

Property Tax Reform in Punjab

Forum of Federations Conference, Islamabad

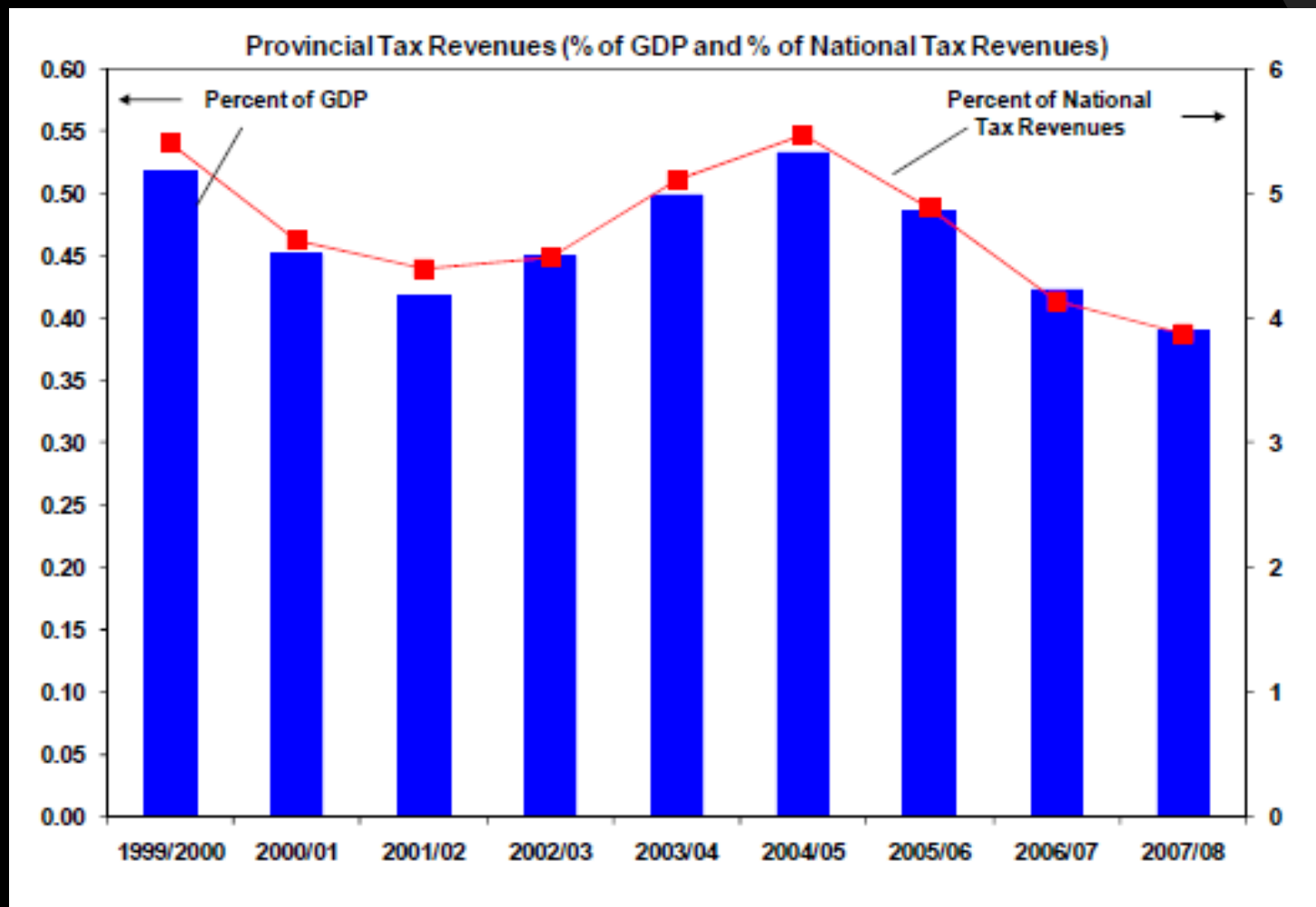
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Overall Provincial Revenue Effort is low

