792,000, based on GDP per capita and estimated population
- US\$849,000, based on estimated population and the number of persons per household
- US\$750,000, based on a survey of sample areas within the city

These values could be averaged to obtain an estimate of US\$797,000, or a more conservative approach could be taken that takes the lowest reasonable estimate. The final estimate will depend heavily on the amount of confidence placed in the underlying data. What is important to look for is reasonable consistency in the estimates. Any one value that is extremely different from the others should probably be discarded. In this instance, all values are between US\$750,000 and US\$850,000, so the final estimate would also fall within that range.

It should be remembered however that these are crude estimates, intended only to give decision makers a rough estimate of the revenue potential from an LPT during initial discussions of strategies, alternatives and potential. More refined estimates can be generated as the system design emerges. And actual revenues will depend on how well implemented and managed the LPT system is.

10. LPT AS A TOOL FOR ECONOMIC DEVELOPMENT AND SOCIAL POLICY OBJECTIVES

There are numerous examples of both national and local attempts to use the tax system to pursue other social and economic policy goals, and LPTs are no exception to this pattern. This section describes some of the most common strategies for using LPTs to address fundamental social or economic policy concerns such as the redistribution of income, land redistribution or controlling speculation. At the same time, LPTs have both administrative and practical limitations that should be carefully considered in all such attempts to use LPTs for purposes beyond simply raising revenue.

The discussion is divided into a consideration of economic development policy goals and social objectives. Economic development goals include attempts to raise additional income for specific purposes, or to change development incentives, subsidize particular businesses directly or use the tax system to facilitate long-term financing of projects. Common social objectives include attempts to make the LPT system more progressive with the intent to redistribute wealth, and attempts to shield identifiable protected classes from the tax. The basic argument made here is that LPTs are generally more effective in economic development efforts than in attempts to promote social policy goals.

10.1 ECONOMIC DEVELOPMENT

As used here, the term economic development includes both attempts by local governments to generate additional revenue for specific projects or services, and attempts to influence either the direction or pace of economic trends in the community. LPTs have been used successfully for both and can be an effective tool for economic development if appropriately designed and implemented.

10.1.1 GENERATING EXTRA REVENUE THROUGH THE SPECIAL DISTRICT

LPTs are often used to generate additional revenue for projects or services in a specific area. The most common approach is for the local government to create a special improvement district, sometimes called a business or community improvement district. The essential concept is that with the support and cooperation of land holders in a given area, the local government designates that area as a special district and applies a supplemental LPT to all land and property within the district. The additional revenues raised are then used to fund the desired project or service.

Since the creation of these special districts may include taxing the LPT base in the district more heavily than it is taxed outside the district, the power to create special districts may require that special legal authorization be granted to the local government. Generally this involves passage of a law that specifies the legal framework and process that local governments must follow in creating special districts. Special districts thus created become quasi-governmental entities and their governance structure needs to be specified. Commonly, the governing body of the city in which the special district is created is also designated as the governing body of the special district.

With appropriate authorization in place, the process of establishing a special district generally begins with the businesses or land holders in a particular area petitioning the local government to create a designated district. Local officials may approach businesses or residents in a given area and propose that a district be created with specific improvements in mind, but a key aspect of the special district concept is that the land holders themselves, whether businesses or households, agree in advance to the creation of the district with the clear recognition that their taxes will be increased. Thus, once the proposal

to create a special district is received by the local government, the government has a responsibility to assure that the majority of those who will be taxed support the proposal. This verification can be done either through an election process or by signed petition, but in either case those supporting the concept should include a majority of the LPT taxpayers that will be included in the district. In the United Kingdom, the petition or ballot must be approved by both a majority of taxpayers and by a majority of the taxable value within the designated area. The intent is to protect both large and small taxpayers.

Part of the process of creating a special district should include specifying precisely what improvement projects or service enhancements will be undertaken and what the likely cost will be. Frequently the land holders filing the request will specify the improvements they seek, but both the benefits to all land holders as well as the costs should be detailed as part of the formal process of soliciting the opinions of those that will be included in the district.

Once the support of a majority of taxpayers has been obtained, the local government creates the special district, increases the LPT rate within the district and uses the additional revenue to fund the specified improvements. Since support for the special district was obtained on the premise that specific projects or service enhancements would be provided, it is critical that the local government not divert the revenue increases to other purposes. The increased LPT rate can be either temporary or permanent, depending on the nature of the improvements sought by the land holders. If the desired improvement is a specific infrastructure investment such as improvements to a roadway or road intersection that facilitates business access, the LPT rate increase may continue only until the improvement is fully paid for. If on the other hand, the funds are used to enhance ongoing services such as street lighting or better security, the rate increase may be permanent.

One of the issues that could be considered in creating special districts is whether the LPT rate

increase will apply to all taxpayers within the district or only those who have agreed to the district's creation. It is quite possible that if those who do not support the tax increase are allowed to avoid it, then some who benefit from the improvements that result from the district will avoid paying their fair share of the costs. On the other hand, imposing additional taxes on those who do not support the concept of a special district can be politically unpopular. The best strategy for resolving this question is to consider the nature of the improvements made possible by the special district. If the improvements can be focused on those who pay the increased fees or taxes, then it may be reasonable to allow non-supporters to avoid the tax. But if the benefits from the improvements are available to all land holders equally and thus once created, all property in the district benefits about the same, then there is a strong argument that all taxpayers should see the same rate increase.

There is no minimum or maximum size for special districts. They can be quite small and focused, such as a few blocks on a single street where the residents want road or drainage improvements. Or, the district can be quite large, such as a central business district that seeks a range of improvements including better roads, additional street lighting, beautification projects and periodic street cleaning. There are also few limits on the range of improvements and services that a special district can provide. If the city could legally undertake the activity, then certainly a special district could be used to fund that activity.

Special districts of the sort described here are proliferating around the world. The first districts were created in Canada, but soon spread to the United States and are now found in the United Kingdom, Australia, New Zealand, Germany and South Africa. They are also being considered in Brazil, Japan and other countries. While care must be taken to assure that any special districts created are consistent with broader community goals and governance, they represent an important option for local governments (Morcol, 2008).

10.1.2 CHANGING ECONOMIC INCENTIVES FOR INVESTMENT

One objective commonly pursued by local governments is to change the incentives that private investors have regarding the development of vacant land within the community. Whether land is held in anticipation that land values will increase and greater gains can be realized in the future or because of a perceived unfavorable investment climate, land holders may delay the development of land that community leaders would like to see developed. In Taiwan, for example, land values have increased rapidly in recent years. Community leaders argued that part of the reason for the speed and magnitude of the increases was that some owners of vacant or underutilized land were keeping their land off the market, thereby reducing the supply of land and driving prices higher. As in many countries, Taiwan's policy response in early 2011 was to increase the cost of holding vacant land by allowing local governments to increase the LPT rate. The vacant land tax will be two to five times higher than the standard LPT rate. Latvia and Chile present just two examples of similar policies intended to address similar concerns. In Latvia the tax rate on developed land is 1.5 percent of cadastral value, while vacant land is taxed at 3 percent of cadastral value. In 2005, Chile also imposed a similar 100 percent tax surcharge on vacant land with the intent to curb land speculation. In Porto Alegre, Brazil, the city identified 120 vacant sites and passed a municipal law requiring that the sites be developed within a specified time period. This 1993 law specified that if the land was not developed within the time required, the LPT rate would become progressive, starting at about five percent of capital market value and increasing 20 percent each year until the rate reached 30 percent of value.

Whether such policies are effective is an important question. If the tax bill including the vacant land surcharge is still comparatively low as a percentage of market value, a higher tax on vacant land may do little to encourage its development. For example, if the tax rate on land is 0.25 percent of capital market value

and the surcharge for vacant land is 100%, then the total tax rate on vacant land will be 0.50 percent of market value. But if the land is appreciating in value at 8 or 10 percent per year or even more, unless the taxpayer has a cash flow problem, there is very little incentive to sell the land to someone who intends to develop it. In order to effectively discourage hoarding and speculation, the tax rate on vacant land needs to be close to the rate of land value appreciation. And if there is an economic downturn and land values fall, such a tax could quickly become quite burdensome, as Taiwan found just before they repealed a higher tax on vacant land in the 1980s. In most cases where there is a higher tax on vacant land, however, the rate is low enough that there is serious question that it has any meaningful impact on the behavior of land holders. And in the case of Porto Alegre, Brazil, four years after the law was passed, only five of the 120 parcels identified had been developed. The owners of fifty of the parcels were paying the higher tax, suggesting that there may have been problems with the assessment of market value. Of the remaining properties, two large land owners were appealing the constitutionality of the law and the others were simply waiting for the courts to decide, but not paying the tax in the meantime (De Cesare, 1998).

