ANALYTICAL FRAMEWORK AND BASIC ISSUES

INTRODUCTION

Property taxes and their role in local government finance has recently within a number of countries been subject to wide debate. The pros and cons of the property tax over its nearest competitors, local income tax, sales tax, poll tax are all well versed. Whether a particular country uses a tax based on property depends upon a number of factors, many of which will be unique to that country, therefore to implement one country's property tax in another could prove to be disastrous. Having said that the role and importance of the property tax is increasing in many developed and under developed countries. There is evidence to show that property tax systems are being refined or re-introduced, since the alternatives have not been as successful as initially thought. The term property tax can have a wide definition and can be taken to include all elements of property taxation incorporating, capital gains tax, development land tax, stamp duty, and other property sales taxes. However the theme of this work focuses attention on one aspect, namely, the taxation of property to raise finance to fund local authority expenditure for the provision of local services. Local property tax in many countries is usually the single most important source of revenue for local authorities. It gives an
element of autonomy and to some extent financial independence from
central government. The potential revenue can be substantial, and if the
relationship between taxpayers and exempt property is carefully man-
aged the system can have positive and significant allocative and distribu-
tive effects.

The property tax is the single most important local government tax
in developing countries. It is, however, not necessarily the best revenue
raising instrument for a city because it is very difficult to administer
efficiently, can have undesirable land use effects, and is very unpopular
with taxpayers. Yet local governments often have few other sources of
revenue, and important strides have been made toward improving the
fairness and revenue productivity of property taxation.

This study is essentially a fiscal exercise in economic growth. It is
concerned with an analysis—both theoretical as well as applied, of the role
of property taxation as an effective instrument of economic growth in a
developing economy with special reference to India. Property here in-
cludes urban real estate taxed by the urban local units of government. In
this connection it is important to point out that since we have followed
English practice, local units in India have confined themselves to the
taxation of immovable property alone. Taxation of immovable property
consisting of land and buildings not only forms the chief source of
revenue in the budget of the local bodies in India but also in UK, USA, South Africa and in many other developed and under-developed countries of the world.

If the foundations of responsible and democratic urban local government are to be strengthened, it is necessary that these problems of urban local bodies must be tackled quickly by raising the standard of education and by providing the urgent utility services to the urban dwellers. The important thing at present is consequently, to ensure that the urban local bodies are able to play an effective role in the economic development of a developing country like India.

The Property tax occupies the central place in the system of local taxation and the whole system of local finance has to be developed on the assumption that this tax will continue to be the principal source of revenue. The property tax must be the most unevenly administered and most maligned of all taxes but is also the most durable. It has financed the major part of municipal expenditures since the municipal councils were first established in Bombay, Calcutta and Madras in the early part of the eighteenth century. But the unfortunate thing is that the potentials of this tax have not been fully utilised because the existing system of valuation and assessment of property is extremely unsatisfactory and at the same time enforcement of collections has been thoroughly neglected. It is
being realised now that undervaluation of land and building and poor collection of taxes have put many of the municipalities into financial trouble. In general, it is levied more as a source of revenue than as an instrument for regulating land use. It is not then surprising that there is an increasing level of concern expressed about its efficacy as a revenue measure since there has been increasing evidence over recent years that the property tax has not been a very buoyant source of revenue.

It is strongly believed that vast amount of potential resources can be generated if structural and administrative changes are brought about with regard to this tax. The rich potentialities of the urban property tax are clearly revealed by the fact that Mrs. India Gandhi, while presenting the budget proposals for 1970-71 had included urban housing for fresh taxation. In the developing countries the process of economic development tends to be accompanied by an investment boom in housing in urban areas.

An accelerated process of economic development tends to promote urbanisation leading to large profits being earned from investment in housing. Investment in real estates also serves as a hedge against inflation and in those underdeveloped countries where economic development is associated with mounting inflationary pressures, a sizable volume of resources tends to flow into investment in housing especially luxury housing.
As a matter of fact, an uninterrupted flow of resources into real estate would not be conducive to the promotion of a high rate of economic growth in these countries. In the initial stages of development of an underdeveloped country, there is an extreme scarcity of resources and as a result these resources must flow into sectors with maximum growth potentials. Investment in housing is not as productive as investment in the formation of plant and equipment and other forms of physical capital. Besides, such investment in housing tends to generate a large multiplier effect as compared to its sigma effect. Consequently, it generates inflationary tendency in the economy. In view of these facts a stiff taxation of property in urban areas is urgently needed in the interest of promoting the flow of resources into high priority developmental sectors of the economy.

Policymakers rarely consider reform of the entire property tax system, that is, rate and base structure, valuation principles, and administration. As a result, reform measures, sometimes have offsetting effects or unintended side effects and do not lead to the expected increase in revenue. Second, governments have adopted a wide array of property tax practices, and there seems little by way of a pattern to help us understand the determinants of this variation. Third, policymakers tend to overload the property tax with policy objectives-for example to effect the distri-
bution of land use to change the distribution of income or to reward homeownership. Not only does the property tax fail to meet such objectives, but the overload compromises its more basic mission: to raise revenue. Fourth, it is more the quality of administration than the structural form chosen that determines the success of the property tax. Fifth, while the property tax is often a source of revenue for local government, it is almost always controlled to some extent by the state government.

The importance of the property tax as a source of financing is often overlooked because fiscal analysis usually focuses on central government finances, and in that context the property tax is truly a minor source of revenue. For example, Chelliah (1971) reported that the average ratio of property and wealth tax revenues to gross domestic product (GDP) among fifty-two developing countries was less than 1 percent. More than a decade later Tanzi (1987) reported that property taxes on land and buildings accounted for no more than 0.2 percent of GDP and 1.2 percent of total tax revenues in forty-nine developing countries. According to these analyses, the property tax is neither an important nor a growing component of aggregate revenue mobilization in developing countries. We do not have enough data to test rigorously the determinants of intercity variations in the level of property taxation. We can, however, offer some basic hypothesis that appear to be supported by these data.
The property tax will be a less important source of finance under four sets of circumstances. The first is that local governments are unimportant relative to the central and state governments in providing services, that is, where the fiscal system is highly centralized (for example, in Kingston and Cartagena local governments accounted for less than 20 percent of urban area financing). The second is that expenditure responsibility has been decentralized but heavy use is made of grants and shared taxes. The third is that expenditure responsibility has been decentralized but the local government finances a major share of its expenditure responsibilities with locally raised nontax revenues (Bagota and Seoul) or with another local tax (Ahmedabad). The fourth is that the national government collects the property tax and returns a portion of receipts as transfers to local authorities (Jakarta). Since relatively few cities fall under the latter to explain one might generalize that where local government taxes play a major role in financing urban public services, the property tax will be an important source of revenue.

One would like to use these data to infer whether the property tax has been increasing or declining as a source of local government finance. Such comparisons, however, are difficult and depend on the sample of cities and the time period chosen. Still the median share of the property tax in total local taxes fell from 54.7 percent in the pre-1979 period to
42.4 percent in the post 1979 period. Yet it is worth noting that the cities for which we have comparable data for the 1970s and 1980s were as likely to increase as decrease their property tax shares.

A reasonable hypothesis, again supported by data, is that the property tax had a rougher time of it in the 1980s. This was attributable to several factors: (a) the financing pressures on local governments, which forced the search for new revenue sources (b) the inelastic response of property tax revenues to income growth and inflation; (c) the legal and administrative difficulties associated with increasing property tax revenues through discretionary actions, and (d) the special difficulties posed by high rates of inflation. The last two factors may be particularly important since discretionary changes in sales tax rates and some user charges are less visible than changes in the property tax and are therefore politically more feasible.

**Concept of Property Tax**

As a matter of fact, it is not possible to give a systematic conceptual growth of property taxation but as far as Indian tax system is concerned, property tax in its early phase was specific and not general. It means some specific types of property were taxed and rest had been exempted. In course of time, a transition from specific to general was seen but in recent years it has again become more or less specific i.e.,
real property is virtually the sole target of taxation.

Originally there were two main principles of taxation. Firstly, that the property tax should be universal. That is to say, all types of property, due to their being possessed of exchange value and capable of private ownership, should bear the burden of taxation, the second emphasised full value taxation at equal rates.3

Thus, it was due to this reason that property taxation was called the general property tax. But, in recent years, the character of property has substantially changed. Consequently, universality and uniformity as characteristics of property taxation have disappeared from the fiscal dynamics of today.

The Kinds of Property Taxed

The first basic type of property to be taxed, is the real estate. The word-real comes from the Latin word 'res', which means 'thing'. In ancient times, land was the thing, which later on was regarded as the first type of property.