Provincial Tax Revenue Mobilization in Pakistan

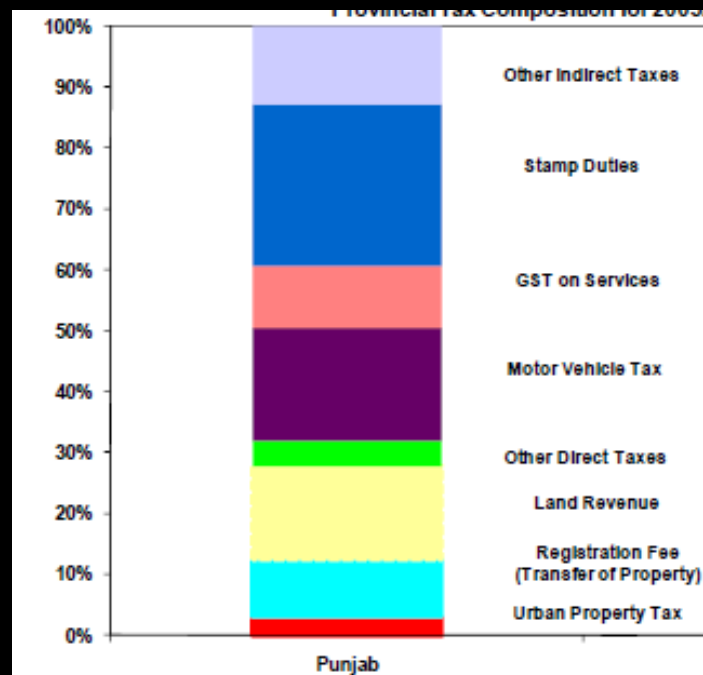


Provincial governments raise approx **0.4%** of GDP in tax revenues (4% of national tax collection)

Provincial governments spend about **16 times** as much as they collect in taxes

Property Tax – Important even as Provincial Tax effort is Poor

Provincial Tax Composition – Punjab



Years	Property Tax	Motor Tax	Professional Tax	Excise Duty	Cotton Fee	Hotel Tax
2003-04	2,051.16	2,410.95	197.433	692.252	345.948	131.641
2004-05	1,961.17	3,162.97	200.92	790.874	507.718	173.567
2005-06	2,188.00	4,025.76	232.833	888.68	430.495	234.749
2006-07	2,146.97	4,527.61	270.723	1,030.54	453.428	279.551
2007-08	2,467.42	4,260.33	298.449	1,214.20	380.851	275.209
2008-09	2,855.05	3,474.13	335.097	809.021	352.949	208.423
% of Target	47.5	53.3	90.6	61	63	71.7

Property Tax Should be doing better as seen in...

a) International Comparison of Property Tax Revenues: Select Countries

Country	Percent of GDP
Pakistan (Punjab)	0.026%
Chile	0.7
Ethiopia	0.5
Croatia	0.2
Indonesia	0.1
Slovak Republic	0.6
Sri Lanka	0.7
Thailand	0.3
Hungry	0.3
Poland	1.1
Argentina	0.9
Mexico	0.3
South Africa	0.7
Canada	4
USA	3%



**Property Tax
Collection in Pakistan
is 1/5th of
International Average
& Less than 10% of
TMA revenues in the
Punjab**

b) Potential in Pakistan

Revenue potential of tax reform :

Could boost provincial tax collection by **110%** (from Rs 41 billion to Rs 86 billion [2007-08]) (excluding gains from GST reform) → contributing to 11% of the overall revenue increase in Pakistan

With simple restructuring property Tax collection in Punjab → 3.3 billion in 2009-10 (unprecedented)

With major tax reform Property Tax revenue for Punjab can increase to **Rs 25 billion (13 % of Punjab's 2010 development budget; 26 percent of health and education budget)**

This has broader Economic Management Consequences

- ⦿ Non level playing field
- ⦿ (manufacturing contributes to 1/5th of the GDP but pays 2/3rd of the taxes)