10.1.3 TAX FORGIVENESS AND PUBLIC SUBSIDIES

Often an important objective for local governments is to encourage private investment in a particular area of the community. It may be that a section of the city is seriously run down and needs to be refurbished. Or it may be that in an effort to attract private investors, community leaders have identified a specific location where they feel that investment is warranted, and in order to facilitate that investment, the city wishes to make land or infrastructure available to potential investors. LPTs can be an important tool in the urban development strategy through two strategies in particular that use the revenue from the LPT in partnership with private investment.



Trader counts cash at a market in Accra, Ghana. Photo © UN-HABITAT/ Julius Mwelu

Tax Increment Financing—The first method is commonly known as Tax Increment Financing (TIF) and it is used to encourage development in a specific area. In order to do so, the city determines that providing financial incentives to one or more private developers is desirable. This assistance can be used to offset specific project costs or to repay a specific business-related loan. The incentive that the local government has to create a TIF zone is the hope that it will stimulate other investment and growth outside the TIF zone, and that the life of investments within the zone will extend beyond the duration of the financing term.

The steps in creating a TIF zone begin with the identification of a location or zone to receive the support and one or more projects to be located within the zone. The current tax revenue from the location is identified. An estimate is then made of both the taxable value and the resulting tax obligation of the proposed project after it is completed and in operation. The difference between the current tax generated by the property in question and the tax after the investment is made is then earmarked to be used to offset development costs or to finance a debt issuance

to pay for a capital improvement. The key here is to use future gains in taxes to finance future improvements. The earmarked and returned tax revenue can either be a fixed amount for the life of the agreement or it can decline over the agreed period.

To see how TIFs work more clearly, consider the numerical example displayed in table 10.1. In this example, the current taxable value of the land that is to be used in the development is 100,000 in the local currency, and the tax rate is one percent. Thus, the current tax obligation for the property is 1,000 per year (in the local currency). The proposed development is expected to cost 900,000 for immovable site improvements such as buildings, and therefore after the project is completed and in operation, the tax obligation will be 10,000 per year (one percent of one million). If a TIF mechanism is used to help project financing, then the increment in the tax obligation (10,000 – 1,000 = 9,000) would be returned to the project to be used to offset project costs. Note that the full tax is paid by the land holder each year, but the agreed upon increment is then returned to reduce financing costs.

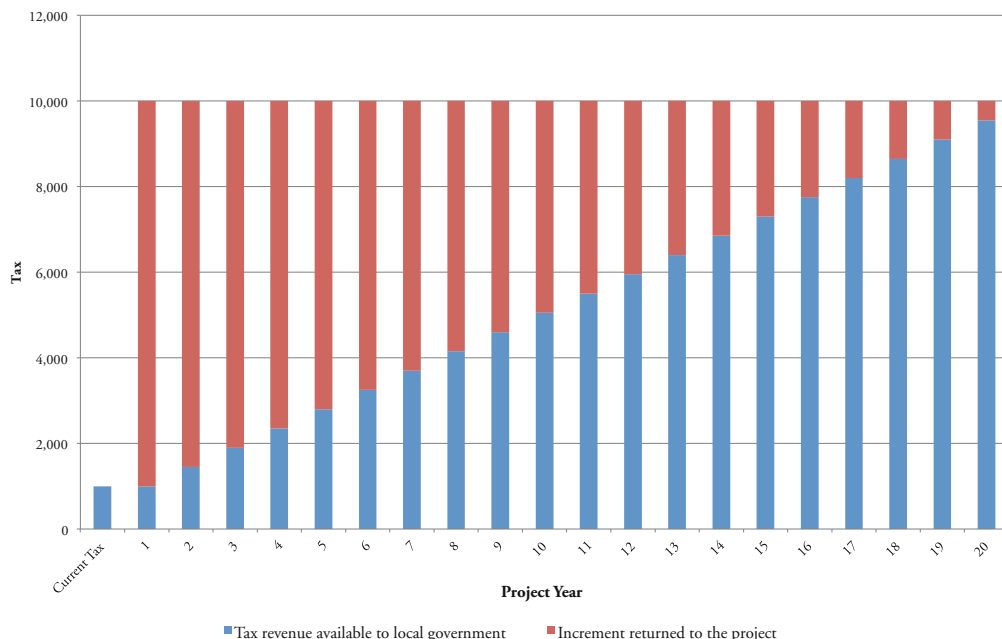
TABLE 10.1 **HYPOTHETICAL TIF EXAMPLE**

Current land value	100,000
Current tax rate	1%
Current tax (A)	1,000
Proposed project investment (to be privately funded)	900,000
Value of land and investment after completion	1,000,000
Tax due after project completion (B)	10,000
Tax increment (used to offset project costs) (B-A)	9,000

Agreements to create a TIF zone are generally for a fixed period of time, though some are renewed for longer. And the division of the incremental revenue can either be fixed for the entire period or the project's share can decline over time. Figure 10.1 illustrates the concept of a declining share going to the project each year over a 20 year period. In the figure, the blue bar represents the share of the total tax obligation that is available to the local government, while the red bar represents the share returned to the project. Another option would certainly be to have a fixed division for a period (say, five years) with a declining share returned to the project each year thereafter.

The evidence assembled over time indicates that TIF zones can be successful in promoting more rapid growth within the zone than would otherwise have occurred. But community leaders should exercise some caution in implementing TIF zones, because the evidence that TIF zones promote more rapid overall growth in cities is mixed. TIF zones are a method of financing development, but they do not change fundamental development opportunities. For example, using TIF mechanisms to finance retail expansion will likely merely move retail sales to the zone from other areas outside the zone, thus reducing land values outside the zone as growth occurs inside the zone. A better strategy is to use TIF zones to promote industrial growth and the production of goods for sale outside the area (Dye and Merriman, 2006).

FIGURE 10.1 HYPOTHETICAL DIVISION OF TIF TAX REVENUE OVER TIME



Redevelopment/Economic Development Areas—The second method that employs the LPT in promoting private investment in a community involves the creation of what are commonly called redevelopment areas (RDA) or economic development areas (EDA). In both cases, the local government designates a specific land area in which to promote private investment. The distinction between the two is that in an RDA, the local government finds that the existing development in an area is outdated or underutilized, while EDAs usually involve undeveloped land areas. In practice the distinction is not large and may be a function of the specific language used in the law that allows local governments to create these entities. Both RDAs and EDAs are used to promote investment and growth in a specific land area and often to funnel LPT revenues back into the development project. RDAs and EDAs differ from TIF zones in that TIF is strictly a method to reduce the cost of financing a private project, while RDAs and EDAs actually create a commission appointed by the local government to oversee the RDA/EDA and often to provide specific augmented local government services in the area. Thus TIF is just one tool available to RDA/EDA managers.

The steps involved in creating either an RDA or EDA are similar. Assuming that the necessary legal authorization exists, the local government first determines that there is a need for development or redevelopment in a specific area and declares its intent to create a commission or body to oversee the RDA/EDA. The boundaries of the RDA/EDA should be clearly specified when the RDA/EDA is created and the commission is appointed. As outside investment into the RDA/EDA is sought and negotiated, the commission can agree to provide services not available outside the RDA as part of the inducement to attract investors. For example, the commission may agree to provide additional lighting or pedestrian amenities in a retail shopping area, or they may install transportation improvements in a manufacturing or shipping center. Some of the services may simply involve facilitating normal business processes such as negotiating the often complex process of obtaining necessary permits and licenses, training and support for start-up companies or helping to arrange funding through local or regional banks. The key points are that the local government has a specific development plan in mind and that it is prepared to offer service, infrastructure and/or financing

inducements to investors that are not available outside the RDA/EDA. These inducements are financed through the increment in LPT revenue that results from the new private investment.⁴⁰ While some of the LPT revenue may come in the form of one-time development fees and other betterment levies, ongoing services should be funded through an annual LPT.