Real property is technically defined to include not only land in the strict sense of the word but also permanent improvements to land such as buildings, fences and irrigation system.4 Its essential feature is that it is immovable and at the same time fixed in location. Real property is not
only the major item of revenue raiser in Indian local tax structure, but in almost all countries of the world.

In addition to this, there are countries like India and England where only real estate is taxed and none else.

**Personal Property**

There is another basic type of property which has intrinsic value, but is readily movable meaning thereby that it is not permanently attached to real property. It is popularly known as personality. The best examples are jewellery, clothing, automobiles, furniture, etc. Sometimes it so happens that it becomes difficult to draw a line of distinction between realty and personality, because immobility and mobility are relative matters.

In some of the states in America where both realty and personality are subjected to taxation at equal rates, the line of distinction between the two carries little weight. However, where rates and the limits of exemptions are different, it is definitely significant. Ultimately both these items of taxation are distinguished by the courts.

Personal property falls into two main classes: tangible and intangible. Tangible personal property is that type of property which has a physical substantive existence in its right. It is under the (ownership) possession of a person subject to be movable or transferable from one
place to another. The instances of tangible personal property are automo-
biles, clothes, furniture, and many other personal effects. Some of them
are consumption goods and some are production goods, and most of them
can be hidden and concealed from the eyes of the assessors.

The second main division is intangible personal property. This
division may further be broken down into representative and non-repre-
sentative intangibles. Representative intangibles are, in fact, bundles of
legal and contractual rights usually in the form of paper instrument. It is
an evidence of interest in other forms of property. If the latter is
destroyed, the former would lose its value immediately. Notes, mortages,
hundis etc are most suitable examples of representative intangibles.
Since the same property is viewed in two different ways, there is every
likelihood of its being taxed twice.

The last form of intangible property is non-representative in
nature. There is incorporeal rights which do not diminish the rights of
other material things. The best examples of it are patents, royalties,
trade marks, franchises etc. Although there is no case of double taxation,
chance of evasion is however fairly wide.

Thus, it is quite obvious that both tangible and intangible are
insignificant from revenue point of view. Moreover, these are very easily
concealed and this evade taxation. This is the reason why in certain
countries local units have given up the idea of taxing personal property.

**Classification of Property Taxes**

So far as the classification of property tax is concerned, it can be broadly divided into the following headings:

(i) First classification is done between periodical (perpetual) and occasional (temporary) property taxes. Periodical tax is being paid by the owner of the property at regular intervals. The house tax in India and the British rates are the best examples of this tax. In case of occasional property taxes, it is generally paid at the time of the change of ownership of property. Death duties may be considered as one of the special variety of occasional property taxes.

(ii) Second classification is between taxes levied on physical persons (households) and juridical persons (corporate business in particular). Household taxation is quite popular in England, India, Switzerland and other countries while the taxes imposed on juridical person can be seen in West Germany. Property taxes are further distinguished between general and particular taxes. When the taxes are imposed in such a way that they cover almost all possible objects of wealth owned by the tax payer, it is called general property tax. But in case of taxes which hit any specified object such as, real estate or real
property, it is simply said property tax or rate as it is a case in England.

(iii) Another distinction is made from the standpoint of tax base. With periodical general property taxes, the tax base will usually be the net wealth of the taxpayer although exemption to this rule is found in case of West Germany. The same basis is, sometimes, seen in case of periodical taxes like death duties. But special periodical property taxes (viz. real estate) with the gross value as the tax base may also be found.

(iv) As regards the rates of property taxes, they are both proportional as well as progressive. The examples of proportional rates are found in Netherlands and West Germany. Whereas progressive rates are imposed in Scandinavian countries.

**The “In Rem” Character of the Property Tax**

It is generally believed that property tax is levied on the things or business or transactions. These are looked upon as impersonal in nature. These taxes, the impact of which, is upon the things, business and transactions-are usually looked upon as impersonal. Hence property tax is said to be impersonal or in rem in character. This tax can very well be contrasted with the poll or personal income taxes which are highly personal in nature. Some evidences are given to suggest that property tax
is impersonal or in rem rather than personal in nature. First is that property tax is levied only within the municipal jurisdiction or in the district or its location. Secondly, assessment of property, is done on the basis of listed property and legal description of lots rather than by the names of the owners. In Bihar particularly holding number is recorded rather than the name of the person. Thirdly, property serves as the security for the payment of tax. Fourthly, legal owners of property are made liable for tax payment and if the true or legal owner is not traced out, the occupants are asked to pay the tax. And lastly, the owner is not permitted to off-set his debts and mortgage against the assessed value of his property.9

The greatest defect of the in rem character of property taxation is that it is opposed to the principle of equity. In the economics of taxation, the in rem character of the tax means that there is no effort to tax net equities. The legal title holder to the property must pay taxes on the full value of the property in spite of the fact that his equity may be only a fraction of the full value. In many states of America the mortgagees interest is also taxed-a situation which may result in double taxation. The in rem approach, thus completely disregards ability principle and taxes the mortgagor on a value that he does not possess.10
Equity or Ability as the Basis of Property Taxation

Property tax existed in some form or the other from the most primitive time and the main principle which existed that time was, of course, ability to contribute.

The idea of contributing according to ability was advanced by Greek and Roman writers and in medieval times this concept emerged more clearly. Thus the requirement that the distribution of tax payment should be just is very old. This principle predates the benefit doctrine.11

J.S. Mill had argued that equity should be defined as requirement that each tax paper should suffer an equal sacrifice. To this he added that such a solution "is the mode by which least sacrifice is occasional or the whole".12

Mills classical version of ability to pay rejected the benefit approach. The term faculty, or ability as used in the Elizabethan poor law, refers to property, and the same was the case in the early legislation of the American Colonies.13

With the rise of the modern constitutional Government in Europe, the concept of ability as a criterion of Justice was definitely enunciated. Canan, for example, speaking about local taxes in England, observes, "it seems to be quite clear that in the 14th and 15th century the accepted view was that each inhabitant should pay according to his ability or
substance for in those days ability and substance meant much the same thing, the man who has the large income without having a large capital is a product of modern civilization"14.

It seems clear, therefore, that throughout the early period of its development property taxation was conceived in the minds of both legislatures and tax payers as resting definitely on the principle of ability. The dominance of this principle throughout the early period was occasioned mainly due to the fact that government’s activities were very few and far between. It was, of course, a period of police state and so that ordinary individual anticipated no benefits from his government and was happy if he were unmolested by it. It is generally found reasonable that other things being equal, a person should be taxed heavier the larger is his net wealth. A number of arguments are given to justify this tax on equity grounds. First of all it is pointed out that apart from income flowing from property, property in itself, contributes strength and security through the safety which it grants against economic risks, loss of income in case of sickness, old age, unemployment and other sorts of economic calamities.15

Secondly, property is valuable because it can either earn income or in case of house as a form of consumption goods can save income. It also represents wealth in the form of past accumulated income. Property,
thus, possesses the tax paying potential and future spending power. Seligman conceived the term ability to pay comprised of two elements—sacrifice and faculty. While the former is a psychological concept the latter concerns itself with instrumentalities (personal and impersonal) that are capable of meeting the tax bills. Since property has exchange value it indicates that it is capable of rendering economically productive services. Thus ability to pay as faculty can be attributed to property or possession of property as such.\textsuperscript{16}

Thirdly property owner has the advantage over another who owns no property but entirely depends upon his working power for acquiring income. In that case the former possesses more capacity to pay than the latter with lesser amount of effort.\textsuperscript{17}

Moreover income flowing from property is not adequately taxed. Even the progressive rate of income tax many fail to tax property’s income to the desirable extent. If it so happens, discrimination is bound to take place. Property owners would be placed in a most advantageous position. This can be remedied if supplementary taxation in the form of property tax is independently imposed.

There is a widespread belief that income from property is earned with lesser and lesser effort than the income from work. In course of getting income from property, property owners get more leisure and
comfort than a man who is absolutely dependent upon his working power.

In addition to this, property or wealth is a symbol of social prestige, power, strength and influence in the community. It also gives happiness to the miser. 18

It is further contended that income from property is more stable than the income from work. In case of income accrued from working potentiality, although increases initially, ultimately decreases and finally ceases, when the earner dies. But such is not the case with the property owner where only the fruits of property are taxed whereas the sources thereof, i.e the item of property, remains unaffected.

If these two sources are to be taxed on equity basis, it is desirable that either the proceeds from income should be reduced or the proceeds from property should be increased to the point where similarity of sacrifice is achieved. Even if it is assumed that property does not yield any fruits there is sound reason for differentiating the tax burden in the personal sphere according as owned property is present in addition to income.