	Contribution to (in percent):		
	GDP*	Growth*	Taxes
Agriculture	22	10	1
Industry	25	30	63
Services	53	60	26

- ⦿ Dutch disease
- ⦿ Stunting cities as engines of growth

Property Tax - In Principle a Good Local/Provincial Tax

- Revenue Potential and Stability
 - Value of land and property constitutes a broad base
 - Relative Stability of the tax base (unlike sales and income)
- Fairness and Equity
 - Benefit charge hence both efficient and fair
 - Property tax paid corresponds to the benefits received
 - Vertically equitable and progressive
- Tax Exporting is Less Likely
 - Much of the tax burden borne by residents
- Low compliance cost
 - Tax payer intervention is minimal – not self-assessed
 - Assessed by tax authorities
- No Tax Base competition
 - No significant problem of competition with central government
 - Not a tax base which the central government covets
- Land Use Efficiency
 - Significant improvements in the quality of land

Why is it good for Pakistan?

Unleashing the growth potential of cities :

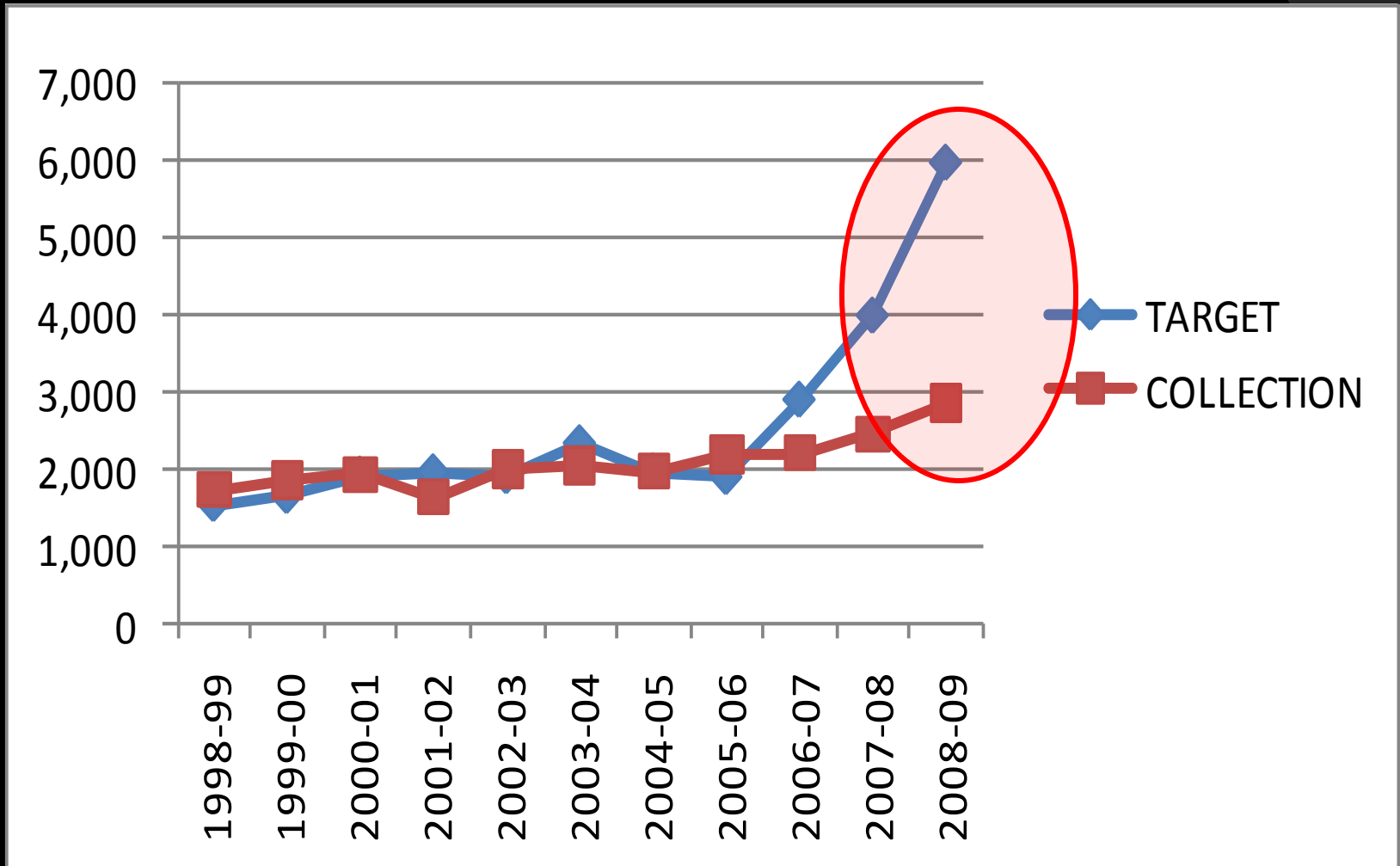
- ◎ Improving the quality of urban services
- ◎ Implementing zoning important for unleashing the development potential of cities. Can be seen as a tax on urban land and buildings and be used as an instrument of urban policy to promote the rational use of land to generate social benefits to the community at large.
- ◎ Developing capital markets to promote public private partnership in improving city infrastructure and other services