To date, tax increment financing has been employed in the United Kingdom, the United States and Canada. Australia is beginning to explore the tool's potential in New South Wales as well. There is an abundance of empirical evidence including from developing countries that documents the impact of public investment (particularly in transportation infrastructure) on nearby land values.⁴¹ The potential of tax increment financing to fund these and other public investments suggests that the tool may have wider application and merits careful consideration.

10.1.3 TAXES AND LONG-TERM FUNDING

In countries that permit local governments to borrow, LPTs, especially annual LPTs, can serve as a stable and secure revenue stream which can be used to finance public services at very favorable rates. Essentially, the local government can pledge future LPT revenue in order to obtain private loans to fund public projects. It is strongly recommended, however, that strict limits be placed on the amount of debt that is permitted. Local government debt should be used only for capital investment and not for current operating expenses or to cover past budget shortfalls. Generally, the limit on local government debt is expressed as a percentage of the taxable value of all property in the jurisdiction. But public debt for capital investments and repaid by LPT revenue is a reasonable option for funding investments that will endure beyond the period required to pay the debt.

It is often the case that emerging economies have limited access to debt. It may be that the central government limits the ability of local governments to borrow. And it is often the case that appropriate and transparent accounting, cash management and auditing procedures are lacking, and therefore banks and other entities that finance municipal debt are unwilling to risk their capital. Thus the option of using LPT revenue for long-term funding of capital projects must be evaluated in the context of broader municipal finance.

One useful case of borrowing to meet local public investment needs is provided by Johannesburg, South Africa. (Ngobeni, 2008) With the collapse of apartheid and the expansion of municipalities to include disadvantaged areas, municipal access to private credit markets in South Africa essentially disappeared.⁴² By 2003, Johannesburg began to realize that selling bonds had several advantages over commercial borrowing. Issuing bonds could raise more capital, at lower interest rates and with a longer maturity than was available from commercial sources. In addition, more of the proceeds would be available for funded projects because bonding does not have the same collateral requirements. In South Africa at the time, nearly 20 percent of funds borrowed had to be placed in an escrow account, usually with the lender and at below market interest rates.

Johannesburg found, however, that bond issuance often carries higher up-front costs than short-term borrowing, though most of the additional cost can be incorporated into the bond issue. In addition, the interest rate paid on bonds depends heavily on the credit-worthiness of the city issuing the bonds. Through a series of carefully thought out decisions, Johannesburg was able to successfully enter the municipal bond market, and now has a variety of bonds that it issues to meet its needs for long term financing. It is beyond the scope of this Guide to review the important questions that must be

⁴⁰In some cases, governments use RDAs/EDAs to disperse development aid as well. Another type of economic stimulus zone is the Enterprise Zone which is also intended to promote employment growth in an area. Such zones use tax incentives other than the LPT and are therefore not considered in this Guide.

⁴¹See for example Smith and Gihring (2006) for an annotated bibliography of nearly 100 studies concerning the impact of transit services on nearby property values.

⁴²The Infrastructure Finance Corporation, a nonbank investment fund, did raise private capital and lend to municipalities at commercial rates.

addressed in issuing a municipal bond. But the case of Johannesburg demonstrates that issuing bonds is a viable option for cities willing to make sufficient commitment to quality financial management. And LPT revenues can play an important and stable part in servicing municipal debt.

To summarize, LPT revenues, especially revenues from annual LPTs, because they are stable and consistent can be used in a number of ways to promote private investment and secure long-term funding for local governments. The ability to use LPTs in this way is constrained by the quality of local tax administration and financial management, but the potential should not be overlooked or underestimated. Of course, in addition to pursuing economic development, community leaders also seek to promote social objectives and often look to the LPT in this regard as well.

10.2 SOCIAL OBJECTIVES

Taxes have social implications. One of the most basic considerations in designing or evaluating a tax is its impact on different economic groups. The progressive or regressive nature of a tax is measured by comparing across income groups the percentage of total income that goes to the tax. If low income groups tend to pay a higher percentage of their income for the tax than do high income groups the tax is said to be regressive and policy makers may seek to revise the tax so as to lessen the burden on the poor. On the other hand, those same policy makers often seek to increase the burden on society's wealthiest individuals, arguing that such individuals have greater ability to pay. At the same time, income is not the only criterion that policy makers consider in evaluating the impact of taxes. Often there are specific social groups that a community will seek to protect from the full burden of taxes because they are considered vulnerable in some way. Whether it is to pursue greater progressivity or protection for special classes of taxpayers, the policy arguments are generally driven by a desire to make the tax fairer, and these arguments have been applied to taxes on land and property as well.

10.2.1 MAKING THE LPT MORE PROGRESSIVE

As noted previously, a number of countries have implemented graduated or progressive rates for the annual LPT. The range of taxable values is subdivided into categories and a different tax rate is applied to each category. In some cases the lowest category is not taxed. Both Morocco and Egypt are examples of countries in North Africa that have progressive LPT rates based on annual rental value. Argentina, Brazil and Colombia are examples from Latin America. In Bogotá, Colombia, the annual LPT is based on cadastral value, and a progressive rate is applied to residential property, after placing each property into one of six social and economic strata. However the rates applied vary only from 0.4 percent to 0.85 percent of cadastral value at the maximum, and for the average property in each strata the range is only from 0.5 percent in the lowest stratum to 0.7 percent in the highest. Thus, any meaningful difference in the amount of LPT paid in Bogotá depends more on differences in cadastral value than on the progressivity of the tax rate.

This is a common problem in emerging economies that attempt to make the LPT progressive. The combination of very low LPT rates overall, undervalued property and poor enforcement combine in most cases to seriously undermine the effectiveness let alone the progressivity of the LPT. (Bird and Slack, 2004, pg 37) And attempts to reform the LPT and rigorously impose a progressive rate are quite likely to encounter political resistance, legal challenges and attempts to illegally influence tax administrators. Thus, in the Namibian example cited previously, the graduated rates imposed may be effective in using incentives and markets to redistribute agricultural land, but only if the political will is sustained, all land is accurately valued and tax administration is conscientious and fair.

Another important question to ask about increasing the progressivity of the LPT through graduated or progressive LPT rates is how effectively these rates target the intended population. Most implementations of a

progressive LPT rate are intended to facilitate redistribution of society's resources. This was a very explicit goal, for example, in Singapore's adoption of a progressive rate structure in early 2011. However, even without a progressive tax rate, complaints are frequently heard that LPTs impose unfair burdens on those who are land rich but cash poor. Anecdotes are routinely reported of families forced to sell the land that has been the family home for several generations because they cannot afford the property taxes. While there is good reason to question how often such dislocation actually occurs, it points out that the LPT system is a very crude tool for addressing income or wealth redistribution. In the LPT system, tax administrators may know a great deal about the land and structures being taxed, but they know very little about the actual financial condition of those who possess the land.

On the other hand, property interests in emerging economies tend to be concentrated among the wealthy so that even a single rate tax on land that is accurately valued would tend to be progressive if all land (and potentially buildings) is included in the tax base. And systems that exempt a fixed amount of either property value or building area tend to make the LPT more progressive. (Bahl, et al, 2008) Thus, the best strategy if progressivity in the LPT is the goal is to begin by improving the fiscal cadastre, minimizing and carefully targeting any exemptions, and improving the quality of tax administration. At that point, any increase in a single-rate tax will in all likelihood have a progressive impact. Introducing a progressive rate structure is possible but should be weighed against the additional political and administrative challenges such policies create.

10.2.2 PROTECTING SPECIFIC CLASSES

Policies intended to assist specific classes of owners or occupants take several forms.

Farm land—One of the more common groups to receive special consideration in the LPT system is farmers. In many instances, agricultural land is simply exempted from the LPT. This approach may seem politically expedient, but it often creates significant administrative challenges. Records for exempt land may not

be maintained with the same rigor as other land records which can affect the quality of the fiscal cadastre. Further, it is often difficult to define and determine when land use changes from agricultural to a more urban use. And rural areas are often in need of public investment for roads, electricity and other infrastructure that would improve the lot of farmers. Even a very low rate LPT can augment much needed revenue.

