Chapter-VI
Conclusion

6.1: Focus of the study

The Kerala Panchayat Raj Act 1994 passed in the wake of the Seventy-third Constitutional Amendment, while entrusting the GPs with enhanced functional and expenditure responsibilities, had not effected any change in their resource raising capability by assigning new sources. Therefore, it has become imperative for the GPs to play an active role in improving the productivity of the existing sources of revenue.

The most important single source of own revenue for the majority of GPs in Kerala is Property Tax. But, due to a variety of factors, only a small fraction of the Property Tax potential is being exploited by the GPs. The reasons behind under exploitation of this important source of revenue range from underassessment by the Panchayat staff to negligence on the part of the State Government during the 13 year period from 1994 to 2006 in issuing orders directing the general revision of Property Tax, along with the guidelines for the same. Given the potentiality of Property Tax as a source of revenue to the GPs, especially in the event of the building boom experienced in Kerala during the last two decades, any study aimed at suggesting measures for improving the own resources of the GPs should start with a study of the varied aspects related to the assessment and collection of Property Tax.

The present study is aimed mainly at examining the relative importance of Property Tax as a source of revenue to the GPs, the problems faced by these institutions while assessing the tax and the extent to which Property Tax potential is exploited by them, simultaneously suggesting norms that may be followed in Property Tax assessment in the future. The major findings of the study based both on the data collected from 12 GPs of Kannur District and on a field survey covering 500 houses in one of the GPs of the selected sample, may be summarized as follows:

6.2: Major findings

1. Houses contribute more by way of Property Tax than the non-houses (the share of houses in the total Property Tax receipts ranging from around 54 percent to 84 percent),
except in the case of one Special Grade GP with urban characteristics. The share of houses is relatively low (approximately 44 percent to 62 percent) for all the Special Grade GPs when compared with the share of houses in backward GPs (approximately 76 percent to 84 percent).

2. The average Property Tax on houses is found to be greater than the average Property Tax on all non-houses taken together in three-fourths of the backward GPs, though the First Grade GP Pinarayi also exhibits this feature. The converse is true for all the remaining GPs. Also, the lowest of the average tax on non-houses is found in the case of the aforesaid backward GPs together with Pinarayi GP.

3. Shops occupy the second position next only to houses as far as the relative contribution of each sub category of buildings in the total Property Tax receipts of the GPs is concerned (the share of shops in the total Property Tax receipts ranging from 10.94 percent to 30.85 percent), except in the case of Eranholi GP where the share of company buildings exceeds the share of shops.

4. The combined share of shops, company buildings and quarters together in the total Property Tax receipts is the highest in the case of Special Grade GPs, their share ranging from around 30 percent to 45 percent of the Property Tax receipts.

5. The share of quarters in the total Property Tax receipts is high, ranging from 9.88 percent to 19.86 percent, for the Special Grade GPs whereas the said share is less than 2 percent for the majority (that is, for seven GPs) and less than 1 percent for the four backward GPs.

6. The average Property Tax on quarters in every GP is greater than the average Property Tax on all other tax-imposed buildings taken together.

7. Given that most of the sheds and pump houses are tax-exempted and only small amounts are levied on the remaining, the share of each one of these sources in the total Property Tax receipts is less than one percent for every GP in the sample.

8. Large-scale Property Tax exemptions are given, both to houses and non-houses. Cases of Property Tax exemptions given are the highest in the three GPs with the highest proportion of backward (SC/ST) population in Kannur District, the proportion of tax-
exempted buildings ranging from around 35 percent to 44 percent of the total number of buildings. These three are followed by the only two Third Grade GPs in Kannur District. Tax exemptions given are the lowest for the two Special Grade GPs with urban proximity, with only around 5 percent of the buildings exempted from Property Tax.

9. When houses are taken in isolation, it is seen that more than a quarter of the houses in each one of the 3 GPs with the highest proportion of backward population (more than one-third of the houses in two of them) are tax exempted. These three are followed by the two Third Grade GPs, with the number of tax-exempted houses standing at slightly above 20 percent of the total number of houses in each. Instances of tax exemptions given are comparatively lower in all the Special Grade and First Grade GPs except Naduvil, the percentage of tax-exempted houses standing at 7.05 percent or less in 6 out of 7 such GPs.

10. The percentage of tax-exempted non-houses is greater than the percentage of tax-exempted houses in all the GPs except Kolayad, which has the highest proportion of SC/ST population in Kannur District (and therefore, as high as 36.48 percent of the houses exempted from Property Tax payment).

11. Majority of the buildings in backward GPs pay insignificant amounts as Property Tax. More than 70 percent of the buildings in each one of the two Third Grade GPs in the sample and 55 to 67 percent of the buildings in the 3 GPs with the highest proportion of SC/ST population, are either tax-exempted or are bound to pay less than Rs.25. In the context of the above 5 GPs, around 75 percent to 83 percent of the buildings belong to the tax class Rs.0 - Rs.50. However, for Special Grade GPs, the number of buildings in the lowest tax class Rs.0 - Rs.25 is relatively lower, standing at between around 29 percent and 36 percent and the proportion of buildings that belong to the class Rs.0 - Rs.50 is between around 39 percent to 50 percent.