The Case of Punjab – Some Recent Improvement in Property Taxation

Revenue performance of UIPT as a percent of Total Revenues (all intergovernmental transfers)

	1999/0	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
Urban Property Tax	0.22	0.49	.03	0.87	0.80	1.05	1.66
All Taxes	13.88	14.95	11.67	12.48	15.69	14.33	13.21

Still Way off!Target and Collection of Property Tax in Punjab



Why has property taxation been ineffective?

◎ Tax Structure & Administration

1. Valuation
2. Exemption
3. Tax Rate
4. Coverage

◎ Legal Impediments

- Federal and Provincial (rental versus capital value systems)
- Conflict of laws - Provincial or local level tax

◎ Tax payers attitude

- Unwilling to pay the taxes → do not see any value in the services received from local governments

◎ Low Political Appetite:

- Politics has remained on the forefront for discouraging efforts to increase tax base and rates.
- Punjab government postponed the introduction of new property tax valuation roll, due in 2007, in part because of the upcoming elections

Valuation

● Problem

- Under PUIPT Act 1958 → assessment of all rented or owner-occupied properties on the basis of actual rent
- Unusual increase in rental market (from 2002 to 2007) but tax base static for both residential and commercial properties
- Average property in Punjab might be undervalued by 45%
- TMAs, entitled to carry out valuation, have neither capacity nor expertise
- Overall valuation system lacks buoyancy, has inherent inability to address peculiarities of properties and their rent-ability & unable to capture rise in capital value of property

Proposed Reforms

1. New valuation table must be enforced
2. The interval between successive surveys be reduced from 5 to 3 yrs
3. Accordingly amend the PUIPT Act, 1958
4. Annual indexation of tax demand with inflation to be determined by the government through notification for each successive year till 2015
5. Project underway in zones 5 of 5 CDGs by the E&T Deptt for piloting the outsourcing of valuation to a third party
 1. Compare valuation results of public sector and private sector
 2. Focus on zone 5 → posh area of the city → high yielding in terms of taxes

Coverage

Problem

- Cities have expanded over the years whereas the tax base has not → Failure to notify new rating areas and extension in existing rating areas
- According to a modest estimate, which is two years old, there are approximately 73 more rating areas in the Punjab.
- Approx 300k of 750k properties untaxed in Lahore alone.
- Proper assessment and collection with the help of GIS

Proposed Reforms

- ⦿ Proper categorization of localities to capture full market rents
- ⦿ Redefinition of rating area in PMIU Act in accordance with PLGO → to create 144 rating areas & make all properties in the Punjab subject to the UIPT
- ⦿ Arrange selected audit to ensure quality and accuracy of survey and categorization of localities.
- ⦿ Out sourcing may also be explored as done under valuation

Exemptions

Problem

1. Low revenue yield and low coverage → results in a reduced tax
2. Inefficient use of land (vacant not taxed)
3. Estimated revenue loss due → approx 1/3rd of the total collection
4. Major source of corruption due to discretionary use