Another facet of property which gives it a special physical position for taxing separately is the better consolidation that it commands. Property acts as reserve for future spending and this strengthens the position of property owner in the labour market. Property is made instrumental in
collection of cash and it also gives better preparedness for life than would be possible without owning property. Thus a tax which is based on property is preferable to that on income from work.

These arguments suggest not only a higher taxation on income from property but also the necessity of an independent tax on property along with the general income tax.¹⁹

An argument against taxation of property income is that the low yielding property will be hit less hard than the high yielding property. For this it is sometimes, desired that there should be general property tax. Moreover, the rate of property tax should not be so high that it might not be given out of property's income. Care should therefore be taken so that capital aspect of property is not injured.²⁰

It has already been said that since income from property stands on a better footing and so, it requires higher taxation. But the difficulty is as to how to differentiate such types of income. Sometimes it so happens that part of the income is consolidated and the part is unconsolidated. An analytical income tax which imposes higher tax on income from property than on other items of income, further, has a number of drawbacks of practical nature. In accordance with its object it would have to impose higher tax on the actual income from the property according as such income is better consolidated, that is acquired with less efforts and less
risk. This can not, in general, be inferred from the nature and the size of the items of income from property themselves. If one starts moving along the road of such a differentiation with the sphere of income from property, the question arises whether one is not to go on and is to proceed to differentiated taxation according to the amount of effort made for acquiring the income within the sphere of income from work as well. And indeed, the difficulty then presents itself to determine the tax position of the half consolidated income from enterprise. Needless to say that such a method of differentiation is not feasible and that further more, a differentiation which stops half way and in many cases can not avoid that items of income are transferred from a highly taxed category to a less highly taxed category will convey to tax payers the impression of just taxation. In such situation the task of differentiation seems to be difficult. But this drawback may not be present if the consolidation is related to the property itself.

On the basis of these arguments it can be safely concluded that it is desirable on the grounds of equity and generality to make both total income and total property form the basis of separate taxes. If this be combined with the general consumption taxes, it will constitute as broad a basis as possible for a taxation in which the various factors of individual taxable capacity are done the fullest possible justice. On these grounds
a general income tax, and in addition a yearly tax on property has been levied in Netherlands, since 1914.\textsuperscript{21}

It is frequently argued that superiority of a tax on income from property to income from work is losing ground in the developed countries due to the active employment policy, extension of social insurance scheme and privileges of pension facilities. But in the case of underdeveloped countries like ours, property is still a very important basis of tax paying capacity.

The case for property taxation on grounds of equity has met with increasing criticism on account of the following reasons:

In case of urban residential estate, it is complained that there is very poor correlation between the value of property and the income of its owner. Evidence to this fact is provided by the fact that the owner of a house who has the burden of mortgages hardly gets any credit for his liability under this tax.

It is also argued that the inflation of recent years has reduced their real income and, therefore, the ability to pay taxes but no corresponding reduction has taken place in the property tax.

The Netherlands Government considers it as the most suitable taxation to safeguard a socially and individually just division of the unavoidably high tax burden. This tax has been founded on the two aspects
of taxable capacity, namely of the property itself, independent of the proceeds from it, and of the consideration of income from property as compared with income from work 22.

But if a careful consideration is given to this problem, it will be obvious that the real villain of this problem is inflation rather than the property taxation. Even the personal income tax becomes enormous when the inflation pushes up prices high.

Another criticism of this tax is that it hits hard such an item of consumer's budget which has a very strong sentimental attachment. That is to say, majority of the families consider this as the symbol of social prestige. Such families prefer to forego other items of their expenditure rather than to give up their houses in which they live. It is, therefore suggested that sale tax would be preferred because their decreased expenditure on goods would enable them to avoid sales tax.

But it is not necessary that every person should have an inelastic demand for houses. There are persons who prefer to maintain their standards of living with respect to other commodities rather than housing and such persons would be penalised if sales tax is imposed.

Thus the reduction of the general property tax as a solution to the hardships overlooks the probability that the incidence of this tax is to a considerable extent diffused among all items of consumption.
In case of tenant occupied residential real estate, a good part of the tax is passed on to the tenant and hence it becomes a levy on the consumption of housing. It is also a fact that the percentage of income spent on housing diminishes with a rise in income. Thus the property tax on residential real estate is obviously regressive. It is, therefore suggested that if the sales tax is substituted in place of property tax, it would reduce the regressive effect of property tax. Sales tax not only affects occupants but also merchants and manufacturers.

Over and above, it is traditionally believed that part of the residential real estate tax which is levied on the basis of site value of the land tends to be capitalised. To the extent to which the buyer is successful in anticipating and thus discounting, it does not affect the net rate of return on his investment on property and consequently that part of tax is not shifted to the tenant. The present occupant is not burdened with all the property tax. This idea shows substantial doubt on the proposition that consumers of housing will be relieved by less regressive sales taxes (the incidence of which is all or nearly all conceded to be on the consumers). To cite an extreme case obviously a highly regressive tax need to be of small concern to consumers if they only bear let us say 1 percent tax. 

Some taxes are like taxes on dividends which are imposed and paid on the basis of success. But there are certain other taxes including
property taxes, which are like taxes on interest. In a world of free contracts, it does not matter whether the tax is borne by debtor or creditor, occupant or owner as long as some creativity is taxed only once. Some objections are, however offered to this approach.

Even though sales value and, in case of property earning a cash income, capitalised earnings measure the economic productivity of the property, it may be argued that assessment techniques lay insufficient stress on sale value or capitalised earnings. To the extent that this is true, of course, property tax can not be justified as a levy on the economic productivity of property and if such a justification is accepted assessment techniques might have to be modified accordingly.\textsuperscript{25}

It is further contended that although the value of property represents its economic productivity, taxes can not be paid in terms of economic productivity but in cash. Some forms of property such as owner occupied homes, yield services but no cash income to the owner. However, the property is not less productive because the owner chooses to be owning land.

It is further argued that property tax loses all validity because much of the levy of the property tax is shifted to tenants. But this is not true because it is not sure that property taxes can be shifted. The risk associated with prices is one that goes with the responsibility of
ownership. The property tax, in this respect is like other non-contingent cost and conditions of business.

Another objection is raised that since taxes are paid by individuals, impersonal taxes and impersonal criteria are at best fictions and at worst dangerous illusions about the nature of the tax system. In this regard, it can be argued that incentive and inadequacies of administration (particularly local administration) make it inexpedient to load all the burdens of government on personal income tax.

On the basis of the above discussion, it can be safely concluded that "the tax culprit have sometimes been exaggerated. And the analysis further suggests that property tax relief by the substitution of certain other regressive levies may be a case of jumping from bad to worse."26

**Benefit Theory of Property Taxation**

As a matter of fact ability theory was never abandoned and it is still recognised as an effective tool of justice in the field of property taxation. But towards the middle of the 19th century, there was remarkable resurgence of benefit theory and a surprising recognition of its pertinence and validity mainly because both English and American courts had been accustomed to speak of benefits as the justification for taxation in general.27
The reason for the wide spread recognition of benefit theory was that there was spectacular growth of cities and towns and this has continuously increased the pressure on local bodies to improve and expand amenities and services to the communities in respect of health, education highlighting, water, roads, markets and safety against fire etc. It is all the more pressing in case of urban local bodies.\textsuperscript{28}

Urban local bodies thus provide mainly two types of services which benefit the urban real estate
(1) Direct services rendered to urban real estate
(2) Indirect services which produce desirable influence upon the urban real estate.

There are certain services performed by the urban local bodies which directly benefit property as such included in the first category are garbage collection, sewerage system, street maintenance and such other services.\textsuperscript{29}

A tax levied according to the principle of benefits received has three major characteristics.\textsuperscript{30}

(1) It is compulsory contribution exacted from the individual or group by the government. This characteristic is common in case of all taxes;
(2) There is absence of direct quid-pro-quo; and

(3) The revenue from the tax is spent in such a way that measurable benefits proportionate to his payment are received by each tax paper.\textsuperscript{31}

Property tax becomes benefit tax because there is a positive correlation between the value of a unit of property and the municipal services rendered to that property.\textsuperscript{32}

Now one important question arises, should the government recognise such benefits, adopt the procedure and impose separate fees for its services upon all benefitted persons? should the goal be to make as municipal activities self-supporting as possible?