12. Only a small fraction of the total number of buildings pays relatively larger amounts as Property Tax. The number of buildings that pay Rs.500 or more is just 1.15 percent or less of the total in the two Third Grade GPs and also in the three GPs with the highest percentage of backward population in Kannur District. In the Special Grade GPs, 6.18 percent or less of the buildings pay Rs. 500 or more. There is not a single GP in the sample where even one percent or more of the buildings pay Rs.1000 or more as Property Tax.
13. Turning to houses alone, it is seen that more than half of the houses in Pinarayi GP, in the two Third Grade GPs, and also in two (Kolayad and Naduvil) out of the three GPs with the highest percentage of SC/ST population, pay either 0 or an amount less than Rs.25 as Property Tax whereas for the other GP that belongs to the latter category, the number is slightly less at 48.95 percent. For all other GPs in the sample, the percentage of houses that belong to this lowest tax class is between around 29 and 36. The number of houses that pay more than Rs.500 is less than 5 percent of the total for all the GPs. The share of houses that pay Rs.1000 or more in the total Property Tax receipts on houses is 4.9 percent or less for any GP in the sample, and it is less than 2 percent in the case of 7 of them.

14. Majority of the buildings fall in lower tax classes; but the contribution of this majority amounts to only a small portion of the total Property Tax receipts. For example, about 55 percent to 71 percent of the buildings of the two Third Grade GPs and the three GPs with the highest proportion of backward population (falling in the tax class Rs.0 – Rs.25) contribute only around 5 percent to 18 percent of the total Property Tax receipts. In the case of all Special Grade GPs and most of the First Grade GPs, nearly one-thirds of the buildings (of the lowest tax class Rs.0 – Rs.25) contribute less than 5 percent of the total Property Tax receipts of each.

15. With respect to houses, around 27 percent to 74 percent of the houses (of the tax class Rs.0 – Rs.25) existing in the various GPs in the sample contribute only 3 percent to 17 percent of the total Property Tax receipts on houses; 39 percent to 84 percent of the houses (falling in the tax class Rs.0-Rs.50) generate only around 6 percent to 28 percent of the total house tax receipts.

16. The share of houses of the lowest tax class Rs.0 - Rs.25 in the total Property Tax receipts on houses exceeds the corresponding share of non-houses for all GPs except Malappattam. Conversely, for the higher tax class ‘greater than Rs.1000’, the share of non-houses in the total non-house tax receipts is greater for all GPs in the sample when compared with the corresponding share of houses.

17. A frequency distribution of Property Tax (ranging from Rs.0 to just below Rs.1000) prepared with 40 classes of equal class interval (interval of Rs. 25) reveals that the greatest concentration of buildings for all the GPs of the sample, irrespective of the level of
development attained by each, is in the lower classes. Thus, for all the GPs, the bottom 25 percent of the said 40 classes (that is, classes Rs.0 – Rs.25 to Rs.225 – Rs.250) includes 79.16 percent to 98.74 percent of all the buildings (94 percent to 99 percent of the buildings in the case of the four backward GPs and Naduvil GP). Conversely, the last 25 percent of the said 40 classes (that is, classes Rs.750 - Rs.775 to Rs.975 – Rs.1000) accounts for merely 0.03 percent to 1.52 percent of the buildings in the case of all the GPs in the sample.

18. A similar distribution prepared exclusively for houses reveals the highest concentration in the lowest Property Tax class Rs.0 – Rs.25, followed by the second class Rs.25 – Rs.50. It is seen that the bottom 25 percent of the classes include 80.71 percent to 98.62 percent of the houses whereas the top 25 percent of the classes have 0 percent to 1.09 percent of the total number of houses.

19. Likewise, 67 percent to 99 percent of the non-houses are concentrated in the lowest 25 percent of the aforesaid 40 Property Tax classes whereas only 0.05 percent to 2.97 percent of the non-houses are spread over the last 25 percent of the tax classes.

20. Though the concentration of buildings is the highest in the lowest tax class Rs.0-Rs.25 for all the GPs in the sample, the contribution made to total Property Tax receipts by the buildings of the said class is the highest only in the case of 3 GPs for which more than 67 percent of the buildings are concentrated in this class.

21. GPs are extremely reluctant to charge Property Tax at the maximum rate, which is permissible by law (that is, 10 percent of the ARV). As many as 7 out of the 12 GPs in the sample are sticking to the lowest rate of 6 percent, two GPs are assessing Property Tax at 7 percent whereas the rate followed by the remaining 3 GPs is 8 percent.

22. Estimation of the elasticity of Property Tax (in the sense of responsiveness of the tax receipts to a unit percent increase in the tax rate), assuming that the ARVs have been correctly estimated by the GPs, has given the following results: For the GPs presently charging Property Tax at the minimum rate of 6 percent, one percent hike in the rate will lead to 16.67 percent increase in the aggregate Property Tax receipts, for those charging the tax at the rate of 7 percent, an extra percent of tax charged will yield 14.29 percent more as Property Tax and for those charging 8 percent at present, raising the rate by one percent would mean an increase in Property Tax receipts by 12.5 percent. Moving to the maximum
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permissible rate of 10 percent rather than increasing the present rate charged by one percent would mean 66.67 percent increase in Property Tax receipts for those GPs now assessing tax at 6 percent, 42.86 percent increase in Property Tax receipts for those levying tax at 7 percent and 25 percent increase in Tax receipts for those charging tax at 8 percent. In absolute terms, the aforesaid changes in tax rates can bring out an increase in Property Tax receipts by amounts ranging from around a quarter of a lakh (for Malappattam GP) to more than 7 lakhs (for Elayavoor GP). The gain will be by more than 3 lakhs in the case of two-thirds of the GPs in the sample.