Following properties exempted from paying the tax

1. Properties owned by federal, provincial and district government
2. 5-Marla residential houses (rented & owner occupied) irrespective of its location.
3. Building and land with ARV not exceeding Rs.48,600 owned by widow, disabled or minor orphan
4. Building and land used exclusively for educational purposes including schools, boarding houses and hostels owned by the government or a body owned or controlled by the government
5. Building and land or portion used exclusively for public worship and public charity.
6. A residential house measuring an area up to 1 kanal owned and occupied for residence by a retired government servant of the Federation or a Province.
7. Building occupied residence, the annual value of which does not exceed Rs.1620

Proposed Reforms

First Set: Rationalization of exemptions under Section 4 (c) of the UIPT Act

1. Exemptions to widows, disabled and minor orphans, be linked to reliable data
2. Valuation of owners of 5 *marla* residential houses
 - a) replaced by GARV (discrepancy)
 - b) exemption to be restricted to lower categories (D and below)
 - c) GARV based exemptions offered separately to commercial and residential properties
3. Private educational institutions assessed to be tax

Second set: Relief and incentives to tax payers

1. Annual value based tax rebate enhanced from between Rs 1200 and Rs 2400 to between Rs 1800 and Rs 3600 to avoid taxation on non-taxable modest residential and commercial assesses
2. Increase tax rebate from 5% to 10%
3. Extension in lump sum payment rebate from 2 months (July-Aug) each year to 3 months (July-Sept)
4. Restrict overall and individual tax liability up to a max of 100% increase against the existing tax liability (annual tax demand of Rs.5.6 billion)

Tax Rate

Objective:

Adjust tax rates to reduce differential between owner-occupied and rented properties

Problem:

1. Tax rate of 20% - 25% too high & creates incentive for tax evasion
2. Differential between owner-occupied and rented property unjustifiably high (1:10). It is much higher than in Karachi (1:2) and in Islamabad (1:1)

Proposal

First Set: Tax rates

Lower tax rate from 20% (+25% surcharge) to 10% to bring relief to tax payers

Second Set: Curtail differential

- ⊙ Reduce differential between tax rates of self-occupied and rented
- ⊙ Process → Conduct simulations
 1. permutations of differentials (1:7, 1:5 etc)
 2. Different tax rates (15%, 12% etc)
- ⊙ Implementation of reform in steps:
 1. 1:10 to 1:5 for residential properties over 3 years
 2. 1:5 to 1:3 for commercial properties over 3 years
 3. Eventually both to be brought at 1:2 and eliminate by 2016-17

Overall Revenue Impact

Rs in Million

Description	Residential			Commercial			G. Total
	Self	Rented	Total	Self	Rented	Total	
1.Existing Demand	98.91	472.13	571.04	343.87	1915.83	2259.70	2830.74
2.Demand with new valuation	247.27	1180.33	1427.60	1719.35	9579.15	11298.50	12726.10
3.Difference (2-1)	148.36	708.20	856.56	1375.48	7663.32	9038.80	9895.36
4.Demand with new valuation & reduced differential	1236.35	1180.33	2416.68	4298.36	9579.15	13877.52	16294.20
5.Difference (4-1)	1137.44	708.20	1845.64	3954.49	7663.32	11617.82	13463.46
6.New demand (4) with reduced tax rate	494.55	472.13	966.68	1719.35	3831.66	5551.01	6517.69
7.Difference (6-1)	395.64	0.00	395.64	1375.48	1915.83	3291.31	3686.95

Process

- ◎ Task force constituted by CM with a mandate to reform property taxation in the Punjab
- ◎ Between Dec 2009 and Feb 2010 – series of consultations (around 20)
- ◎ Deliberations on technical and political feasibility of reform
- ◎ Discuss threadbare political/technical implications