As for as social necessities and justice are concerned, it would be extremely undesirable. Because in this situation individual interests would be fulfilled at the cost of the common good.\textsuperscript{33}

It would imply that one might refuse the benefits and therefore pay no fees. This would amount to great injustice particularly in the light of prevailing inequalities in the distribution of income and wealth. It is vital to recognise that the broad collective interest with respect to such services is paramount, even though in some instances there is present a clear element of individual benefits. In other words the principle of taxation should be retained even though it is a benefit tax.\textsuperscript{34}
Naturally the poor persons who are the major partners or the vital limbs of the community's interest will virtually be deprived of those vital municipal services.\textsuperscript{35}

So even if it is felt that some services are more beneficial to certain classes of property than to others and that each class is equally able to carry its respective tax bruden, the principle of classified taxation might be further extended.

Thus rising land values which are recognised from time to time could be subjected to an increment tax; or land, which is the chief beneficiary in rising reality values could be exposed to heavier tax rates than those chargeable to improvement values.\textsuperscript{36}

A building tax might be justified for supporting the greater part of the burden of fire protection or a sewer tax might be added to the water bill in terms of flow accommodation received.\textsuperscript{37}

Moreover, considerable portion of local government activity directly benefits property in a sense that if these services are not provided by urban local bodies, the property owners would have to provide themselves, because these services are so vital and urgent that in their absence no civilised life can be imagined.\textsuperscript{38}

It may be that the benefits from these services are not necessarily in proportion to the value of property but it can be roughly presumed to be so.
In this situation, two important conditions of Benefit theory are fulfilled. First it is that the benefit is to a large extent measured; because so long as the expenditures made are kept at such levels that the burden of the tax is in close promixity to incomes, no serious inequality would be apprehended. As for as economic effect of this tax with regard to the business firms is concerned, it is all the more advantageous.\(^{39}\)

Optimum allocation of resources in the economy requires that the cost to society of rendering the services should also appear as costs to the business firms which are responsible for the need to them and thus enter into the prices of the finished product.\(^{41}\)

Suppose that a new factory is built. It will immediately require some of the essential amenities like the new streets, road lights, garbage collection, provision for water and additional fire and police protection. If these services are not provided by the urban municipal bodies, the factory would have to provide them at its own expense.\(^{41}\) In that case the cost of these services become real cost of the society which arise out of the particular business activity. Thus the assessment of the charges against the firm or the factory is perfectly justified in terms of the best use of the resources.\(^{42}\)

There are certain other services provided by the urban local bodies which indirectly influence the value of the urban real estate. Induced in
these are the maintenance of schools, playgrounds, parks, hospitals, libraries, and such other services. To some extent a correlation between property values and government services does, of course, exist. If these services are withdrawn, it would definitely reduce the value of urban property in that case urban property becomes less desirable and its value in the market would tend to fall abruptly. In order to prevent the reduction of value of the urban real estate, the property owners would have to establish these services on private basis. It is, of course, obvious that these municipal services are not the only factors which determine value, there are certain other factors like business conditions, age of structure etc. But municipal services are undoubtedly the very dominant factor and on the basis of this correlation between the value of the unit and municipal services, benefit principle of property taxation is justified.

This sort of correlation is possible if other things remained equal but things generally do not remain equal. Consequently it becomes very difficult to measure directly the benefits of government services to property. But it can be argued that benefit could be measured indirectly by using the cost of services, that is, by defining cost and services as equal.

The benefit principle is more applicable in local taxation. The main function of the urban local bodies is to provide civic amenities and
the principle that the cost should be distributed among consumers of the amenities—according to the satisfaction they have derived—seems very convenient for municipal taxation. Erik Lindahl has expounded a model where revenue expenditure process for the satisfaction of social wants is determined by a competitive process similar to that in a private market. Assuming two tax payers, the equilibrium output and relative cost shares are determined at the intersection of their respective demand relating different units or amounts of social goods to the cost share they are willing to bear. The demand schedule of one tax payer becomes the supply schedule for the other. With a large number of tax payers, only the mechanical difficulty of determining expenditures and tax shares is increased but the argument is not affected. Each tax payer must place his demand for each service. The government must solve for the equilibrium output for each of the social goods and realize or bill each citizen in accordance with his offer prices for these equilibrium outputs. This may be very well compared to a trial and error process of trading in the market, with continual reconstructing until an equilibrium is reached. Actually all this does not have to be repeated in case of every budget period, rather the process of choosing and providing for social goods is constant and only marginal adjustment need to be made from time to time. The voting behaviour of representatives brings about this outcome. But there are
serious difficulties with this model in both the partial and general equilibrium settings. If there are large numbers, preferences will not be revealed and if the numbers are small, the solution need not be optimal.47

As regards the operational aspect of property tax in case of our country it is broadly of two types viz., general and special. Special levies also known as service taxes which are mainly based on quid-pro-quo principle. However, the benefit principle is relevant in so far as the benefits from the services rendered by the local bodies can be approximately identified. For instance, it is true to say that property value or rental is a fair indication of the several civic amenities enjoyed. Such a presumption can be applied in levying general rates like house tax, a general conservancy, a sanitary tax or a tax to meet the expenditure of fire brigade.48

Regarding water, however, a special tax is desirable and this tax should be based not on the size of connection, but in proportion to the water consumed which is measured through meters. There are certain advantages associated with a general water tax based on rental value or a tax based on size of connection, there will always be dissatisfaction among consumers that they pay more than what they should. Consequently, there will be a tendency to waste water provided they get enough water to waste and there is no way open to the local body to recover the
cost of entire water thus used. It is, therefore, desirable that water tax
should be charged as special levy mainly with a view to prevent waste of
water and thus satisfy the consumers of water at large in the locality.\textsuperscript{49}

The Benefit principle of property taxation is based upon the
principle of compensation. Every property owner who pays property tax
receives compensation in lieu thereof. In this connection the New York
Court of Appeals aptly remarked, "A property tax for general purpose of
the government is regarded as a just and equitable tax. The reason is
obvious. It apportions the burden according to the benefit more clearly
than any other inflexible rule of general taxation. A rich man derives
more benefit from taxation in the protection and improvement of his
property than a poor man and ought therefore to pay more"\textsuperscript{50}. Thus, every
species of taxation is based upon an idea of advantage, benefit or compen-
sation. If any tax is at variance with the idea of benefit, it would be grossly
unjust and thoroughly unprincipled.

The supreme court of Michigan declares "Taxation not based upon
any idea of benefit to the person taxed, would be grossly unjust, tyranni-
cal and oppressive and might well be characterised as public robbery"\textsuperscript{51}.

This inverse correlation between benefits and taxes clearly shows
that the present day theory of property taxation is distinctly different
from the benefit principle. Property taxation is now-a-days hard to define
on the basis of ability to pay or the benefits received from the government. Its persistence in tax system must be accounted for largely on grounds of expediency. The pronouncement of the Federal Court of America justifies the modern principle of expediency in the field of property taxation where it declares that "the district was a governmental body and could finance its governmental services through general taxation from which appellant could receive as much benefit as does an aged or dying bachelor from the tax he pays for the education of school children. It is therefore, safe to conclude that the theory of property taxation in present time rests on no particular theory but on the fiscal necessity of government.

**Property Taxation: What is Good and What is Bad About it**

As men and women of good will seek ways to improve the communities in which they live and for which, as members of the body politic they have ultimate governmental responsibility, the reform of property taxation deserves their attention-and action. Achievable reforms in this area can yield substantial results. We would like here to outline, perhaps all too briefly, some of these reforms which we consider the more important ones. For this discussion we shall assume that the aim of these reforms is to produce a tax instrument yielding about the same total revenue as is currently collected plus that derived from "normal" growth
in the tax base from new construction.

To start with can we not agree that property taxation will continue as a major revenue source?

At times in the last few years the casual observer having little knowledge of public finance and the options really open to politicians might have had some excuse for dreaming of drastic reductions in property taxation. Press summarises seemed to say that the courts were about to force sweeping change in school financing. Revenue sharing might pour even larger amounts of federal income tax revenue into local treasuries. State legislatures might step up their financing of local functions to reduce the pressure on property taxation.

But as of mid-1973, what do we see? clearly, property taxation will continue as a source of substantial revenue. It will continue as an important element (direct and indirect) of family expenditure, as a significant item of cost for some businesses, and as an influential determinant of capital investment and land use.

Note that in this listing of factors which make property taxation important I have included two distinguishable aspects-revenue and non-revenue. We do so because the tax affects behaviour in ways beyond those involved in exacting funds. Individuals and businesses will take account of property taxes in decisions involving property and its use. In preparing
for the future, therefore, we would make a determined effort to reform property taxation into as good a revenue source as possible. States and localities that work intelligently, deliberately and courageously to structure property taxation to get the best nonrevenue effects and the least damaging ones can hope for generous rewards.