23. The mean of the taxes on all categories of buildings taken together is the highest for the two Special Grade GPs with urban proximity (Pallikkunnu and Elayavoor, with average Property Tax exceeding Rs.150) whereas it is very low for the Third Grade GPs (Malappattam GP and Thillenkeri GP, with average Property Tax of less than Rs. 50).

24. When houses are taken in isolation, the two Special Grade GPs with urban proximity and another one of the same category with urban features (Chirakkal GP) occupy the first three positions with average Property Tax on houses ranging from around Rs.110 to Rs.145. In the two Third Grade GPs and also in the other three characterized by the highest percentage of SC/ST population among the GPs of Kannur District, the average tax on houses is low, ranging from around Rs.36 to Rs.57.

25. It is also seen that the mean Property Tax on non-houses is greater than the mean tax on houses for all the GPs other than Kanichar GP, Kolayad GP, Malappattam GP and Pinarayi GP. Further, among the individual categories of buildings, the average tax on quarters is the highest, exceeding Rs.200, in 75 percent of the GPs, and exceeding Rs.300 in 50 percent of the GPs of the sample.

26. Building density per square kilometre in 1995-96 ranged from 95 (for Kanichar GP) to 826 (for Pallikkunnu GP). Density was the lowest for the 5 backward GPs (standing at 160 or less) whereas it was greater than 500 for all the Special Grade and two of the four First Grade GPs. In 2005-06, building density ranged from 114 (for Kanichar GP) to 1269 (for Pallikkunnu GP). The largest change in building density over the 10-year-period is seen in the case of the four Special Grade GPs – the number of buildings per square kilometre rising by 283 to 443. The increase in the context of the First Grade GPs is also high – ranging from...
133 to 205. In the case of all the 4 backward GPs of the sample and of Naduvil GP, the increase is negligible, ranging from only 19 to 51.

27. House density in 1995-96 was high, standing at around 400 or more in the case of Special Grade GPs as well as in two First Grade GPs whereas it was low, ranging from 60 to 123 for the two Third Grade GPs, two SC/ST-high GPs and also Naduvil GP (which, though a First Grade GP, occupies the third position in Kannur District with respect to the percentage of SC/ST population). As far as the change in density that has occurred in 2005-06 over what it was in 1995-96 is concerned, the largest increase ranging from 188 to 298 is found in the case of Special Grade GPs, whereas it has been negligible for the four backward GPs as well as for Naduvil GP, the increase in house density ranging from only 16 to 38.

28. Whether all the different categories of buildings are taken together or houses alone are taken in isolation, it is found that the annual average growth rate over the period 1995-96 to 2005-06 is the highest, standing at 4 percent or more, in the case of the four Special Grade GPs of the sample whereas the minimum growth rate in either case is found in Kanichar GP followed by the Third Grade GP, Thillenkeri. When the overall growth rate of buildings during the said period is computed, it is found that the number of buildings has grown by more than 50 percent in a matter of just 10 years in the case of two Special Grade GPs with urban proximity whereas the growth rate has been above 46 percent in the other two Special Grade GPs. Even for the two Third Grade GPs and also for the three GPs with the highest percentage of backward population among the GPs of Kannur District, growth rate is 20 percent or more, standing at above 30 percent in the case of two of them. Houses alone have grown by more than 50 percent in the two Special Grade GPs with urban proximity whereas the growth rate has been high at above 44 percent in the case of the other two Special Grade Panchayats.

29. The annual average growth in Property Tax receipts over the period 1995-96 to 2005-06 ranges from 7.29 percent to 14.2 percent. The rate of growth has been by around 10 percent or more in the case of 10 out of the 12 GPs. The overall growth rate of Property Tax receipts during the period has been by more than 100 percent for all the GPs in the sample, more than 150 percent for 8 GPs, greater than 200 percent for 3 GPs and greater than 250 percent for 2 of them.
30. Comparison of the annual average growth of buildings and that of Property Tax receipts shows that for all the GPs in the sample, Property Tax receipts have been increasing at a faster rate than the rate at which the buildings have been growing. Also, the growth of Property Tax receipts relative to the growth of the number of buildings is found to be higher for the backward GPs. Thus, the percentage increase in Property Tax receipts has been more than twice the percentage increase in the number of buildings for all the GPs in the sample, less than 3 times for all the Special Grade GPs, more than 3 times for the two Third Grade GPs as well as for those three with the highest percentage of SC/ST population, and around 5 times or more in the case of two of the latter five.

31. Coming to the overall growth rate, it is seen that the most impressive growth rate of Property Tax receipts in relation to the growth rate of the number of buildings have been exhibited by the relatively backward GPs, Kanichar and Thillenkeri (the overall growth rates of Property Tax receipts being respectively 7.75 times and 7.7 times greater than the overall growth rate of the number of buildings). The corresponding growth rate is less for the Special Grade GPs.

