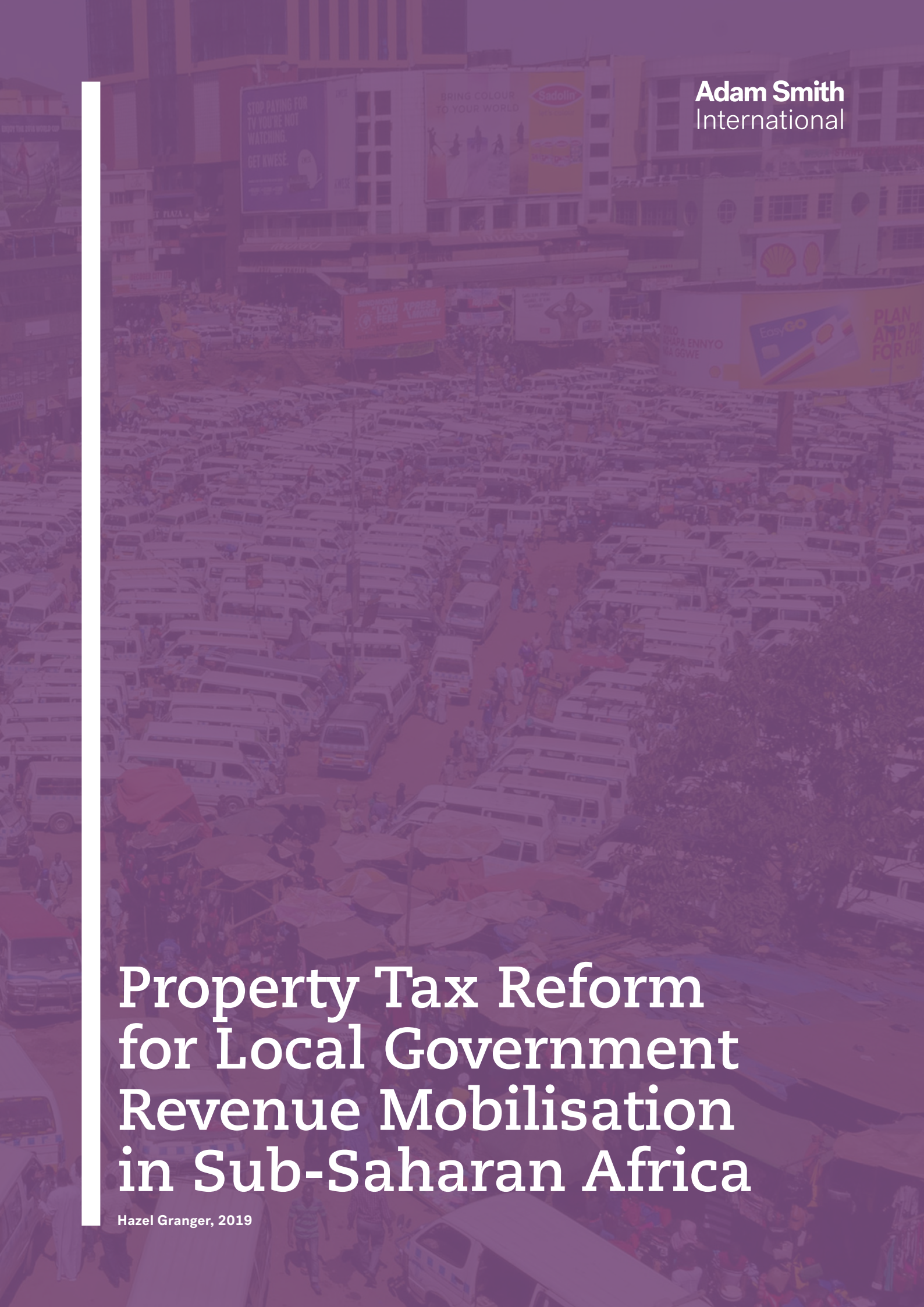
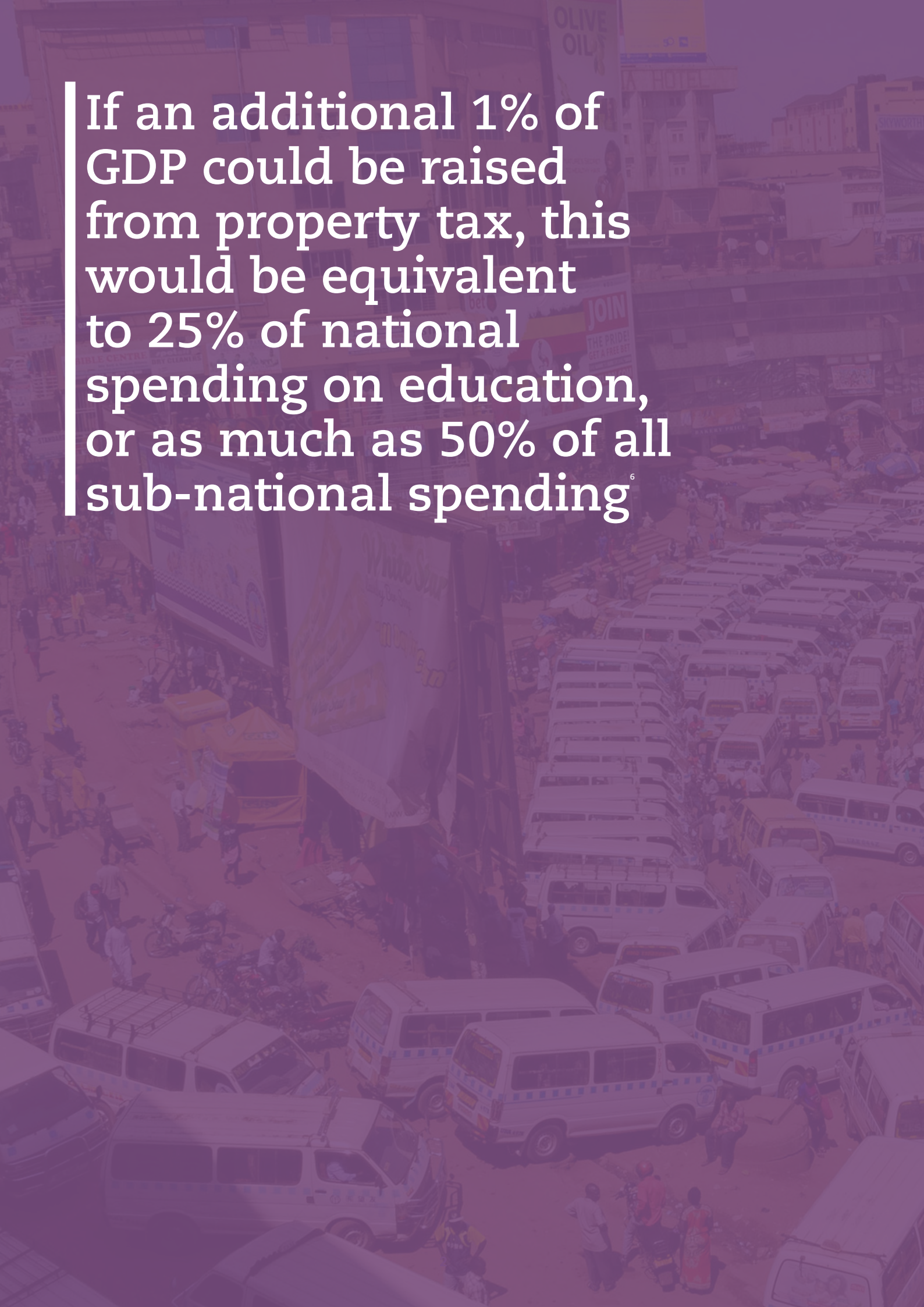