This reform would build upon a vital difference in the two elements of the property tax base. Economically, the property tax is two markedely different levies: (1) a tax on land and (2) one on manmade capital - buildings, machinery, and the inventories of business.

Property taxation comes in for lots of criticism in this period. These result largely from decisions about spending. Somehow, costs of government have risen so much that any means of paying for them would arouse objections. But property taxation has merits and strengths. Let us examine them.

FAVOURABLE FEATURES

1. Viability of Local Government

The tax now helps to finance local activity, enough to make local government as meaningful and as viable as it remains. Cities, towns, countries, and school districts do at times fail to meet our aspirations for good government. And state and national government are also less than
perfect. So is the world of business and of non-profit, organizations. Be reality as it may, the use of localities, as distinguished from state and nation, to get some of the things we expect from collective (governmental, political) action has merit.

Property taxation offers people in different localities an instrument by which they can make truly local choices significant. People in one locality are not forestalled, inexorably, by the decisions of voters elsewhere. Who among us would want to limit his children to a level of education which might satisfy, say, a majority of voters in a state? This tax helps to provide freedom and opportunity to do things differently— not to be held down to a level set by others who may live in areas which are quite different.

2. **Voter Influence on His Taxes-and Government Spending**

Either an increase in assessed valuation or a boost in the tax rate requires a positive act. Such tax-raising action can lead to more voter resistance than will an automatic rise in income tax from established rates which applying to growing income. Voters have an opportunity to relate (a) budget proposals which will require higher taxes, (b) to the desirability of more government spending. Is not the ability to reject more spending and taxes a desirable element of "the good society?"
3. **Benefit and Justice**

The equity which we seek in public finance consists of various forms. One feature associates costs with benefits (in the making of decisions and in the results). Fairness of this type is evident as property taxation does adjust the payments for different quantities of services from one community to another to local burdens.

Generally, the localities in which burdens are highest are those providing residents the most services. Here is an element of justice in a basic sense, a quid pro quo. Within communities the relation of benefits received per family to tax paid will be crude. Families with relatively large property holdings pay more tax than others who get equal services. Yet the intercommunity aspect commands respect.

4. **Fairness-Capturing Some of Socially Created Values:**
   **“Unearned Increments”**

Socially created increments in property values are sometimes substantial. The Property tax can capture a portion for financing government. Considerable property value increases (above general inflation) have appeared in the last two decades. Nationwide, land prices have risen substantially.

In my view, more of the increment would better have gone to local government treasuries. Property taxation could capture more of values
due to (a) social growth and (b) local government spending for financing local services. Is this not almost the epitome of fairness in taxation? We shall say more about this potential-one which makes property taxation the very opposite of the customary assertion that it is the most unfair tax. To some extent, I submit, it can be a most fair tax.

5. **Equity - New Measures ("circuit Breakers") to Relieve (Some of) the Poor.**

With rapidity unusual in tax policy, states have enacted provisions for granting property tax relief for the aged poor and some other groups. Experience indicates that this one defect can be largely eliminated without undue loss of revenue.

6. **Good Results of Age**

"An old tax is a good tax" this is an ancient proverb, and it is not completely true, of course. Nevertheless, property taxation has worked its way through the economy, especially the portion represented by rates other than the most recent increases. Some elements have been capitalized, and other adjustments have been made as owners and users have taken the tax into account. Inequalities and crudities lose some of their sting as men adjust over the years.
7. **Some of the Tax is No Real Burden**

Part of the tax is no current burden on the present owner or user. In many communities probably 15 to 20 percent of the property tax represents (a) tax on land values (b) at rates which have existed for such a long time that most present owners allowed for it in the price they paid. The annual payment of this portion constitutes no true burden on the user.

Part of what the owner pays over to the local treasury each year does not really leave him worse off, compared with what would have been his situation if the tax had not applied when he bought the property.

8. **Administration and Compliance.**

To include administration under favourable features may seem at best an act of faith. Through much of the country property tax assessment continues to be shamefully bad. Yet good administration is achievable. And compliance burdens on taxpayers can average as very low. In combination they probably cost less per rupee of yeild than any alternative source of large revenue for state-local government.

9. **Revenue Yield**

Property taxes are the most important source of sub-national government revenue.
10. **Resource Allocation - Good And Bad**

Property taxation exerts some forces for better resource allocation. But other allocation results of present taxes are undesirable. Before discussing them - and weaknesses generally—a vital point about the economic foundations should be repeated.

Economically, the tax is two instruments. A long evolution has blended elements which in basic respects differ fundamentally. (1) Land has been created by nature. It is immobile. The quantity is largely fixed and will not rise or fall depending on the height of tax. Value depends upon forces other than cost of production (2) Manmade capital—buildings and machinery—must be created by labour and materials. The weight of tax will affect the quantity and quality of such capital to be expected in any locality.

The economic distinction presents challenges to analysis, to statesmanship, to citizen leadership, and to public administration. One offers a positive opportunity for strengthening the finances of local government. The other promises relief from adverse non-revenue effects of taxes on manmade capital. Needless excess burdens now impose quite unnecessary losses of well-being moreover, a reformed tax could exert pressure for higher and better land use, yielding positive advantages. In any case, some present defects result from
the failure of framers of our taxes to take account of the basic economic
difference in the elements of the tax base.

**DEMERITS AND WEAKNESSES**

1. **High Effective Tax Rates Affect (Distort) Behaviour**

   Although property tax rates when expressed as percentages are
usually small numbers, they apply to capital values. comparison with
taxes on income or sales can be very deceiving. For example a 3 per cent
property tax equals 33 per cent of the pre-tax net income- and 50 per cent
of that after tax-from a property which yields 6 per cent to the owner. The
tax frequently exceeds 25 per cent when expressed on the same basis as
a retail sales tax.

   Any tax that brings in large revenues will alter behaviour and
not just because people have less to spend and save. Individuals and
businesses alter the ways they carry on their affairs to adjust to the tax.
When rates of tax are high, and when differences in tax burdens are large
(eg. from one area type of property, or activity to another), the non-
revenue results can be substantial. Economic distortion can be produced
by the affects.

2. **Inequilities : Elements of Unfairness.**

   As ultimately shifted, is the tax (or are the taxes, for we insist that
economically "the" property tax is two (levies) fair?

Critics say that the property tax runs counter to the concept of fairness by burdening low-income groups more heavily in relation to income than those with larger incomes. (Families with higher incomes, of course, do pay very much more than those with less) A regressive element does exist. However, if as much as half of the tax on business utility and rental residential property is assumed to remain on the supplier of capital-only half being shifted to the consumer-then picture is one of substantial inequality against the middle and upper income groups. Yet there is regressivity, and it is generally believed to conflict with vertical equity. Nevertheless, for the families with incomes covering most of the population in a community, the property tax is probably roughly proportional with income. But our firm knowledge is inadequate.

Still another criticism lies in "horizontal inequity: Taxpayers in about the same circumstances do not receive essentially similar tax treatment. Where this criticism is valid, the chief culprit is the poor quality of assessment and review.

3. Perverse Character of Burden in Relation to Costs of Government

New well constructed, high quality buildings are taxed more heavily per unit of space than are slums and junk. Is it not stupid for
society to decree that if a family or a company supplies more and better capital facilities it must also pay more toward the costs of government? can justification for such burden discrimination be found in the cost differences which the two types of property impose on local government (per unit of occupied space or machine used)? Most probably, no. The badly run-down and less heavily taxed buildings are more likely to be associated with the greater costs per unit of usable interior space.

4. **New for Obsolete: Obstacles to urban Renewal.**

Cities which need to replace obsolete, decayed, degrading buildings nevertheless put tax impediments in the way of progress. No one tried deliberately to base local finance on a tax that would favour holding on to the decrepit structures while penalizing the new. Nobody planned to set up a tax system to discourage improving productive facilities.

The persons who wishes to shift from poorer to better quality housing, or business property can not do so without also paying more toward the costs of government. Is this not both irrational and self-defeating?

5. **Maintenance versus Deterioration.**

The tax on buildings discourages maintenance and modernization. Partly because of the realities of assessments as made, and partly
because of what people believe the assessor long somewhat. Whatever
the amount of such retardation, it represents an unfortunate result.

6. **Inducement to Smaller Structures Sacrifice of Potential Benefit**

The property tax on buildings produces a rarely recognized effect
which imposes what economists call excess burden.