32. Log-quadratic models fitted to the data on the number of buildings reveal that their growth has been accelerating (as revealed by the positive parameter c, and p value of less than 0.05) in the case of 9 GPs in the sample during the 11-year period 1995-96 to 2005-06 whereas it has been neither accelerating nor decelerating in the case of the remaining 3 GPs (since for the latter three, p is greater than 0.05 even though c is positive). A Similar function fitted to the data on the Property Tax demand, on the other hand, shows that its growth has been accelerating only in the case of two GPs – Pallikkunnu GP and Thillenkeri GP (with positive c value and a p value of less than 0.05), decelerating in the case of 2 GPs and neither accelerating nor decelerating in the context of 8 GPs. The growth of houses has been accelerating in the case of 6 GPs, decelerating with respect to one GP and neither accelerating nor decelerating in the context of 5. On the other hand, house tax demand has been accelerating only in the case of two GPs (Pallikkunnu GP and Thillenkeri GP), decelerating in 3 GPs and neither accelerating nor decelerating in the case of 7.

33. An examination of the rise in the average Property Tax on buildings constructed during the period 1995-96 to 2005-06 over the average tax on those constructed prior to the
said period shows that the increase has been by around 4 times to more than 7 times in the case of the Third Grade GPs as well as the three GPs with high percentage of backward population, whereas the increase has been by less than 3 times for all First Grade and Special Grade GPs, except Pinarayi and Elayavoor.

36. Property Tax alone constitutes 50 percent or more of the total own tax receipts of 75 percent of the GPs in the sample, whereas in the other 25 percent of the GPs, its share is less than 50 percent, only because the latter receive large amounts in the form of Profession Tax, Entertainment Tax, and Show Tax. With the exemption of Pallikkunnun GP, Property Tax and Profession Tax together form more than 90 percent of the total own tax receipts of all other GPs. Property Tax alone forms around 30 percent or more of the total own tax and own non-tax receipts taken together in as many as 11 GPs, around 40 percent or more in 8 GPs and above 50 percent in the case of three of them.

37. Even though Property Tax forms the most important single source of own revenue for the majority of the GPs in the sample, its share in the overall receipts of any GP is negligible. The receipts from this source form less than 13 percent of the total receipts (including own taxes, own non-taxes and all grants, both from the Centre as well as from the State, but excluding receipts under ‘debt heads’ and pensions) of all the GPs, less than 10 percent for 8 GPs and less than 3 percent for 5 of them. If Central Government Grants and State Government Grants received in respect of the institutions transferred to the GPs after the 1994 Act are excluded apart from debt heads and pensions, Property Tax receipts form less than 14 percent of the total receipts of all the 12 GPs, and less than 5 percent for 5 of them.

38. The study based on a sample of 500 houses drawn from Pinarayi GP (hereafter referred to as ‘sample survey’) reveals that the actual Property Tax receipts of the Panchayat is only a small fraction of the potential receipts if tax is assessed properly on the basis of the annual rental value (ARV) estimated from the cost of construction. The actual Property Tax receipts on all the 500 houses of the sample during 2005-06 is only 11.91 percent of the potential receipts if assessed at the minimum rate of 6 percent of the net ARV estimated on the basis of cost of construction, and only 7.15 percent of the potential receipts at the maximum permissible rate of 10 percent of ARV. To put it in a different way, the actual tax
receipts on houses would have increased by 739.4 percent (at 6 percent of the net ARV) and by 1298.9 percent (at 10 percent of the net ARV) if tax were assessed as per the cost-based method, giving due weight to the plinth area and the quality of construction.

39. Paired t-tests applied (i) to test the significance of the difference between the potential Property Tax receipts estimated on the basis of the costs of construction and the actual tax receipts in respect of the 500 houses of Pinarayi GP and (ii) to test the significance of the difference between the potential Property Tax receipts estimated on the basis of the net expected annual rental values and the actual Property Tax receipts, reveal that the aforesaid difference is highly significant.

40. When estimated on the basis of the cost of construction, the highest level of underassessment is found in the case of houses with tiled main roof, for which the actual receipts in 2005-06 are 3.9 percent and 2.34 percent of the potential receipts at 6 percent and 10 percent of the net ARV respectively. With proper assessment, the GP’s revenue from this category of houses could have increased by 2467.1 percent even if the minimum rate of 6 percent of the net ARV is applied. Tax assessment in the case of houses with RCC main roof is comparatively satisfactory, with the realized Property Tax receipts forming 15.71 percent of the potential tax receipts at 6 percent of the net ARV, and 9.43 percent of the potential receipts at 10 percent of the net ARV. For houses in the case of which no portion of the wall is in sun-dried mud bricks, the actual Property Tax collection in 2005-06 is 13.16 percent of the potential tax collection at 6 percent of the net ARV, and 7.9 percent of potential collection at 10 percent of the net ARV.

41. Actual Property Tax receipts as percentage of potential tax receipts estimated on the basis of the cost of construction are found to be improving through years. Thus, for houses with RCC roof, the said percentage (at 6 percent of the ARV) has increased from 11.79 for those built before 1987, to 12.79 percent for those erected from 1987 to 1996, and further to 16.96 percent for houses built from 1997 to 2006. When all the 500 houses are taken together, actual tax receipts relative to potential receipts (at 6 percent of ARV) which is less than 7 percent for the houses built before 1951 and even less than 6 percent for those built from 1951 to 1975, rose to 10.02 percent for houses constructed from 1976 to 2000, and further to 16.82 percent for those constructed from 2001 to 2006. Similar improvement in tax
realization is found when houses with no portion of the wall in sun-dried mud bricks are taken into account.