Adam Smith International

Property Tax Reform for Local Government Revenue Mobilisation in Sub-Saharan Africa

Hazel Granger, 2019



If an additional 1% of GDP could be raised from property tax, this would be equivalent to 25% of national spending on education, or as much as 50% of all sub-national spending[6]

Introduction

To ensure sustainability and accountability of financing the Sustainable Development Goals and challenging infrastructure needs, developing country governments and development partners are looking at a range of measures to enhance domestic revenue mobilisation. One of the measures that is often cited, especially as a source of local government own revenue is property taxation. This paper aims to provide an overview of the features, advantages and challenges of operating a property tax. With reference to two case studies from DFID and World Bank programmes, we share lessons from Adam Smith International's experience of assessing and implementing property tax reforms. Why is property taxation important to Sub-Saharan African countries?

Sub-Saharan African (SSA) countries raise a median average of over 18% GDP in domestic revenues (excluding grants) and 15% from taxes alone. This compares to a median domestic revenue-to-GDP ratio of 23% across all emerging market and developing economies[1].

While there is evidence to suggest that tax 'effort' is relatively high in SSA[2] given the structural and economic constraints they face, there is a growing consensus that there is still untapped potential for domestic revenue mobilisation. IMF estimates that countries in Sub-Saharan Africa could raise an additional 3-5% GDP in tax revenues (IMF, 2018). This could be through improvements to several sources of revenue, of which property tax may be just one. Stepping up efforts on domestic revenue mobilisation is the driver of the Addis Tax Initiative, which was launched in 2015 and has brought together more than 55 countries, international and regional organisations. Examples of successful reforms that could be applied more widely include property tax reforms, among others.