The best approach is to include all land in the fiscal cadastre. If the policy decision is to reduce the tax burden on agricultural land, two approaches are common. First, in a system based on land area, a lower rate can be adopted. Alternatively, in systems based on capital market value, valuing agricultural land based on its current use as farm land rather than its potential for development is widely done. Thailand, for example, convenes a panel of agricultural experts to evaluate the typical agricultural productivity of various agricultural land categories in different parts of the country. Valuation is then based on this assessment of farm productivity. The result is that the final tax burden on agricultural land is generally much lower than on other land valued with market value concepts.

The poor and other social groups—There are often two motivations for granting LPT relief to low income households. First, even if taxed, the revenue collected from the poor may not exceed the cost of collecting the tax. Second, in countries where significant proportions of the population live in extreme poverty, it may seem unfair and unreasonable to add to their burdens through the tax system. On the other hand, municipal services and urban infrastructure are often key to improving the living conditions of the poor. And creating a culture in which the populous is actively engaged in local governance can be facilitated if all households are expected to contribute through the tax system. Even modest tax payments tend to encourage a sense of ownership and a desire to receive good value from the local government. Thus, a number of countries have established a minimum annual LPT which applies even to the poorest, unless special petition is made to and granted by the local government. Example countries include Jamaica, Argentina, Latvia, some provinces in

Canada and some states in the United States. In some municipalities in Mexico, the minimum tax is stated as the equivalent of 1 or 2 days of work at the minimum wage. In Montevideo, Uruguay, the minimum tax applies only in areas that are served by street lighting and other similar urban services. In each instance there is a recognition that those who own or occupy property receive benefits from the local government and have some obligation, however small, to help pay for those services.

Among those communities that grant exemptions to low income households, the challenge is to balance administrative complexity and cost against the revenue lost through the tax relief program. Approaches that are simple to administer often result in revenue losses that are much larger than intended. More targeted approaches tend to be more difficult and costly to administer. For example, one common strategy is to exempt either a specific amount of taxable value (in market-based systems) or a specific amount of built area (in area-based systems). Singapore is one such case. The LPT in Singapore is based on annual rental value, and the tax rate on the first €3,400 of annual value is zero for owner-occupied residential property, thus providing a complete exemption to all property owners whose property is valued at or below this level.⁴³ But an apartment near the central business district with a rental value of €27,000 per year would also have the first €3,400 of value exempted. In a small country with GDP per capita approaching €34,000 and where over 80 percent of residents own their homes, it seems clear that a majority of the benefit that flows to taxpayers from this exemption flows to non-poor households. And this will be true in most circumstances implementing this approach. It is relatively easy to administer, but the revenue losses for the local government will be much larger than if the tax relief is targeted more narrowly on those most in need.

An alternative that is often taken and that points out the other side of the issue is to require all property holders to pay the LPT in full, but then to allow those in need to apply for a rebate. The rebate application process allows administrators

to review the level of need and issue rebates as the economic condition of a household merits. One advantage of this approach is that the requirements to receive a rebate need not be limited to poverty status, but can also be extended to the elderly, the disabled, or other groups targeted for tax relief. South Africa has such a rebate system, and it is not uncommon there to see rebates of 40 percent granted to residential property. The difficulty with rebate or grant systems similar to that found in South Africa is that it is much more costly to administer. In addition to administering the LPT itself, there must also be the administrative infrastructure to process rebate applications in a timely manner. Those most in need can least afford to wait for months for a rebate to be processed. It also seems likely that some households that merit the rebate will fail to receive it, either because they fail to or cannot complete the necessary application, or because of administrative errors. On balance, then, a rebate system for low income and other households may be more fair and result in higher net revenues (revenue less cost of administration) than simply granting a specific exemption to all principal residences. But the cost to society's least advantaged in terms of the additional effort necessary to obtain the rebate will be substantial.

An approach slightly different than the rebate system that is often used to grant tax relief to groups such as pensioners, veterans, and the disabled is to establish an application and approval process before the tax bill is determined or the tax is collected. Here the local government (or other body) establishes the criteria for granting full or partial relief from the LPT. Local administrators notify the public that such relief is available and process applications as part of the tax bill preparation phase of tax administration. In this manner relief is granted in advance and does not involve rebates of taxes already paid. This approach has the advantage of being financially easier for taxpayers, but it still requires taxpayer effort to complete and submit the necessary application and documentation. And it requires local governments to expand their administrative capacity in order to process the applications received.

What should be clear at this point is that LPT systems are cumbersome tools for rendering aid to the poor or redistributing income and wealth

⁴³ A similar strategy can be applied to all primary residences if the owner-occupied designation seems too restrictive.



A family having a meal in their shanty at Phnom Penh, Cambodia. Photo © UN-HABITAT/Keisuke Ikeda

in a country. Adapting LPTs for this purpose nearly always results in one of two outcomes. Either the local government gives up much more revenue that it should through the creation of broad exemptions, or it creates an expensive auxiliary administrative structure, such as agricultural experts to evaluate farm land or additional staff to process applications for relief, while at the same time increasing the annoyance and difficulty for taxpayers seeking relief. This is not to say that such relief is unwarranted or inappropriate. But it does suggest that other mechanisms such as the income tax system should be considered as perhaps a more efficient method for providing needed assistance.

10.3 LPTS AND INFORMAL SETTLEMENTS

The growth of informal settlements in the developing world is well documented. UN-HABITAT has estimated that over 36 percent of the urban population in developing regions live in slums, and that almost 90 percent of new urban settlements in sub-Saharan Africa are taking the form of slums. (UN-HABITAT, 2008a) It is important therefore to consider how LPTs relate to and might be implemented in informal settlements. While it is beyond the scope of this Guide to review the literature on the causes and potential remedies for informal settlements, several observations should be made to provide context for the discussion

which follows. First, informality is a very multidimensional phenomenon with a number of interacting causes stemming from the limited supply of affordable land, poverty, local land tenure and land use regulation practices. Second, several past observations regarding informal settlements now seem questionable. (Smolka and De Cesare, 2006)

- The assumption that occupants in informal settlements are neither willing nor able to pay an annual LPT is likely overstated. Rather, it appears these occupants are both willing and often more able than previously believed to pay a tax on property. Payment of the LPT often creates evidence of possession that can be used to regularize tenancy.
- The belief that occupants in informal settlements are necessarily poor, or that they are always unemployed or informal workers is likewise overstated. First, there are examples of middle and high income informal settlements. (See for example Owei and Ikpoki, 2006) Further, as shown in Table 10.2, in a number of countries the percent of the population living in slums substantially exceeds the percent considered to be poor and is increasing at the same time that poverty rates are actually declining. This was the case for thirty-three of the forty countries listed in Table 10.2.