42. A similar analysis bringing out the difference between actual and potential Property Tax receipts (estimated on the basis of the cost of construction) separately for each year of the period 1975 to 2006 in respect of the 339 houses of the sample for which no portion of the wall is in sun-dried mud bricks (and therefore, only the officially recognized PWD rates could be applied in assessing cost and tax) revealed that actual receipts as percent of the potential at 6 percent of ARV, which remained very low for houses erected during most of the individual years of the first 20-year period, maintained the higher level of between 12 percent and 16 percent during the next 10 years and further increased to around 20 percent for houses built during years 2004-05 and 2005-06.

43. Potential tax receipts on the sample of 500 houses judged on the basis of the expected annual rental values in comparison with the taxes actually levied by the GP on them have led us to the following conclusion: Actual Property Tax receipts on all the 500 houses of the sample are only 17.98 percent of the potential receipts. When estimated separately for houses of different types of construction, it is found that tax realization as percent of the potential is the highest for houses with RCC main roof (23.62 percent) and the lowest for the houses with tiled main roof (5.67 percent). Again, it is seen that tax realization has been improving over the years. Thus, it increased from 6.44 percent of the potential in respect of houses built before 1951 to 15.14 percent for those built from 1976 to 2000, and further to 27.56 percent for those completed since 2001. The same trend is seen in the case of houses with RCC main roof – tax realization as percentage of the potential rising from 15.11 percent for houses erected before 1987, to 17.33 percent for the houses built from 1987 to 1996 and again to 26.84 percent for those constructed from 1997 to 2006. Exactly similar trend is observed in respect of houses for which no portion of the wall is made up of sun-dried mud bricks.

44. When estimated in terms of the expected ARV, the actual tax realization is found to be less than 10 percent of the possible receipts (at the rate of 6 percent of the net expected ARV) for houses constructed in as many as 9 years of the twenty-year period 1975 to 1994; between 10 percent and 15 percent for houses built during 8 years; and between 15 percent
and 20 percent for those constructed during 3 years of the period. Actual collection as percentage of the potential of collection maintained a higher level of 15 percent to 24.84 percent for buildings erected in each year of the next 10-year period (1995 to 2004) and further increased to reach between 30 percent and 35 percent for houses built in 2005 and 2006.

45. There is high degree of positive correlation (measuring 0.8018) between the estimated cost of construction of the 500 houses and the taxes levied on them in 2005-06. Further, correlation between the expected annual rental value (estimated at the time of the field survey) and the Property Tax levied by the GP on all these 500 houses is also positive and high, the correlation coefficient measuring 0.8059. That means though there is still, as we have already seen, gross underassessment at the prevailing rate structure in fixing Property Tax, the tax fixed on the average rises nearly in proportion to both the increase in the cost of erection as well as the expected annual rental value.

46. The buoyancy coefficient estimated by taking all the 500 houses of the sample constructed from 1877 to 2006 is 1.33. Though the tax efforts judged in terms of buoyancy coefficient in the context of all the houses in the sample appear to be good (the value of the coefficient standing well above one percent), it is seen that this is not because of good tax performance, but due to much better tax performance in the case of buildings constructed from 1976 onwards relative to the tax performance in the context of those built prior to 1976.

47. Seven out of the sample of 500 houses chosen are exempted from the payment of Property Tax. But, it is seen that 5 out of these 7 houses do not deserve tax exemption, judged in terms of any of the criteria prevalent at the time of the survey.

48. The extent of the problem of underassessment (judged in terms of the potential of tax estimated on the basis of cost of construction) would be all the more clear from the fact that actual tax imposed on the majority (52.4 percent) of the houses is less than Rs.50, whereas proper assessment at the minimum rate of 6 percent of the net ARV would mean that only 0.4 percent of the sample of houses could come under this tax class. Further, 60.4 percent of the houses pay less than Rs.100 whereas only 1.8 percent of the houses deserve to be included in this class. Whereas 72.2 percent of the houses should have paid a tax exceeding Rs.500, such amounts are levied only on 3.0 percent of the houses. Further, no
owner of the houses in the sample of 500 pays Rs.1250 or more as house tax whereas the
cost-based method suggests that 24 percent of the house owners should have paid the said
amount or more.

49. Judged in terms of the potential of tax estimated on the basis of the expected ARV
of houses, it is seen that whereas the GP has imposed, during 2005-06, Property Tax of less
than Rs. 50 on 52.4 percent of the houses in the sample, only 0.6 percent of the houses could
be included in this tax category if assessed at the rate of 6 percent of the net expected ARV.
While 60.4 percent of the houses actually pay less than Rs.100, only 1.8 percent of the
houses deserve to be included in this class. Whereas 54.6 percent of the houses should have
paid a tax exceeding Rs.500, such amounts are imposed only on 3.0 percent of the houses.
While Property Tax of Rs. 1250 or more is not imposed on any house included in the
sample, our assessment shows that owners of 10 percent of the houses ought to have paid the
said amount or more, even if tax is assessed at the minimum rate of 6 percent.