CM's Directions/Observations

- Sequencing of property tax reform over a period of time – Initially consider only categories A, B and C
- Identify and re-categorize non-affluent zones within posh localities
- Conduct simulations using different combinations and permutations of differentials (1:10 to 1:7 to 1:5) and different tax rates (15%, 12% etc)
- Plan be prepared to reduce the differentials up to an optimum level that should be based upon provisions of civic services to these areas.
- Keep in mind affordability of people to pay tax
- Put up signs depicting 'Your Tax Rupees at Work'
- Rs 296 million for capacity building of E&T deptt needs to be doubled
- Action against employees and others involved in corruption
- Reform process to be accompanied by a media strategy

Media Strategy

- Proposed strategy
 - relief to the underprivileged (reducing tax rates)
 - inline with international practices (reducing tax rates)
 - Implement reduction in differential on a yearly basis to lesson shock
- Mechanism
 - Drafting & releasing appropriate news items
 - Interactive discussions
 - Advertising campaign (informative and motivational)
- Managing the reaction
 - Using the following platforms
 - Chambers of commerce & industry
 - Trader community
 - Civil society

Result

- ◎ Left untouched in the Budget 2010-11
- ◎ WHY?
- ◎ Lack of political will and leadership
- ◎ Kerry Lugar Bill

Property Tax Project in Pakistan (International Growth Centre)

Objective

Testing the role of wages, incentives and audit on tax inspectors' behavior

Method

Randomized Control Treatment over 240 tax circles covering most of Punjab involving

- Pure wage increase
- Pure wage plus audit
- Output based incentive
- Output based incentive plus audit

Pilot project involving 11 tax circles currently underway

Apart from the main project evaluation:

- ◎ Tax Inspector Performance Measurement
 - Statistically & Objectively estimate tax personnel performance

- ◎ Data Guided Circle Redrawing
 - Rationalize tax circle boundaries using empirical analysis

- ◎ Capacity Building within E&T Department

- ◎ Data Compilation and Analysis
 - Quality and extent of data will improve
 - Data analysis will improve dramatically as a result

Why is Government interested in this project

- ◎ Currently provision or non-provision of bonuses/incentives in government is
 - invariable,
 - driven by image and perception of a department and
 - not guided by any scientific study or research
- ◎ Organizational reforms need to be brought in as part of a wider change-management strategy
- ◎ Need to change organizational culture from command and control to modern HRM practices based on motivation, career decisions reflecting performance and productivity
- ◎ Key challenge for policymakers and researchers → framing such projects so that these do not lead to de-motivation of staff who are left out of the project in the short run

A missed Opportunity

○ **NFC Award**

- Marks watershed - agreeing upon a set of multiple criteria that goes beyond population → reduce horizontal fiscal imbalance
- More than double the amount of annual resource transfer to the provinces → reduce vertical fiscal imbalance

○ **Eighteenth Amendment**

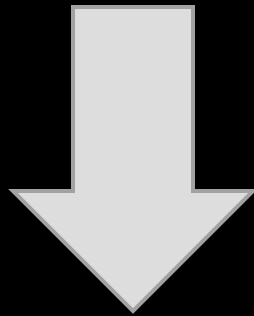
- More economic and political power to provinces
- Share of provinces in the divisible pool frozen in time and can only be increased
- Provinces have right to raise local and foreign loans
- Collect entire amount on excise duty on oil and gas
- Abolition of the concurrent List - 44 of the 47 items on the concurrent list would stand devolved

No hook up with incentives to improve own revenue mobilization

Redefined Federal-Provincial relations

- ⊙ **Enhanced Provincial Autonomy** enhanced by Delegation fiscal space to provinces, increased expenditure responsibilities & altered political and economic rights
- ⊙ **Reduced fiscal space at the center** due to Revenue loss at the centre → federal deficit in 2010-11 could go beyond the target level of 5% of the GDP
- ⊙ **Disincentive to raise taxes** → NFC Award- enhanced provincial shares, award not linked to revenue mobilization
- ⊙ **Provincial Capacity** → Serious financial and administrative implications

Increasing pressure on enhancing
resource mobilization at the provincial
level



Provincial level taxes
(Case of Property Tax)