TABLE 10.2 URBAN POVERTY RATES AND SLUM POPULATIONS BY COUNTRY

Country	Poverty headcount ratio at urban poverty line (% of urban population, 2006-2009)	Percent of urban population living in slum area (2007)	Population in slum areas exceeds urban poor?	Poverty headcount ratio at urban poverty line (% of urban population, 2002-2005)	Percent of urban population living in slum areas (2005)	Population in slum areas exceeds urban poor?
Argentina	26.9	23.5	No	54.3	26.2	No
Bangladesh				28.4	70.8	Yes
Benin				29.0	71.8	Yes
Bolivia	50.9	48.8	No	54.4	50.4	No
Burkina Faso				19.2	59.5	Yes
Cameroon	12.2	46.6	Yes			
Central African Republic	49.6	95.0	Yes			
Colombia	39.8	16.1	No	48.3	17.9	No
Comoros				34.5	68.9	Yes
Côte d'Ivoire	29.4	56.6	Yes	32.3	56.2	Yes
Dominican Republic	45.3	16.2	No	51.0	17.6	No
Egypt, Arab Rep.	10.6	17.1	Yes	10.1	17.1	Yes
Ethiopia				35.1	81.8	Yes
Ghana	10.8	42.8	Yes			
Guatemala	30.0	40.8	Yes			
Guinea	30.5	45.7	Yes	23.5	45.7	Yes
India				25.7	34.8	Yes
Indonesia	13.5	23.0	Yes	14.5	26.3	Yes
Iraq	16.1	52.8	Yes			
Kenya				33.7	54.8	Yes
Madagascar				61.4	80.6	Yes
Malawi				25.4	66.4	Yes
Mali	25.5	65.9	Yes			
Mexico	39.8	14.4	No	41.2	14.4	No
Mongolia	26.9	57.9	Yes	54.1	57.9	Yes
Morocco	4.8	13.1	Yes			
Mozambique	49.6	80.0	Yes	51.5	79.5	Yes
Namibia				17.0	33.9	Yes
Nepal				9.6	60.7	Yes
Nicaragua				29.1	45.5	Yes
Niger	36.7	81.9	Yes	44.1	82.1	Yes
Nigeria				43.1	65.8	Yes
Pakistan	13.1	47.0	Yes	22.7	47.5	Yes
Peru	31.2	36.1	Yes	46.4	36.1	No
Rwanda	23.2	68.3	Yes			
Senegal				35.1	38.1	Yes
Turkey	10.4	14.1	Yes	22.3	15.5	No
Uganda	9.1	63.4	Yes	14.4	66.7	Yes
Vietnam	3.9	38.3	Yes	6.7	41.3	Yes
Zambia	26.7	57.3	Yes	52.2	57.2	Yes

Source: UN-HABITAT, 2008, *State of the World's Cities 2010/2011* and World Bank, *World Development Indicators database*.

- The assumption that informal settlements are homogeneous entities clearly distinguishable from formal settlements is unwarranted, at least in South America.
 - The belief that occupation of informal settlements is made through nonmarket transactions does not seem to hold true.
- 3) Consider implementing a self-assessment or self-reporting scheme similar to that used in Bogotá or Bangalore. Care should be taken that the forms are simple in design and that there is abundant help for those seeking assistance.
 - 4) Implement a tax relief process that will protect the poorest households. There should be a minimum tax that all must pay (probably the equivalent of one or two days working at minimum wage). But there should also be a process to grant relief that considers the economic conditions of households. While such a process implies additional administrative costs, the creation of a fiscal culture in which taxpayers feel they are engaged but not overburdened will pay dividends over time.
 - 5) Raise the tax rate on all land. One important contributing factor to increasing informality is the lack of available affordable land. Increasing the effective tax rate on land will discourage hoarding and actually reduce the market value of land, thus making it more available and affordable for all. (Bahl and Linn, 1992) But to be effective, the final tax rate must represent a significant cost to land holders. Existing rates in most emerging economies are so low that they have virtually no behavioral impact on land holders.

What is clear is that poverty is extensive in informal settlements, that tenure is often not secure and that by their very nature aspects of informal settlements are outside the normally recognized urban development process. The implication of the last point is that fiscal cadastres in informal areas are frequently lacking. Thus the implementation of an annual LPT in such areas is at best challenging. However, there is emerging evidence to suggest that it is both possible and highly desirable to effectively tax informal settlements. For example, at least in many South American countries, much of the land in informal settlements is already on the fiscal cadastre. (Smolka and De Cesare, 2006) But effective implementation can be enhanced if several key policies and practices are adopted. These features can be organized around some of the same concepts discussed previously: designing of the tax and the rate, improving the fiscal cadastre, linking the LPT to tenure security, and administrative issues. The way forward with regard to implementing LPTs in informal settlements will depend on selecting and adapting these principles in the local context determined by the local practices and capacities.

Designing the tax and setting the rate

- 1) Tax the occupants of land rather than legal owners or possessors. It is more practical to locate occupants in settlements than owners or legal possessors of the property. The countries of Honduras, Ecuador and Chile have adopted this approach for this reason.
- 2) Consider implementing a land tax. Tracking immovable improvements in informal settlements is difficult and costly, and discourages investment in further improvements. Taxing land only relieves the administrative burden of maintaining records on improvements and promotes improved land use.

Improving the fiscal cadastre

- 6) Encourage community organizations to form and then collaborate with such organizations to obtain and improve the fiscal cadastre.
- 7) Partner with other entities working in the informal settlements to obtain and update the fiscal cadastre.

Linking the LPT to tenure security

- 8) Do not require uncontested possession of the land before the tax must be paid.
- 9) Allow payment of the LPT to create a legal tenure claim recognized in the fiscal cadastre.
- 10) Create a process for converting claims in the fiscal cadastre to eventually result in legal title to the land.



Property and Infrastructure development in Shanghai, China. Photo © UN-HABITAT/Julius Mwelu

Administrative issues

- 11) Make it convenient for taxpayers to pay the tax. The tax should be payable in installments and at multiple locations convenient to the settlements.
- 12) Spend the tax revenue collected in informal settlements in those settlements. There must be a clear connection between the taxes paid and improvements in services and infrastructure within the settlement. Taxpayers need to see the value they receive for the taxes they pay.
- 13) Work with community groups to establish spending priorities within the settlements.

It has been observed that “the major cause of concern [in implementing a property tax in informal settlements] is not so much informality itself, but the way public officials treat informality and how they administer a property tax system” (Smolka and De Cesare, 2006, pg 19). To be sure, informal settlements present challenges, but when quality administration and political will combine, the annual LPT can be an important tool in both regularizing and improving conditions in such settlements.

11. SUMMARY AND THE WAY FORWARD

The 1968 United Nations Manual of Land Tax Administration:

Land taxes as set up currently present serious problems in equity and administration, which have become exacerbated in many countries where the base or even the amount has remained unchanged for decades and has failed to reflect changing price levels, land uses and revenue needs. The principal difficulty has heretofore been to obtain and maintain a reasonably accurate and current valuation of each property at a reasonable cost. Another difficulty that has hampered fair taxation of land is the influence exercised in many Governments and legislatures by the owners of much of the potential taxable real estate. In both respects, the present situation is much more favourable to land tax reform in many countries than it has been in the past. This change in favour of property taxation is a result of urban growth, economic diversification and the tendency of Governments to seek wider bases of popular support (page 1).

2011: UN-HABITAT 23rd Governing Council Resolution on ‘Sustainable urban development through expanding equitable access to land, housing, basic services and infrastructure’

‘Encourages Governments and Habitat Agenda partners, with regard to land issues...To create mechanisms for broadening land-based revenue streams, including by improving the competencies and capacities of local and regional authorities in the field of land and property valuation and taxation, so as to generate additional local revenue for pro-poor policies and to finance infrastructure development [page4, paragraph 7 (d)].

Despite several decades of technical innovation, in many respects not much has changed since the 1968 United Nations *Manual of Land Tax Administration* was written. LPTs are still underutilized by most emerging economies, and for many of the same reasons that challenged policy makers and administrators fifty years ago. Fiscal cadastres are often underdeveloped. The technical and administrative challenges of obtaining and maintaining “reasonably accurate and current valuation” information remain, though the major impediments are now more administrative than technical. And the political influence of those with large land holdings is still very strong. Nonetheless, there are good reasons to be optimistic about the potential for land tax innovation and reform today.

There is now international recognition that bringing government closer to the people improves the quality of governance. The momentum to make government more responsive and to improve both essential infrastructure and basic public services also creates momentum to mobilize and enhance revenue sources that are under local control. And taxes on land are increasingly recognized as an important component in achieving both service delivery targets and quality governance goals. But the similarity of the current situation to that described fifty years ago in the UN *Manual* should also point out that realizing the potential of land taxes requires political will and administrative commitment.

In the preceding sections the case has been put forward that land and property constitute an important base for mobilizing revenue to meet

local needs. Land is immovable. Immovable improvements on the land are difficult to hide. Those who benefit most from public investments will likely pay a larger share of the tax. Taxes on land and improvements can capture part of the increased private land values that often result from public investments and improved public programs. By giving local authorities autonomous revenues, LPTs can foster improved local accountability and responsiveness.

The various types of taxes applied to land and improvements were described, with an important distinction drawn between those LPTs that represent one-time taxes, fees and charges and the annual LPT that yields on-going revenue. The one-time taxes and fees are applied when something about the land changes, such as ownership or land use. The annual LPT applies to all taxable land. One-time taxes and fees are best used to fund specific projects, whereas the annual LPT can be used to fund continuing services or to underwrite modest debt levels.