The expense per cubic foot of construction decline as the size of
the house, office, display area, apartment, or other unit increases (within
varying limits). In terms of one of the major things generally desired-
cubic contents-unit cost drops as room size increases. Content rises
more than proportionately to floor, wall and ceiling area. Moreover,
much the same plumbing, wiring, kitchen, heating, and other facilities can
serve larger as well as smaller rooms and buildings through a range of
sizes. The general public welfare can be served best (within a range) by
the construction of rooms, houses, and buildings of larger as opposed to
smaller, size. Resource allocation in the economic sense will be more
efficient when labour and raw material go into more commodious or less
cramped housing, office, and other use.

Not observably from one year to the next but unobtrusively and
mixed with many changes, the property tax on buildings will lead to the
construction of rooms, apartments and buildings somewhat smaller than
would be built in the absence of tax. The public unknowingly deprives itself of opportunity to exploit fully the potential benefits from the "law of the cube".

7. **Tax Islands and Central City Difficulties**

This and the next criticism apply to local taxation and not in any necessary sense to property taxation as such (applied on a wide scale). Tax rates much above average in one locality will reinforce incentives for creating "Islands" of relatively low tax rates nearby. Among the independent governments in a general area a few with tax bases which are much above average in relation to service obligations can get by with lower rates. They can attract capital for new structures and become low-tax enclaves. Per unit of output or sales, businesses operating there incur below-average property tax.

The actual extent of this force may have been quite exaggerated in the literature. But some communities, perhaps by the use of zoning power and building codes, are able to exclude types of property associated with high governmental expense.

As regards buildings, not land, lower tax rates here and there on the fringe of an urban area encourage dispersal and the development "far out" of activities, including housing, which in a full economic sense
“ought” not to be so distant. Property nearer. The center will be subject to high tax rates, and unless the services provided improve each increase in tax rate will reduce the value of the property and the tax base. The land can not leave. Improvements can, and will, shift location.

Tax differences can aggravate the troubles as (effective) city rates rise, due in some cases to lag in downward assessments. The self-reinforcing destructive process may be scarcely perceptible from one election to another yet over the years cumulative harm will mount.

As applied to structures (not to land) this pattern of taxation arbitrarily favours horizontal over vertical growth in metropolitan areas. The resulting land use then imposes higher costs on the whole society. These higher costs appear in the time and money cost of traveling greater distances from home to work and for recreation and perhaps schooling, higher expense of supplying water, sewer, and utility services farther from central locations; and reduction in the economic and social benefits from population concentration.

8. Localization of large units of Business Property

Small taxing districts sometimes contain concentrations of business buildings, machinery, and inventory. Local residents can, in fact, get some of the cost of services paid for by outsiders-consumers and
suppliers of capital, depending upon the ultimate incidence of the tax on manmade capital. The results, it seems to me, can be inexcusable inequitable. Reform lies within our power without reducing the use of this revenue source.

9. **Property tax as a Business Tax**

As the property tax falls on business it affects decisions about when, where, how much, and in what forms to operate and to invest in productive facilities. The influences that grow out of property tax considerations will rarely help companies grow or to produce more efficiently. In general, tax-created additions to business operating expense are undesirable. Businesses are overwhelmingly the source of income and product. They provide most of our jobs. In taxes, however, businesses encounter impediments-costs for which there are usually no identifiable aids to production.

The significance of property tax for business will depend in part upon the relation between the tax and the governmental services provided for business as such. Some companies, of course, are firmly attached to a location eg. those providing a local service. They will not leave if the tax rate goes up, but their growth or decline will be affected. Firms which deal in highly competitive markets can not afford to incur avoidable
costs which do not, in return, either yield a saleble output or reduce other costs.

Each rise in property tax on structures and machinery useless matched by improvements in local services to business as such will tend to reduce the business use of manmade capital. The amount of production in the locality will fall below what would otherwise be the case, perhaps not observably, or grow more slowly than otherwise.

10. **Pressures for “Socialization” and Exemptions**

High Property tax rates stimulate somewhat the expansion of the scope of governmental activity by giving misleading signals of the relative desirability of governmental as compared with private, ownership eg. public housing and governmental ownership of utilities. Property tax exemptions have properly been getting attention. The higher the tax rates the greater the incentives for some groups to press for exemptions.

**Problems of Property Taxation**

Of all the problems of property taxation, the problem of assessment is most vital and at the same time a highly complicated affair. Property assessment consists of three basic functions: (a) the discovery, (b) the recording, and (c) the valuation of the property.
Problem of Choosing the Base of Property Taxation

In most countries of the world where the system of local government has for its main source of finance the proceeds of a property tax, the existing basis of the tax is being questioned. In the United States of America where the basis of taxation is the capital value of both land and building, there is interest in and investigation of the site value method as an alternative. In Great Britain where the local government taxing base is annual rental value of property, there is an active consideration for capital value as an alternative base of taxation. In New Zealand too, there has been a questioning of the basis on which local government taxation is levied but unlike the United States and Britain, its legislation has provided for three alternative systems on which the real property tax or rates in New Zealand terminology may be levied. These systems are (a) capital value, (b) unimproved value, and (c) annual rental value. Similarly in other countries also, there is a serious search for a suitable base of taxation of all the different bases, annual rental and capital value base are most popular.

Administrative Problems of Property Taxation

Of all the important taxes of the world, property taxation is the most poorly administered. Consequently, there is not only loss in poten-
tial revenue but it also breeds gross inequality in the distribution of burden. This defect in administration arises due to two reasons.

(1) The first is that the defect is partly inherent in the tax arising out of the use of a base which does not involve a market transaction and therefore requires administrative discovery of the taxable items and establishment of value figures. In addition to this there is also the failure to establish suitable administrative organisation and procedure for the purpose.

(2) Secondly, the assessment of property is often highly unsatisfactory with a wide range of variation in the ratio of assessed values to reasonable appraisal figures. A number of studies have been made of the assessment patterns, frequently by comparing assessed values with actual sale prices of property sold during the year; university, they have shown a wide variation in the ratios. One of the most complete studies was made in conjunction with the 1957 census of government. For the purpose of measuring variation, a co-efficient of dispersion was developed, this is the percentage which the average of the deviations from the Indian ratio of the assessment ratios of properties sold during the periods bears to the Indian ratio. Only eight percent of the cases studied
had co-efficients under 15, and over half had figures over 30; 1/6th had figures in excess of 50 percent.

**Property Taxation Exemption**

There are several possibilities for improving the quality of the property tax, one of them is of granting exemption to certain forms of property. The theory behind the property tax exemption is that some types of property have special characteristics which make it socially advantageous to exclude them from taxation. There are many justifications offered for exemptions. These include economic, social, political, ethical and administrative aspects.

**Problem of Delinquency of Collection**

Property tax delinquency is another grave problem. The extent of delinquency may sometimes be measure of administrative efficiency. The main reasons responsible for widespread delinquencies are economic distress, poor administration, loose legislation, excessive burden on the property, intentional delinquency and negligent delinquencies. A good deal can be said about all these causes, but it will be better if their problems are analysed and up-to-date methods are sought for their prevention.

If the amount of delinquencies accumulates to gigantic propor-
tions, it raises serious fiscal problems for the local units of government. Consequently, essential city services curtailed, salaries are reduced or unpaid, workers are retrenched, and the functions of local units of government are severely impaired. Because of delinquencies the burden on tax paying properties becomes progressively heavier. Not only this, pyramiding of burdens upon the tax paying land drives successively the less able tax payers into delinquency. Thus the effective tax base shrinks more and more. Naturally, it becomes difficult to enforce collection. Nonpayment of taxes will eventually force the tax authorities to proceed against the property. This may take the form of offering the taxes for sale at public auction. When the delinquent property is posed in the market for sale, it would further shatter real estate markets for many communities. In such a period of economic distress, very few buyers with ready cash are available. Usually only the better properties are picked up on tax sale and the remainder still continue delinquent.

In view of the seriousness of this problem it is essential to bring drastic improvement. More efficient administration would lessen short term delinquency and would prevent its prolongation into long term delinquency. Existing law, machinery and procedure seem to be inadequate. Merely putting teeth in delinquency under control, although this will help. At first, it is desirable to educate the public in order to appreciate
the gravity of the problems. If avoidable delinquency is brought under control by more effective tax administration and other methods, much of the long term delinquency will be prevented.

**The Classification of Property**

Classified property taxes are a deliberate departure from the theory of general property tax and are an open confession of its inadequacies and unequal distribution of tax burden.  