50. The relatively higher level of underassessment found in the case of houses with
tiled main roof is mainly due to the fact that the majority of the houses of this category are
older than concrete houses and taxes on them were assessed years back when a good number
of them, as admitted by the owners themselves, were having thatched roof and mud walls.
The subsequent modifications, alterations, extensions and even reconstructions, in many
cases, remained unreported and undetected, with the result that the owners of such houses
continue to pay meagre amounts as Property Tax.

51. The concept of reasonably expected rental value used for Property Tax assessment
was vague in the sense that the Government did not frame definite norms for the fixation of
the same. Thus, the Panchayat staff could use their discretion in fixing rental value and hence
Property Tax. The method of assessment, therefore, gave ample scope for favouritism,
corruption, bribery and consequent underassessment.

52. The Panchayat staff had expressed the view that even if reasonably expected rental
value could be correctly assessed, the tax fixed on its basis would be ‘too high’. Therefore,
Panchayat staff always used the element of vagueness in the definition of reasonable rental
value and fixed the tax, on the basis of their own discretion, at a much lower level than what
it otherwise should have been.
53. Discussions with the GP staff have given the impression that they are afraid of public protest in the event of imposition of high Property Taxes on the basis of estimated actual costs of construction. Therefore, given the freedom to fix Property Tax on the basis of expected rental value, they fix it at any level as they like since no objective norms need be followed in fixing expected rental value.

54. From the last two points, it follows that strict compliance to the Property Tax assessment method based on the cost of construction would lead to the imposition of very high tax on houses, provided that both the rate at which rental value is estimated from the cost of construction as well as the rate at which Property Tax is estimated from the rental value, are not scaled down.

55. The fact that five-yearly general revisions of Property Tax have not been effected in the majority of the GPs in Kerala during the last 14 years, gave the owners of several houses the opportunity to pay only small fractions of what they ought to have paid to the GPs by way of Property Tax.

56. It is admitted by several Panchayat Secretaries that the field staff are not interested in locating and reporting cases of extensions, alterations and even reconstructions of buildings. They are more interested in getting the monetary incentive in the event of 100 percent collection of Property Tax, and this is easier when only smaller amounts are imposed as tax.

57. Property Tax assessment registers maintained in most of the GPs are found to be incomplete in the sense that all relevant details pertaining to the nature of the buildings are not recorded therein. Therefore, it is difficult to find out the nature and extent of subsequent modifications and revise the Property Tax accordingly.

58. Some Panchayat staff have admitted that the provision of huge amounts of Government grants to the GPs has turned out to be a disincentive to efficient mobilization of Property Tax.

59. The problem of staff shortage experienced by the GPs even after redeployment of staff from other Departments makes it difficult to arrange frequent field visits with a view to finding out whether any extension or modification work is being done on the buildings.
60. Whereas the Kerala Panchayats (Building Tax) Rules 1963 suggests that 6 percent of the estimated present cost of construction of buildings may be taken as the ARV, the present study reveals that the rent that can actually be earned is less than this – only approximately 4.25 percent, 4.00 percent and 3.75 percent respectively for houses on the main road side, subsidiary road side and on the side of narrow paths.

61. Tax receipts on the sample of 500 houses, if estimated on the basis of the new set of guidelines embodied in the 2007 Government Order, will rise by just 31.99 percent over the receipts on these houses during 2005-06, if the increase in tax owing to tax revision on any house should not exceed 60 percent as stipulated in the Government Order. The rise will be a negligible 27.54 percent if the increase is to be restricted to 50 percent or less. To be noted is that this insignificant rise is after a long interval since the last revision and over the existing highly underassessed amounts of Property Tax. If no such ceiling to tax hike is fixed and every one is made to pay the tax estimated on the basis of the new norms fixed by the Government, the receipts on the sample of 500 houses will rise by 139.86 percent over the receipts on them in 2005-06.

62. The two alternative (conventional) methods of Property Tax fixation claimed to have been employed by the GPs up to 31-3-06, will lead to tax receipts that widely differ from each other. In the case of the 500 houses of the sample, the cost-based method will yield Property Tax receipts which is higher by 50.95 percent over what the expected rental value-based method will bring to the GP.

63. The possible tax yield after the implementation of the guidelines contained in the 2007 Government Order will be very much less than what it would have been if the earlier guidelines were strictly followed. Thus, the possible receipts after limiting the tax rise to 50 percent will only be 15.19 percent of the tax yield under cost-based method and 22.93 percent of the yield under expected ARV method.

64. In the case of newly built houses (those built after 2001), those with RCC roof and those with no portion of the wall in sun-dried bricks, the Property Tax revised on the basis of the 2007 Government Order ignoring the provision therein for the fixation of an upper ceiling to tax hike, would yield much less than what the method suggested in the present study would bring to the GP. On the other hand, in the case of very old buildings, the tax that may
be fixed on the basis of the new Government guidelines will be much larger than the tax payable in terms of the guidelines advanced in the present study (larger by around 22 percent, 44 percent and 75 percent respectively in the case of house constructed before 1985, before 1975 and before 1960). The main reason for the above is that the rate of depreciation suggested as per the 2007 Order remains stagnant for all buildings with an age of 25 years or more. Further, higher rates of depreciation are not allowed on buildings with inferior quality of construction (such as, those with thatched roof and wall in mud) than what is allowed on buildings with concrete roof and laterite wall.