11.1 FOUR PRACTICE AND CAPACITY PERSPECTIVES

To be effective, implementations of LPTs need to be informed by, if not constrained by, four considerations. First, the LPT system should reflect and be sensitive to the local institutions and traditions related to land and property rights. If land is seen as an economic commodity in the local culture, and individual private ownership is accepted, then the incidence of the LPT should fall on land owners, and sanctions should include the government's right to seize and sell the land (eventually) if taxes are not paid. On the other hand, if land is viewed by the local culture as fundamental to achieving basic human rights, or if private ownership is foreign to the culture, then it will likely be more practical to make the occupants of land responsible for paying the tax. In such settings, tax administrators need to be able to pursue other taxpayer assets besides the land if the taxes are not paid or create peer pressure through public exposure. A national taxpayer identification system is of great value in such situations.

Second, implementing the LPT requires some form of fiscal cadastre and the LPT system must reflect the realities of the current formal and informal land right registration systems. If land rights are publically recorded and actively enforced by the judiciary, then the fiscal cadastre can be built around the legal cadastre or land book. But if many properties are not formally registered, then the fiscal cadastre should be used as an intermediate step that land holders can use to document and have their tenure claims recognized. The fiscal cadastre will not help much with resolving boundary issues or in resolving competing claims to ownership, but it can be used to link taxpayers to parcels of land and document that linkage. In this, the interests of tax administrators and taxpayers are closely aligned.

Third, since different design options exist depending on the extent and maturity of land and property markets, it is critical that careful attention be paid to market conditions in different locations and for different types of property. In those areas and for those properties where real estate markets are active and information on market transactions can be obtained, valuation approaches based on capital market value, annual rental value or an approach tied closely to market transactions should be used to establish the tax base. If real property markets exist but information is not readily available or if staff capacity is limited, a banding or cadastral value approach should be used. And if markets are limited, an approach based on the physical characteristics of the land and buildings should be used.

Fourth, the administrative capacity of government agencies must be carefully considered in designing the LPT and the administrative processes for its implementation. The best strategy is to divide responsibilities for administering the tax between two levels of government. And cooperation between government agencies that have information critical for the efficient and effective administration of the LPT is essential. If local resources are limited, then the design of the LPT must be as simple as possible and some compromises will be needed on equity issues. For example, if real estate markets are quite

active but local administrators either do not have access to quality market data or do not have the expertise to process the data appropriately, it makes little sense to plan a market-based LPT system. Far better to start with a system based on knowable property attributes that can be administered effectively and then build both the system and the local administrative capacity over time.

11.2 REVENUE IDENTITY PERSPECTIVE

Another way to view the policy and administrative issues related to LPTs is through the lens of the revenue identity introduced in Section 5. The revenue identity consists of five elements: the tax base, the tax rate, the coverage ratio, the valuation ratio and the collection ratio. The eventual revenue received by the government is the product of these five elements. It is consequently important to consider the policy and administrative options for each, but the choices should be informed by knowledge of the four local considerations: property rights, property right registration, market conditions and administrative capacity. The issues and options are explained here and summarized in Table 11.1.

Defining the base – Defining the base for the LPT involves three policy decisions. The first is whether the base will include land only, improvements only or both? It is administratively easier to tax land only. If there is adequate administrative capacity to obtain and maintain the additional information required, both land and improvements can be taxed. There are also strong economic arguments for taxing land only, and a land-only tax may be the most effective way to extend the tax to informal settlements.

The second policy decision is whether the value of the tax base will be linked to capital market value or property attributes? If real estate markets are fairly mature, there are good reasons to link taxable values to market values. But if real estate markets are not complete and reasonably well functioning, the better approach is to link taxable value to property attributes such as size and location. Administrative capacity should also play a role in this decision. Linking taxable value to market value is administratively much more demanding. And if access to land is generally viewed as essential to human rights there will likely be a preference for basing the LPT on property attributes while viewing property rights as economic commodities will tend to favor a market value approach, other things being equal.



Residential housing in Addis Ababa, Ethiopia. Photo © UN-HABITAT/Claudio Acioly

The third policy decision is whether to hold land owners or occupants responsible for paying the LPT? Here all four of the perspectives factor in. If property ownership is well accepted, then taxing owners will likely be preferred. If individual ownership of land is not widely accepted, the tax obligation should fall on occupants of the land. If formal property right registration systems are well established, then taxing owners may be preferred. In areas with incomplete formal property registration, occupants will likely be easier to identify. This will be true as well if real estate markets are limited. And without individual ownership and strong property registration systems it will generally prove to be administratively easier to tax occupants rather than owners.

Setting the tax rate—Two policy decisions are central to setting the LPT rate. First is the question of whether rates will be set locally or centrally. Local autonomy and accountability argue in favor of local rate setting. Uniformity and tax harmonization argue for more centralized rate setting. The best strategy is likely to be a mix of the two, with a central authority establishing the range of acceptable rates, and the local government selecting the final rate within that range.

The second policy decision with regard to rate setting is whether there will be a single rate or multiple rates for different types of property. Administratively a single rate is strongly preferred. Less information is required and there are fewer opportunities for error with a single rate. If multiple rates are used, the number should be kept to a minimum.

Managing the coverage of the fiscal cadastre—The fiscal cadastre should include all land and property that is subject to the LPT. Assuring that this goal is met and maintained as land use patterns change is an on-going challenge. The ability to complete and maintain the fiscal cadastre will depend heavily on how property rights are recognized and enforced in a community and on the administrative capacity of the government agency charged with managing the cadastre. If informal acknowledgment of property rights is common or formal registration

of rights is for whatever reason incomplete, then careful consideration should be given to the incentives that land holders may have for having some government entity acknowledge possession of their land. In informal settlements, this may be a desire to establish a legally recognized claim on the land. In other settings, it may be a desire to obtain specific public services. In all cases, administrative capacity will need to be devoted to updating and improving the fiscal cadastre. Eventually, it may prove desirable to integrate the fiscal cadastre with other land records.

Keeping values up-to-date—One of the demanding aspects of managing an LPT system is keeping the taxable values up-to-date and consistent with the specified legal standard of value. This is especially true if that standard is capital market value, annual rental value or some approximation of how the real estate market views a property. But even if the LPT is based on property attributes, those attributes change over time. Land does not move, but land use changes, parcels are subdivided and improved, and the perceptions of desirability change. Thus consistent administrative resources and expertise need to be devoted to monitoring and updating taxable values. The methods employed will depend on the legal articulation of the value standard and on the administrative capacity of the agency charged with maintaining values. But if values are not updated regularly, the relevance of the LPT over time will inevitably diminish, both because the actual revenue will not keep pace with growth in the community and because the tax will increasingly be seen as unfair.

Collections—It will matter very little how the tax base is defined, how rates and values are set or whether a property is on the fiscal cadastre or not if the LPT is not collected. But the ability to collect the tax will depend crucially on whether taxpayers feel that the tax is fair, on the administrative capacity of tax collecting agencies, on how property rights are viewed in the community and on the political will of community leaders. Administrators must be able to deliver tax bills reliably, hear and respond to inquiries from taxpayers, process formal appeals from taxpayers and follow up appropriately with those who fail to pay their taxes in a timely



Newly constructed housing units in Washington D.C, USA. Photo © UN-HABITAT

manner. For taxpayers to feel the LPT is fair, they must understand the basics of how the tax is calculated, they must feel that they are being treated similarly to their neighbors who have similar property, and they should be able to see the connection between the taxes they pay and the services they receive from government.

One of the central issues in tax collection is what sanctions are available to tax administrators if a tax is not paid? If property rights are viewed as economic commodities, then the ultimate sanction that a community can impose for non-payment of the LPT is to seize the property and sell it to pay the taxes. While this option exists in a number of countries, it is rarely actually used. And if land is seen as fundamental to human rights, seizing land is not a viable alternative. In such cases, other sanctions must be available, such as public exposure and the ability to seize other assets.