Of the taxes collected, SSA countries collect about 31% from direct taxes (on income, property and other assets) compared to 55% in OECD countries. At least half of all countries in Sub-Saharan Africa collect some form of property tax and perhaps many more. However, their collections from this type of tax is much lower than elsewhere in the world. Property tax raises up to 3% in OECD countries, but less than 1% of GDP in developing countries and far less than 0.5% in many African countries[3]. If an additional 1% of GDP could be raised from property tax, this would be equivalent to 25% of national spending on education, or as much as 50% of all sub-national spending[4].

Tax systems that raise more from direct taxes tend to be more equitable, since the wealthy will be taxed more than the poor or those without any assets (Moore et al, 2018). With economic and population growth, and greater demand for housing and urban development, land values are rising, especially across the African continent. In Nairobi, for example, land values have increased six-fold since 2007[5]. Capturing gains in land value may be a key strategy for local governments to finance much-needed infrastructure investment and public service delivery[6].

1 Regional Economic Outlook: Sub-Saharan Africa, IMF, October 2018
2 Reassessing Tax Effort in Developing Countries: a Proposal of a Vulnerability-Adjusted Tax Effort Index (VATEI), Hermann Djedje Yohou and Michaël Goujon (2017)
3 Property Taxation in Developing Countries, CMI Brief Vol. 16, No.1, March 2017, Ali, Fjeldstad and Katera
4 Based on evidence that low income countries spend on average less than 2% GDP at the sub-national level, from OECD/UCLG (2016), Subnational Governments around the world: Structure and finance.
5 http://hassconsult.co.ke/real-estate/hass-index/13-the-hass-land-index?typ=2&layout=2
6 Based on evidence that low income countries spend on average less than 2% GDP at the sub-national level, from OECD/UCLG (2016), Subnational Governments around the world: Structure and finance.

The role of property taxes in national and local revenue

Property taxes are among the oldest forms of taxation and were present throughout the ancient world. Land revenue was the main source of revenue in British Colonial India in the eighteenth and nineteenth centuries, which also established systems of local land records, including size, productivity and ownership. In Africa, 'hut and head' taxes introduced by colonial governments were more elementary and often perceived as unfair or coercive. The Sierra Leone Hut Tax War of 1898 is still remembered today and underlies to some extent a level of resistance to local property taxation, among other factors.

Today, land and property taxes are a common form of local (decentralised) revenue, since these are widely accepted to fulfil the desirable criteria for a good local tax, such as providing:

A potentially large and stable revenue source;

- A high level of revenue 'buoyancy' i.e. the value and scope of the property base expands with economic growth;
- A strong, positive connection between local service provision and property revenue, since successful local governments will attract more businesses and households into the area;
- It is based broadly on ability to pay and is therefore a progressive tax, particularly if levied on owners and is value-based, whereby owners of high value property pay more than poorer households;
- It promotes more efficient use of land and economic development, since the taxing of land discourages dormant land holding or withholding of land from the market and encourages uses that have potential to generate cash flow;
- It supports property-related institutions, such as property registers, title deeds, sales agreements, use of courts for resolution of disputes, and town planning (building permits, demolitions, surveys); and
- Compliance is relatively simple: property is easy to observe and therefore difficult to avoid paying the tax. If value-based, there can be difficulties in observing the market value, and administration difficulties arise when there are unclear property rights and ownership tenures, or the owner is not present or a foreign national.

Tax base	Who pays	Rates	Exemptions
Typically, the options are: **- Unimproved Site Value (USV):** based on demand for land e.g. location, infrastructure, population. Using USV discourages inefficient land use, but fails to capture variation in ability to pay based on rental value of structures; **- Land area (or no. buildings):** administratively simpler/cheaper, but less fair/equitable as it is not linked to ability to pay; **- Structural improvements / immovable property value:** Based on cost of construction - also less fair due to disconnect with ability to pay; **- Improved Site Value (ISV):** based on value of land and buildings. This is more common, can be revealed in transaction values and rental value – therefore linked to ability to pay, but can be more expensive and complex to administer.	**Owner:** may be more equitable to tax the owner, as an indicator of ability to pay **Occupier:** administratively easier, since it is harder for occupiers to avoid the tax. They are also the prime beneficiaries of local services provided, although their rents may already capture this value	Range between around 1% in high income countries, but higher in low income countries, up to 20%, due to out of date property values Policy setting can include varied rates based on: **(a) land use type** e.g. agricultural, commercial, residential, industrial, or **(b) geographic location** and proximity to locally-provided services (benefit principle).	Exemptions could be considered, in principle, for equity reasons e.g.: - Low income households; - Micro businesses with low ability to pay, for whom taxing land or property may force them to sell or move.