65. If the new Government guidelines are followed ignoring the provision for an upper limit to tax rise, owners of houses built before 1975 will face a substantial rise in Property Tax payable – a rise by 809.42 percent of the tax that they were paying in 2005-06. However, the tax payable on concrete houses will rise by a mere 59.4 percent and the tax on houses built since 2001 will rise by just 36.52 percent if tax is revised following the new Government guidelines.

66. The new Government guidelines contain some other pitfalls such as Property Tax exemption given irrespective of the nature of roof and walls (whereas in terms of the earlier norms, only buildings with mud walls or roofs thatched with leaves or light weight sheets, deserve tax exemption), jumps in the rates of discount on tax payable on the basis of the age of the building, etc.

6.3: Suggestions

1. Property Tax should be fixed on the basis of a set of transparent norms so that there is no scope, at any stage, for the exercise of discretion by the tax assessing officers. The norms should be so clear that any taxpayer could correctly assess his tax liability. Therefore, a shift in the tax base from reasonably expected rental value to rental value estimated on the basis of the cost of construction of the building, together with a clear set of guidelines for the estimation of cost, is necessary. Once cost is taken into account, the type and quality of construction as well as the plinth area are automatically incorporated into Property Tax determination. An added advantage in considering cost is that the Property Tax based on it will satisfy the principle of ability to pay because only those with higher levels of income can construct costly houses.
2. For estimating the total cost for the purpose of Property Tax fixation, the cost per square metre of plinth area of buildings with different types and qualities of construction announced from time to time by the Kerala PWD can be made use of.

3. Cost of construction of each and every part of the building should get reflected in the tax payable. In this respect, the drawback of the 2007 Government Order is that as per the Order, if a building had RCC roof corresponding to slightly less than 50 percent of the plinth area, the rebate of 10 percent applicable to buildings with tiled roof is to be given to the whole building. Likewise, the Order clarifies that if slightly less than 50 percent of flooring is with costly materials such as marble or marbonite, the entire flooring is to be treated as plain concrete cement flooring.

4. If it is felt desirable that weights are to be given to factors other than cost, the weights should be as percentage of the Property Tax determined purely on the basis of cost. Therefore, all the direct determinants of cost such as plinth area, nature of roof, nature of wall, type of flooring, etc. should be the variables considered at first in Property Tax fixation. But, as per the 2007 Government Order, before considering all the aforesaid determinants, the basic tax arrived at on the basis of plinth area alone (which is just one among the determinants of cost) is to be first adjusted in terms of variables that do not have a direct bearing on the cost, such as the zone in which the building is situated and the type of road from which entry can be made to the building premises.

5. While assessing cost, it is to be assumed that all the building materials can be vehicle-transported up to the plot on which the building is constructed. This is so because if the costs of head load conveyance are also taken into account, it may happen that a small house constructed on the side of a narrow footpath will have higher cost and therefore, higher tax liability, than a larger house constructed on the main roadside.

6. The cost of construction of wells should not be clubbed with the cost of the main building, given that deeper wells may have higher costs of construction. To be noted is that it is not the depth, but the existence of wells that adds to the annual rental value (ARV). Therefore, a given amount, irrespective of the depth of the wells, should be added to the ARV arrived at on the basis of the cost of construction in the case of all the houses to which a well is attached.
7. Appropriate rates of depreciation should be allowed on the estimated present cost of construction. The amount deducted as depreciation should increase simultaneously with the age of the building and should not remain stagnant after a fixed number of years. (Note that as per the 2007 Government Order, rate of discount on the tax payable allowed on the basis of age, for example, is the same for a building with an age of 26 years and another with an age of 100 years). On the same grounds, there is no justification for jumps in the rates of discount as suggested in the 2007 Government Order. The rate of discount should be increased gradually in line with the age of the building.

8. The above, however, suggests that the Property Tax liability on a building should be changed annually in accordance with its age. This would mean additional work burden to the GP staff who will have to revise the Property Tax assessment registers annually. To avoid this problem, the age of the building at the time of a tax revision should be taken into account for determining the rate of depreciation to be allowed and the Property Tax so fixed may be charged until the next revision.

9. Higher rates of depreciation should be allowed on buildings with inferior quality of construction (such as those with mud walls, thatched roof, etc.) than what is allowed to buildings with RCC roof and laterite/brick walls.

10. If tax rebates are to be given strictly in accordance with the age of the building, there should be an additional column in the Property Tax assessment registers wherein the year of construction/modification of the building can be recorded.

11. Strict compliance to the rate at which the annual rental value of a building shall be determined as per the Kerala Panchayats (Property Tax) Rules 1963 (that is, 6 percent of the total estimated value of the appurtenant land and estimated present cost of erecting the building, after deducting a reasonable amount for depreciation), and the rate of Property Tax as per the provision of Section 203 of the Kerala Panchayat Raj Act, 1994 (that is, a given percentage of the net annual rental value of the building subject to a maximum of 10 percent and a minimum of 6 percent), will lead to the imposition of very high taxes on buildings. Hence, both the aforesaid rates should be brought down.