Creating incentives for taxpayers to comply with the LPT is essential, but in some instances sanctions for non-payment will be just as necessary. Imposing sanctions for nonpayment of the LPT is often politically difficult. A community's most influential members often own or control large amounts of land, very

valuable land, or both. But even if the sanction must be imposed on those not so influential, the political pressure can be extreme if the local press is reporting on families of limited means at risk of losing what little they have for non-payment of the LPT. The pressure to provide exemptions, rebates and other escape routes for taxpayers is very high. But such escape routes undermine both the fairness of the LPT and its revenue potential. Systems can be put in place to protect the most vulnerable in society, and to assure that taxpayers are treated fairly. But fair treatment does not equal low taxes. Taxpayers should be able to understand how their tax was calculated, to have their questions answered and to appeal when they feel an error has occurred. But they must also come to accept that the tax must be paid, and that will only happen if political leaders and the judicial system support the LPT system. Support in this case means that community leaders should see that the LPT is administered fairly and efficiently, that there is a clear link between taxes collected and the services and infrastructure that result, and that tax collection is fairly, uniformly and rigorously enforced. Ultimately, collecting the LPT consistently is a matter of political will.

TABLE 11.1: SUMMARY OF KEY POLICY QUESTIONS AND OPTIONS

Policy or administrative element	Key questions	Policy options
Tax base	Will the base include land only, immovable improvements only or both?	Administrative ease and Economic theory favors land only, especially in informal settlements; Data availability and public understanding may favor land and improvements
	Will the value of the tax base be linked to capital market value or property attributes?	If land markets are functioning, use capital market value or annual rental value; Lacking efficient markets, use property attributes like size and location
	Will land owners or occupants be responsible for paying the LPT?	If land ownership is well accepted and registration systems are complete, tax owners; In all other cases, tax occupants or land users, or both owners and occupants
	What land and property will be exempt from LPT?	Exemptions should be kept to a minimum and should be reviewed regularly
Tax rate	Will tax rates be set locally or centrally?	Best strategy is to allow local government to set the final rate within a range set by a higher level of government
	Will there be a single tax rate or multiple rates for different types of property?	Administratively, single rate is strongly preferred; If multiple rates are used, they should be kept to a minimum
Managing the fiscal cadastre	Is formal registration of property rights widely accepted?	If yes, merge fiscal and other cadastres; otherwise keep the fiscal cadastre separate
	Which governmental entity will be responsible to update fiscal cadastre?	Should be assigned to local government, but may need assistance from a higher level
Updating taxable values	How often will values be updated?	Should be done every 1 to 3 years; Indexing can be used between cycles
	Who should update values?	If local capacity permits, can be done by local authority except for complex properties; Often carried out by a national or regional agency.
Collections	What incentive do taxpayers have to pay the tax?	Taxpayers must understand how the tax is calculated Taxpayers must feel that they are being treated fairly and the same as others Taxpayers should see the connection between taxes paid and community improvements
	How will tax bills be delivered?	Mail, if reliable; Other entities such as utilities are possible; Hand delivery is sometimes used
	How easy is it for taxpayers to pay the tax?	Greater convenience leads to better compliance; Consider using banks, cell phones, utility companies or other agents as points of collection
	How will appeals be processed?	Local administrative appeal process should be effective; Ultimate appeals will be to the judiciary
	What sanctions will be used for non-payment?	Penalties and interest rates should be set in law; Public exposure should be considered; Links to other assets through a taxpayer ID system should be considered; If culturally appropriate, property seizure and auction should be an option

11.3 STEP BY STEP

Implementing or reforming the LPT in a country is a daunting task. The legal, technical and administrative considerations may seem overwhelming. The way forward can be broken down into a logical series of steps, some of which can be carried out concurrently.

1. *Begin by envisioning the desired outcome.* This will require careful consideration of the four factors described in this guide, along with the desired policy goals, to assure that general principles and guidelines are adapted appropriately to local conditions. Essentially, this step involves answering the question, “What will be the best LPT system for our context?”
2. *Seek technical assistance.* Most of the challenges confronted in any given context will have been encountered before in other settings. Learning from other’s experiences can reduce both the time and the cost of the reform effort. Seek assistance from international agencies and from other countries, but be sure that those offering assistance understand the local context.
3. *Create the legal framework.* The LPT must have a sound footing in a well-crafted and appropriate legal framework. The adoption of the legal framework also signals that the most senior political leadership is willing to support the LPT.
4. *Identify the resources needed and build an implementation team.* The size of the team and the available resources will determine how quickly full implementation can be achieved. An effort should be made to build on resources and administrative structures already in place. The potential for involving the private sector in aspects of the implementation should also be evaluated.
5. *Start with one city or even one sector of a large city.* Secure the support of senior political leadership and community leaders in the selected area. It is better to limit the area initially selected until the implementation team is able to develop standard procedures that are effective and has a clear idea of its capacity. The size of subsequent implementation areas can then be adjusted to fit the capacity of the implementation team.
6. *Build or improve the fiscal cadastre.* This step will involve a basic land inventory in the city or sector selected, but the initial information collected should be kept to a minimum. Gather only the information that will be essential for administering the LPT. Other information can be added later. Consider also using self-declaration or self-assessment processes, but these should be simple in design and will require a separate infrastructure to provide assistance and answer questions.
7. *Build public support.* It is critical that the public in the selected area understand what the reforms are intended to accomplish and how the LPT will work. This will require public meetings, advertisements, meeting with community groups and potentially other media and venues for explaining the LPT. The explanations should include expressions of support from community leaders, how the tax bill will be determined, what the appeals process will be and importantly how the money collected will be invested in the community.
8. *Design the collection system carefully.* Seek to minimize the compliance cost for taxpayers and the administrative costs of collection. Consider using utilities or other agents to facilitate collection. Even if the initial cost of collection is higher than desirable in the long term, a high collection rate will foster broader acceptance of the LPT.
9. *Levy the tax.* Be prepared to respond to taxpayer questions and appeals. Work closely with local media outlets so that they understand and can help explain the changes in the tax.
10. *Trumpet success but aggressively pursue tax avoiders.* The success of the reforms should be widely publicized, but it is just as important to publicize the fact that non-payment will not be tolerated.
11. *Spend the money collected according to plan.* The long-term success of the LPT will depend heavily on the public’s perception that the tax is fair and that monies collected result in improved infrastructure and local services. People will accept the tax and pay it if they can see the tangible improvements in the community.



Children in front of their newly reconstructed homes in Indonesia. Photo © UN-HABITAT

12. *Move the implementation team to the next city or sector.* Repeat the process in the next area, adjusting the scale of the effort to meet the capacity of the team. If possible, building multiple implementation teams that can be trained by the first may expedite overall implementation.

The take-away from this guide can be summarized by saying that the potential of LPTs to contribute to the improvement of local communities is quite high. To realize that

potential requires first and foremost the political will to do so. If that will exists, policies and administrative procedures adapted to cultural views of property rights, to the ways in which those rights are acknowledged and defended in the community, to the realities of local land and property markets and the administrative capacities of relevant governments can produce a fair and stable tax system that will yield between one and two percent of GDP on an ongoing basis.

GLOSSARY

Ability to pay principle	The concept that taxes should be related to the taxpayer's financial ability to pay the tax, and that taxpayer's with more capacity should be taxed more heavily
Annual land and property tax	An annual tax levied on land, immovable improvements or both. The tax can be based on either value or attributes (see section 7.1)
Annual rental market value	The typical rent a property would command in the current market
Assessment	With regard to LPT, generally refers to the determination of taxable value. More generally the term refers to the amount of tax due
Benefit tax	The concept that the taxes paid by a household should be roughly proportional to the benefits that household receives from the community
Betterment tax or levy	A one-time tax levied by a government when it grants some change in land use that results in increased land value. The tax is generally a percentage of the increase in value
Broad base, low rates	A standard principle in public finance. Including more in the tax base allows the tax rate to be lowered and still collect the same revenue.
Cadastre	An official property register. Legal cadastres (also known as Land Books) list title or ownership of land and buildings. Fiscal cadastres contain tax-related information. Physical cadastres include descriptions of land, buildings and other improvements. These can be integrated into a single cadastre but need not be.
Capital gains tax	A tax levied on the difference between the sales price of a property and the cost incurred by the seller in acquiring the property. Generally integrated into the income tax system
Capital market value	The price agreed to by a knowledgeable and willing buyer and a knowledgeable and willing seller, neither of whom are acting under duress.
Central authority	In this guide, the term refers to a level of government above the local municipality. Which level will depend on the structure of government.(see section 6.0)
Collection ratio	The proportion of billed taxes actually collected
Comparable sales approach	An approach to determining capital market value that is based on comparing the prices of recently sold similar properties
Computer assisted mass appraisal (CAMA)	A generic term used to describe the mass valuation of property for tax purposes. Often employs statistical models or other formulas for assigning value to individual properties
Cost approach	An approach to determining capital market value that is based on land costs and construction costs (see section 7.1.1)