In early days it was believed that since properties were homogeneous in nature, the taxes should be imposed uniformly. But with the rapid growth of the economic system, old beliefs were belied and economic characteristics of the property differ widely. These differences have in turn made attempts at uniform taxation not only inequitable but also impracticable. The main objects of the classification of property are to give considerations to different types of property, to promote greater administrative expediency through diminishing evasion, to promote complete assessment and obtain more revenues, to create greater equity through better adjustment of the tax to the earning power of the property and the ability to pay of the owners and to encourage desirable economic efforts as for example, giving special classification and tax treatment to improvements and residential property.  

Classified property taxation is
a major step towards toning up the administration of the property tax.

Our main concern is to analyse the classified property taxation in the field of Urban real estate. In this context Spengler's suggestion is quite remarkable - while different forms of tangible and intangible property have been classified in great detail and the real estate has been differentiated into timber, mining, agriculture and town plots, little progress has been made thus far in the extension of the idea of classification to Urban land use. In the direction of progressive Urban planning and local tax reform, sound principles of land use classification should be developed so that social aims and tax policy might go hand in hand. This would go far towards the elimination of unwise 'hit' or miss methods of granting subsidies through tax exemption, and substitute therefore a carefully worked out plan of graduated burdens based upon economic and social considerations.

Property Taxes: Emerging Issues and Changing Perspectives

The role of taxes on immovable property in financing lower levels of government is being reviewed in many of the developed and developing countries. In most countries with these taxes a major effort has been made to improve their administration.

One reason for this upsurge of interest is that the relationship
between central, regional and local governments is changing. Some
governments are committed to decentralising expenditure and revenue
functions; many countries have recently implemented major reforms to
the way in which local government is financed. In very next chapter, we
will discuss two important issues. The first is the different ways in which
land and buildings are taxed and the need for more coordination. The
second issue is the very broad question of how governments can improve
taxpayers perception of property and other taxes by improving the "ser­
vice" that the tax administration provides to the taxpayer.

Property tax reforms in India are a very complex legal and proce­
dural issue. With rising demand for urban services, there is no choice but
to raise more local resources. Therefore, a major reform in the property
tax system is long overdue. However, without major amendments to rent
control act not much change can be implemented. Rent control Act
should be so amended that property markets can function more effec­
tively. Along with these changes, establishment of a more objective
method of assessment would aid in the property tax system. The proposed
system based on area, use and zonal rates could be one of the alternatives
for the present method. Lessons from experience of the case study in
India are perhaps true for various other cities in the developing countries.

All of the mediterranian countries are now committed to placing
greater reliance on property taxes, though a few countries, notably the United Kingdom, intend to phase out domistic property taxes. In most countries with these taxes a major effort has been made to improve their administration.

One reason for this upsurge of interest is that the relationship between central, regional and local governments is changing. Some governments are committed to decentralising expenditure and revenue functions many countries have recently implemented (e.g., Belgium, Greece, Portugal and Spain) major reforms to the way in which local government is financed.

**Current Trends in the Use of Property Taxes**

A number of European Countries have recently reviewed the role of the property tax in financing local government. In some cases, this has been in the context of a policy to decentralise government expenditures and revenues. In other cases, it has been part of a wider review of property taxes. Some governments have decided to reinforce the role of the property tax, whilst others have eliminated them.

In most countries, the relative yield for these taxes has declined, though in some (e.g., Netherlands and New Zealand) they have increased. There has also been a tendency to shift the burden from households to companies.
A number of European Countries have recently reviewed their methods of financing local governments and concluded that property taxes should be eliminated or substantially reduced. Thus, the United Kingdom is now committed to replacing the local property tax by a poll tax which will take the form of a fixed levy for each adult in a household.

Ireland abandoned its property tax on residential property in 1978, mainly because of criticisms of the fairness of the tax (rural areas contributed very little and valuations were very much out of date the last full scale valuation took place in 1850). Nevertheless, the need for a viable local tax source led the government to introduce in 1983 a new residential property tax which took the form of a tax on imputed income from residential property. A major review of local finance is currently under review.

Some of swiss cantons (e.g. Zurich) decided in the early 1980s to abolish the property tax. The main reasons given were that these taxes were very costly to administer in relation to the yield, which tended to be small in comparison to other cantonal taxes.

It is of interest to note that countries where property taxes have been abandoned are usually countries which have not achieved regular revaluation of property values.

A second group of countries has decided to introduce new property taxes or to substantially modify existing taxes on immovable prop-
In almost all cases, this has been part of a policy of devolution. Thus Spain has now completed its goal of decentralising many expenditure and revenue functions to newly established regional governments. As part of this process, the methods of valuing properties were reviewed and local authorities given greater autonomy over the tax rate. Regional governments were given a share of VAT and an attempt was made to provide local authorities with a share of income taxes. Portugal is also reviewing its local finance system and, it appears that modernised system of property taxation will become the main source of financing local governments. The new tax will be based upon the capital value of properties determined on the basis of updated cadastral values. Greece is also in the process of decentralising and it appears that taxes on property will become the main source of finance for local government, though it is unclear whether the base and rate will be centrally determined.

**Main Issues in Urban Property Taxation**

In principle, property taxation is an ideal way to finance many urban services. The property tax base, that is, the value of urban real estate, grows rapidly with urbanization and can be objectively assessed; it reflects the value of many urban services to the extent that they provide site-or area-specific benefits; and ownership of real estate tends to be
more concentrated than the distribution of income, thus making the tax generally progressive. Moreover, if properly administered, a property tax will result in only minor distortions in the allocation of resources. Finally, it can be argued that property taxes are most appropriately administered at the local level, because local government will have a better knowledge base for assessing property values and a greater motivation for collecting the property tax than do higher-level governments.

The property tax is the most common and generally the most important of the taxes collected by urban governments in developing countries like India. However, urban property tax revenue have generally not kept pace with the growth of urban incomes or property values, and often not even with the growth in urban population. Urban property tax systems vary widely among developing countries, but the systems seem to suffer from a number of common problems: assessment practices are inadequate, professional expertise for valuing urban properties is in short supply, the necessary data base to support assessment and enforcement is not in place, collection and enforcement problems abound, and taxpayer resistance is a universal obstacle to more effective property tax administration. Some of these problems can be attributed to the limited technical and administrative capabilities of urban governments. Just as important, however, are a number of other factors: landownership and
tenure conditions are often uncertain; higher-level governments interfere with, or limit the use of, property taxes (for example, through the imposition of rent control or limits on tax rates); and higher effective tax rates on urban property are often successfully opposed.

Notwithstanding these practical obstacles, the urban property tax is clearly among the few main sources of local public revenue that can carry a significant share of the financing requirements for urban expenditure. Substantial efforts and ingenuity, however, are required to mobilize the technical and administrative resources to develop accurate urban property registration and property tax valuation rolls, to update them at regular intervals, and to bill and collect property taxes effectively. In order to be politically acceptable, these improvements must be introduced gradually and fairly, and they need to be linked with a major effort to educate the public about the relationships between the provision of essential urban services and the collection of the property tax.

Problems of Property Tax in India

Property tax, unfortunately, has not been fully utilised partly because the existing system of valuation of property for assessment is extremely unsatisfactory and partly because enforcement of collection of even the partly assessed tax has been very slow; in some cases, the property tax for assessment purposes is wilfully under-valued while in
other cases, the locally elected councillors by their training and experience are unable to cope with the complicated problems of valuation or property. This is very sad commentary upon the unsatisfactory state of the system of property tax assessment, and collection in India.

**Problem of Valuation**

The first major problem in administering the property taxes is the determination of the rateable values. This is difficult task and poses various problems for the assessment administration. The most serious objection to real estate is the use of out-of-date valuation. This is partly due to the limited financial resources of the local bodies particularly where their jurisdictions are small.

In India most of the municipalities are too poor to employ well qualified and well paid men for the purpose. Generally the task of valuation is performed by the revenue officers lent by the state government during the early years of the introduction of local government, but that practice as pointed by Taxation Enquiry Commission has been rendered ineffective. 62

**Problem of Collecting Property Taxes in India**

Assessment by itself does not serve any useful purpose unless the taxes which are levied are also promptly collected. Lady Hicks is quite
justified when she says that "even when the hurdles of valuation and assessment have been safely crossed, there remains the trouble of collection." In India, unfortunately, the tax machinery employed for collection of taxes is inefficient and inadequate for the purpose and as a result heavy arrears are accumulating every year. Apart from this, there is a lack of effective enforcement of coercive methods as prescribed under the Municipal Acts. In many cases tax collectors have not been discharging their duties effectively and cases of large scale embezzlement of tax revenues collected by the tax collectors have also affected adversely the municipal finances and these are referred to extensively in the Audit Reports of the Municipal Bodies. There have also been taking place large scale remissions of tax revenues without sufficient reasons and these were being done by municipal commissioners in utter disregard of their adverse effect on the municipal finances. Thus, due to the lack of promptness in collection of revenues, large arrears have been accumulating and in many cases they have become time-barred involving huge financial loss to the municipal authorities concerned.