12. Once the cost of construction of a building is worked out, the annual rental value may be derived by applying at least three different rates to the estimated cost adjusted for
depreciation – a higher rate for buildings on the main roadside, a medium rate for buildings on subsidiary road side and a lower rate for those on the side of all other types of narrow roads and paths. The survey data have suggested that these rates should respectively be 4.25 percent, 4.00 percent and 3.75 percent. Division of Panchayat area into different zones (on the basis of the level of development attained) for the purpose of Property Tax fixation is not practical because it will always be impossible to demarcate the boundary between two zones in a manner that is free of complaints. Further, no uniform criteria could be followed for the purpose of including a building in, or excluding it from, a given zone.

13. The rate of Property Tax suggested in the present study is 3 percent of the net annual rental value. However, in the event of cost escalations, even this rate may turn out to be exorbitant and, hence, may be scaled down at the time of subsequent revision of Property Tax.

14. In the case of houses given on rent, Property Tax shall be levied at the prescribed rate by considering net rent (that is, the rent actually received after excluding electricity, water and telephone charges, if any, to be paid by the owner himself and also deducting 10 percent of the sum so derived towards maintenance allowance) and adding 25 percent of the net rent to itself. The extra amount of property tax resulting from the addition of 25 percent of the net rent can be justified on the ground that unlike the owners of self-occupied houses, the owners of rented houses are earning an income on the same. The advantage in considering the actual rent received is that this will ensure greater revenue to the GPs in proportion to the increased rent obtainable on houses on the basis of locational advantage.

15. The provision of Act 13 of 1999, that the land appurtenant to every building should be considered while fixing Property Tax, may be abandoned. This is necessary because otherwise, the additional problem of valuation of land will arise together with the difficult task of evolving norms for taxation of buildings. From the revenue point of view, even without taxing appurtenant land, the GPs can earn more revenue in the event of rise in the price of land if the Government makes the system of land tax progressive, charging the latter in proportion to the land value prevailing in different places. Since the Basic Tax on land forms part of the General Purpose Grant being given to the GPs, any increase in the Basic Tax receipts will mean more receipts to the GPs.
16. It follows from the above that the term Property Tax may be abandoned and the term building tax should be restored.

17. While revising Property Tax, every building owner should be made liable to pay any amount estimated on the basis of the set of rules prescribed for the purpose. Fixing of ceiling or upper limit to the amount by which tax liability should increase would benefit the most only those who have escaped upward revisions so far in spite of large scale modifications, alterations or even reconstruction of buildings.

18. It very often happens that the owner of a building being constructed approaches the GP authorities once the skeleton of the building is completed and applies for a door number, which is inevitable for getting electricity and water connections. Assessment of such partially constructed buildings will lead to underassessment. It is, therefore, desirable that a provisional number be given to incomplete buildings so that the owner can get electricity and water connections, which will be very much useful in carrying out the remaining work. The final door number should be given to buildings that are fully completed in line with the plans submitted to the GP as part of the provisions of the building rules extended to all the GPs in Kerala from 2007 onwards. If the building owner reports that for one reason or the other, it is not possible for him to complete the work as per the plan submitted earlier, an undertaking to the effect that any work proposed to be carried out on the building in the future will be reported to the GP in advance, should be obtained from him before giving the final door number.

19. While giving final door numbers, details such as total plinth area, number of rooms, nature of the floor, nature of the roof, etc. should be clearly recorded in the Property Tax assessment registers. At the time of the next revision (preferably in 5 years), the buildings should be reexamined and in the event of alterations or extensions, Property Tax should be completely reassessed.

20. The Government may also think in terms of introducing a transparent system of self-assessment of Property Tax, with a penal provision to collect tax at several times the normal rate in the event of detection of underassessment.

21. When Property Tax is assessed by the owner himself, there should be some mechanism to check houses and ensure that there is no underassessment. The checking of the
houses may be entrusted to the officers outside the GP. This is desirable because as the GP constitutes the Government unit at the village level, the staff therein are in frequent contact with most of the local people. Therefore, there is the possibility that in many cases, underassessment will remain unreported.

22. Depletion of traditional energy sources being a huge problem now faced the world over, the use of alternative eco-friendly sources of energy as well as energy saving mechanisms may be encouraged. Therefore, those buildings that have installed solar power systems or biogas plants, those with minimum connected load or with energy-efficient lighting system of the Bureau of Energy Efficiency (BEE) certification may be given tax incentives on the basis of specific norms evolved for the purpose. The buildings with efficient waste treatment systems may also be given tax concessions.

23. Property Tax may be used as a powerful instrument to bring down the craze for the construction of huge and palatial buildings. This can be achieved by imposing heavy extra tax, preferably in the form of a surcharge, on houses, non-commercial complexes, etc., on which amounts exceeding specified limits are invested. The expenditure limit above which surcharge is payable has to be refixed at the time of every general revision of Property Tax.

Experiences during the past three decades in Kerala demonstrate that Property Tax is the most productive and quite elastic source of local government revenue. The local bodies especially GPs should be prepared to realize its full potential. It is up to the Government to formulate transparent and workable norms for the fixation of Property Tax, giving due consideration to the ability to pay of the taxpayers. It is quite disappointing that the long-awaited Order issued by the Government in 2007 for the revision of Property Tax had so many pitfalls, which had to be rectified. No doubt, the fiscal strength of the GPs would improve through fiscal transfers recommended by the SFCs. But, this is not enough. These institutions of grassroots democracy should achieve strong fiscal base mainly through internal resource mobilization, especially through exploiting the full potential of Property Tax, rather than by depending largely on fiscal transfers.