Coverage ratio	The proportion of all properties legally liable for LPT that actually appear on the fiscal cadastre and have tax bills generated for them
Current use	The value of land and property as it is currently used. Contrast with “Highest and best use”
Depreciation	The reduction in capital market value that occurs through normal wear or through changes in market conditions that render a property less valuable
Development fees	A tax or fee assessed on new construction or development as part of the development approval and construction oversight process. Can be either cash or in-kind.
Discovery	The process of identifying and adding to the fiscal cadastre changes in land use, new construction or other property attributes that will affect taxable value
Easement	A limited property right that grants a very specific privilege such as the right to install and maintain a electric power line on a particular property or the right to travel across a property in order to access another property
Economic incidence	The party that ultimately bears the economic cost of a tax. Contrast with statutory incidence
Effective tax rate	The tax paid divided by the market value of the property
Estate agent	Professionals who make their living facilitating the sale of real property. They charge a fee for connecting buyers with sellers and for negotiating services
Estate tax	A tax assessed on the value of an individual’s estate
Excise tax	A tax applied to the number of units rather than the market value of those units
Exemption	A condition of property or of a property possessor that allows the tax obligation associated with a property to be reduced or eliminated.
Federal system	A union of states, provinces or similar entities under a national government
Fee	A charge for services rendered
Fee-in-lieu or payment-in-lieu of taxes	Payments made by a government or otherwise tax exempt entity to compensate for taxes not paid
Fiscal cadastre	The official register of properties subject to LPT
Formula-based approach	The determination of taxable value through the use of a formula that is only loosely related to market conditions
Fractional assessment	Defining taxable value as a fixed percentage (less than 100%) of capital market value. The effect is to reduce the effective tax rate
Freehold title	The most complete bundle of rights associated with possessing land. It includes the right to occupy, use, sell, bequeath, develop, rent and otherwise benefit from the property
Goods and services tax	A consumption tax levied in some countries
Highest and best use	How property would be used if it were sold on the open market without restrictions

Horizontal equity	Very similar properties should be subject to approximately the same tax obligation.
Impact fee	Development fee assessed to mitigate the impact of new private development on public infrastructure
Improvements— immovable vs movable	Man-made changes to a property, such as improving drainage, building structures, etc. Immovable improvements are attached to the land and cannot be moved without damaging the improvement. Movable improvements can be moved to another location without damage
Income approach	The determination of capital market value by systematically evaluating the expected income stream a property is likely to generate as an investment.
Indexing property values	A technique used to adjust taxable property values between valuation cycles. Often tied to the rate of inflation in property prices
Inheritance tax	A tax levied on the value of an inheritance
Land policy	The set of agreed principles to govern ownership (or access to), use and management of land resources to enhance their productivity and contribution to social, economic, political and environmental development and poverty alleviation.
Land rent/ground rent/land leases	The fee charged by land owners for the right to occupy and benefit from a parcel of land. Generally for a set period of time, and may limit how the land is used.
Land rights	Socially or legally recognized entitlements to access, use and control areas of land and related natural resources.
Land use classification	the set of categories or classes in the tax law that distinguish between different land uses as residential, commercial, industrial, etc.
Legal cadastre	The official register of legally recognized titled interests in land
Land tenure systems	Sets of formal or informal rules and institutions which determine access to, and control over, land and natural resources
Lien date	The date on which the LPT becomes a security interest in the land and property. Valuations are determined as of this date and tax obligations are calculated effective this date even though they may be billed months later
Market value—willing buyer, willing seller	The price that a knowledgeable buyer would be willing to pay, and a knowledgeable seller would be willing to accept, for a property if both parties wanted to make the trade but it was not essential for either.
Nominal tax rate	The tax rate specified on the tax notice. Contrast with the effective tax rate
Obsolescence	The reduction in capital market value that occurs because technology or economic conditions have changed rendering the property less valuable than previously
Occupant	A person or group that has possession of land and improvements

Owner	A person or group with freehold title to land and improvements
Parcel	A specific plot of land
Physical cadastre	The official register of land attributes such as dimensions, location, and other property attributes
Property rights	Recognized interests in land or property vested in an individual or group and can apply separately to land or development on it. Rights may apply separately to land and to property on it (e.g., houses, apartments or offices). A recognised interest may include customary, statutory or informal social practices which enjoy social legitimacy at a given time and place
Property tax	A tax imposed on rights related to real property. These rights may include private ownership or may be a subset of rights related to occupancy or the right to use and benefit from real property.
Property	A set of legal rights pertaining to a specific object (Youngman, 1996)
Real property/Real estate	Land and immovable improvements attached to the land
Revenue buoyancy	Also called revenue elasticity. Refers to the relationship between the revenues collected and broader economic trends in society. If the revenue collected from a tax tends to increase without changing the tax rate as fast as or faster than growth in the economy, the tax is said to be more buoyant than a tax that does not keep pace with economic growth.
Rights to land	Right to securely possess and benefit from land
Severance tax	Tax levied on natural resource units taken from the land
Site value	Land value prior to improvements (other than buildings) to the land, such as grading, irrigation, paving, etc.
Statutory incidence	The party that is legally obligated to pay a tax. Contrast with economic incidence
Tax	A fee charged (“levied”) by a government on a product, income, or activity. If tax. The purpose of taxation is to finance government expenditure. One of the most important uses of taxes is to finance public goods and services. Since public goods and services do not allow a non-payer to be excluded, or allow exclusion by a consumer, there cannot be a market in the good or service, and so they need to be provided by the government or a quasi-government agency, which tend to finance themselves largely through taxes.
Tax base	The aggregate value subject to taxation at some specified rate
Tax incidence	An analysis of who actually pays a tax. Compare statutory incidence and economic incidence
Tax rate	The factor applied to the tax base to arrive at the amount of tax due. Expressed as a percentage if the base is a monetary amount such as capital market value. Expressed as a monetary amount if the base is in terms of attributes such as m2

Transfer tax/stamp tax	A tax applied at the time that registered title to a property is transferred from one party to another. Generally a percentage of the value of the property being transferred
Valuation	The determination of taxable value of land and property
Valuation ratio	The ratio of actual taxable value to legally defined taxable value
Value added tax	A consumption tax levied in many countries
Value capture	Taxing the unearned increment or rise in land values resulting from changes in use of land, from public investment or decision, or due to the general growth of the community
Valuer/appraiser	A professional who specializes in estimating the capital market value of land and property
Vertical equity	Very different properties, especially in terms of market value, should have very different tax obligations
Wealth tax	A tax imposed on all types of property, movable and immovable, tangible and intangible.

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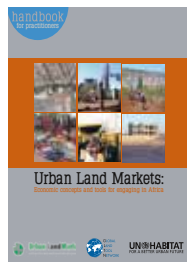
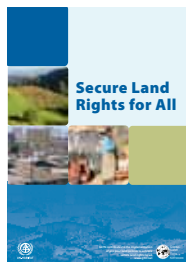
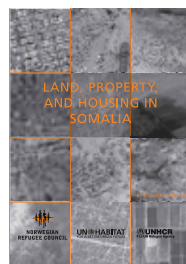
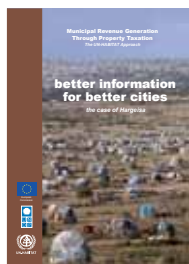
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The GLTN is a demand driven network where many individuals and groups have come together to address this global problem. For further information, and registration, visit the GLTN web site at www.glt.net.

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Land and Property Tax: a Policy Guide is a companion for government officials and land and property professionals seeking to understand how to establish a viable and vibrant land-based taxation system. Using various examples, alternatives and illustrations around the World, the Guide provides a compelling case for generating local revenue through land and its improvements.

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