**Problem of Rate Structure of Property Tax in India**

Another controversial point centres round the rate structure of this tax. We have already seen that in most cases in India, property taxd
There are, however, some instances in which property taxes are levied at progressive rates. They are mainly Calcutta, Poona and Madras City Corporations. In Calcutta, the rate of levy varies from 15 to 17 percent under section 165 read with section 166 of the Calcutta Municipality Act. The local Finance Enquiry Committee was generally in favour of a progressive rate to be imposed at the discretion of the municipality concerned.64

The reasoning of the Taxation Enquiry Commission that high exemption limit caused due to the introduction of progression will entail substantial loss of revenue might be correct in case of smaller local bodies but not in case of bigger municipalities and gaint corporations. The Taxation Enquiry Commission has also agreed in its conclusive remarks that an element of progression in rates may be adopted by bigger municipalities and municipal corporations. But special care should be taken to keep the total exemptions within limit and the minimum rate should be adequately high. In addition to this corrective shouldbe provided to prevent the imposition of high rates on industrial housing, cooperative housing etc.65

Another hurdle in the way of making the rate structure progressive is consessional rate beyond a certain limit of income. This provision
tends to introduce further element of regression.

It can thus, be concluded that in a growing economy for effecting a more equitable distribution of wealth and for larger resource mobilisation, the introduction of progression into property tax at the municipal level appears to be highly desirable. In this connection the idea of classified property tax, is of paramount importance. The grant municipal corporation of India can very well adopt the scheme of classified property taxation and thus can have a diversified tax structure. This is, of course, not a novel scheme for our country.

But, in the absence of specific instructions and principles, the municipal authorities exercise a good deal of discretion in determining the rateable values of self-occupied properties. The exercise of this unfettered discretion can lead to the distribution of favours which is not a healthy practice so far as the revenue collecting departments of the municipal bodies are concerned.66

One of the serious defects of the local rate is that it lacks the quality of built-in-flexibility as a result of which the revenue from it does not grow with the growth of income. It is very necessary to make this tax flexible specially for two reasons. Firstly, a flexible tax system acts as an automatic stabiliser in a developing economy and secondly, it accelerates
the process of mobilising resources for financing local developmental projects.

This work of mine has examined a wide range of issues and rather than attempt to summarise them, it seems more useful to list a number of questions which could be usefully addressed:

* What is the feasibility and desirability of having a consistent and coordinated approach to the valuation of immovable property for all tax purposes?

* Should the tax base used for all taxes on immovable property be market value and how should this be calculated (e.g. capital versus rental values)?

* Is it useful to separate out questions of valuation, assessment, control and collection of property taxes. Or should all (most) of these functions be carried out by the same level of functions?

* How can one overcome the conflict between the need for local property taxes to be fully visible and the fact that this visibility makes property tax systems very prone to criticism?

* What measures are to be undertaken to improve relations between property taxpayers and the tax administrations?
**Data Sources**

Our study is based exclusively on secondary data. Data for the sample states were collected from the state-level municipal directorates. This set of data represents state aggregates which comprise aggregate revenue and expenditure, tax revenue, non-tax revenue and grants in respect of all municipal bodies in the respective municipal bodies in the respective states. For a few states, namely Kerala, Karnataka and Madhya Pradesh, local government share in state taxes is also available. One major problem with this set of data is that states which do not report shared taxes separately club them with tax revenue or grants.

The second source of data is *Annual Statistical Abstracts* of the central statistical organisation. This source reports data in respect of selected municipal corporations under the following heads: tax revenue, service charges, non-tax revenue with grants. Here again shared tax is either aggregated with tax revenue or grants. The third source of information is various reports by the National Institute of Urban Affairs. These reports is the single source of information that gives most disaggregated data on property tax. Data are available in aggregate terms for individual states which are further disaggregated into municipal corporations and municipalities. The fourth source is individual state government budgets, which provide data on local share in state taxes and compensation and
assignments to local bodies. A comparative picture of the latter data is also reproduced in Combined Finance Accounts, an annual publication of the office of the comptroller and Auditor General; Indian Economic Statistics - Part II Public Finance, published by the ministry of Finance and Reserve Bank of India monthly bulletins. For data on individual municipal corporations, their annual budgets and administration reports constituted the major data source.

Depending on the availability of data, comparable data have been prepared in three forms state aggregates, aggregates of municipal corporations and aggregates of municipalities.

For international comparative study, the data are drawn from many different sources. The most important, we relied on World Bank documents. We added to this the results of a number of case studies carried out by World Bank. We also benefited from the results of a number of cross-country analyses done both inside and outside the World Bank. World Bank documents include economic reports, background papers for loan negotiations, appraisals, and so forth. Because these are official documents of the Bank, they may not be cited—even though the data they draw on are a matter of public record. The source notes for data from these documents thus simply read "World Bank data".
Scope, Method, and Limitations

Unfortunately, there is a shortage of good secondary data; a compendium of local government finances in developing countries does not exist. The newcomer to this area of analysis might expect that one of the international agencies would have begun to gather such data by now, at least for the World's Largest Cities. This guess would be incorrect. The best comparable data on international public finance are in the International Monetary Fund's Government Finance statistics year book, but this source reports only aggregate, nation wide data from state and local governments. Even in this source, aggregate statistics for subnational governments are not presented for many countries and are incomplete for others. Neither the United Nations nor the World Bank gathers comparable data on local public finance.

Case studies of various cities carried out under a variety of auspices, using different methodologies, covering different years, but asking similar questions - provide the other basic source of information. The statistics in these studies suffer from some lack of comparability, and the supporting details on fiscal operations are not always available still, when carefully used they can add significantly to what we know.

There are also important caveats. Some of the data are not comparable in form, different years are used in the comparisons, much of the
information is dated, and the sample of cities is not random. We have tried to remedy some of these problems by updating the information where possible and by augmenting the sample where particular types of cities seem under represented.

This work also is limited by what we have chosen to study. Many important subjects - budgeting, financial accounting, personnel management, interval organisation, political structure - are not covered. We also say for too little about the urban economic base which underlies the potentialities of the property tax studied here.

**Scheme of the Study**

This study has been divided into seven chapters.

1. **Analytical Framework and Basic Issues**: An attempt has been made to analyse the theoretical aspects of the property tax. Besides, possibility of optimal property tax structure explored, a discussion about emerging issues and changing perspectives, current trends in use of property tax and pin pointing main issues in urban property taxation in India.

2. **Performance of property taxation in India**: This chapter is major chapter of this work as it includes: property taxation in the tax structure of urban local bodies in India, relative position of property tax in different states, growth of the tax potentials of growth of the tax poten-
tials of the property tax, per capita revenue, total tax revenue and property tax revenue in major municipal corporations; growth rate of property tax in major municipal corporations. Buoyancy and elasticity of property tax and revenue importance of property taxes in generating revenue to finance Urban Public services in India vis-a-vis other cities of developed and developing nations.

3. Rate structure: This chapter deals with the problems of rate structure. In view of the operational difficulties in a tax-price charging system of a combined basic tax with a number of service taxes, possibility of a family of property tax systems for various categories of properties having different base-rate structures coupled with an adequate system of user charges for urban services explored. Further, standardisation of property tax rates among various size-categories of municipalities considered. And finally possibility of intra-state equalisation of rate structure and distributive effects of rate structure and administration studies.

4. Alternative basis of property taxation: This chapter surveys the whole problems of alternative basis. Erosion in the base and legal interpretation of the base studied. Further, site value taxation, area detail system and area based scheme Vs annual rental value approach studied at
length. And finally a review of Rent Control Laws and reforming the annual rental value system discussed.

5. Valuation of the property: Valuation practices in property taxation are major concern. Detail examination of the legal problems of valuation has been done. A detail analysis of the existing administrative procedure of valuation and assessment and a discussion on the organisational aspects of a central valuation agency. This chapter underlines the difficulties in determining the structure and functioning of a central valuation agency.

6. Property Tax Administration: This chapter examines the administration of tax collection and makes specific suggestions for improvement. An analysis of experience in Delhi of an attempt to mechanise its property tax administration. This chapter focusses on steps to be taken for tax management improvement. And finally, what can be done for improving taxpayer's perceptions and relations between the taxpayer and the administration, has been answered.

7. Conclusion: obviously this is the last chapter in which a sort of summary of work done has been made. Further, suggestions has been given to reconstruct the property taxation in India.
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