Reasons for under-performance: common challenges

Low income countries, particularly in SSA, have under-performed in the collection of property taxes for several reasons. Typically, challenges include:

- Property is a key source of wealth accumulation, particularly in regions with limited investment opportunities and the relative lack of regulation and taxation of land and property transactions. Political and business elites will therefore resist taxation strongly[7];
- Taxpayer perceptions of local taxation can be highly negative due to historic factors, poor communications and an apparent disconnect between taxes and public service delivery, and/or between property ownership and ability to pay[8];
- Complex or unclear legal framework, such as customary, poorly legislated land tenure modes or out of date valuation rolls, inconsistencies with changes to fiscal decentralisation reforms, national tax policy and administration frameworks or suffering from overly complex features and variations across geographic areas[9];
- Three types of cadastre (identifiers) are required: Physical (identifying properties and their characteristics), legal (ownership), and fiscal (taxpayer registers). Some or all of these may be incomplete, inaccurate and/or developed and maintained manually;
- Methods of land and property valuation can be complex and expensive to maintain[10];
- Owners are difficult to trace if overseas landlords, or if land tenures are informal, unregistered or otherwise not captured in the legal definition of ownership[11]; and
- Weak revenue administration and enforcement, including revenue management systems, which can be limited, inaccurate or inefficient, from registration and monitoring of taxpayers, to assessment, billing and payment methods, which also leads to a lack of transparency and accountability[12].

7 Merima Ali, Odd-Helge Fjeldstad, Lucas Katera (2017)
8 Moore, M., Prichard, W., Fjeldstad, O-H., (2018), Taxing Africa
9 Documented, for example, in ASI's report Own-Source Revenue Potential and Tax Gap Study of Kenya's county Governments, (2018)
10 Bahl, R., Smoke, P. 2003. Restructuring Local Government Finance in Developing Countries, Lessons from South Africa. Edward Elgar: Cheltenham
11 As found in Kenya, for example (ASI, 2018)
12 Ali et. Al (2017) and as found in ASI's work in Kenya and Somalia.

Adam Smith International undertook a study in 2018, on behalf of the Kenya National Treasury with support from the World Bank, aimed at understanding the revenue potential for Kenya's 47 county Governments. Kenya's Counties have grown increasingly dependent on financial transfers from the National Government in recent years as their own revenues have decreased relative to the transfers. This study looked at how much revenue Counties could potentially collect if they had full compliance (called a "top-down" analysis) and if they brought their revenue administration practices into line with the current best-performing Counties (a "frontier" analysis).

The study showed that Counties have major potential to increase their revenues across the board both in the short and long term, which would help them to fund local services and reduce dependence on National Government transfers. Property tax, of all the revenue streams available to Counties, has the most currently untapped potential. Constitutionally, this is the largest decentralised tax.

Counties currently raise around US$365 million from all local revenue sources, but our estimates indicated that they could do much more, even just from property tax. Under very conservative assumptions – a single 1% rate levied on the 10% highest-valued properties – counties could raise approximately US$660 million under an ideal scenario, almost double the current total local revenue collections. This represents 1% of GDP and 16.5% of the annual county budgets. The more conservative frontier analysis still indicated that counties could raise between US$520-650 million from all sources of revenue, of which most would likely come from property tax.

The potential analysis represents an ideal scenario in which all Counties resolve administrative inefficiencies related to revenue collection, management and accounting. In practice, there were several issues that we observed that would need to be resolved to improve performance, including:

- Out of date and incomplete property valuation rolls, some of which dated back to 1982; Counties currently use a discrete valuation method, which is costly and relies on a well-developed property market;
- High rates, up to 34%, to compensate for the outdated valuation rolls, and complex variation of rates across counties;
- Tax base uses Unimproved Site Value, which does not capture ability to pay based on the type and size of buildings on the land e.g. commercial property rental value;

Property tax in Kenya's counties

Case Study

- Enforcement challenges due to difficulties determining ownership from traditional or informal tenures and overseas landlords;
- Low administration capacity (human resource, skills, ICT, accounting systems etc.) and lack of risk-based approach to compliance; and
- Political interference to protect key 'elites' form taxation in return for political or other support.

While these are difficult issues to tackle, relatively modest improvements can have significant implications for revenue. Many Kenyan counties have introduced a range of payment methods, such as mobile payments and handheld devices, which encourage compliance by making it easier to pay. With some private providers charging high commission rates for these services, some Counties have begun entering into agreements with the Kenya Revenue Authority for collection instead. Although the national revenue authority may not always prioritise local revenue sources, its receipting and information management systems can be applied to local revenues more cost effectively than local solutions. It also offers the possibility to share taxpayer data across national and county-level taxes, which could enhance compliance further.

To address the inconsistencies and weaknesses in the policy and legal framework, the National Treasury has published a draft policy and county revenue law, with plans to work together with stakeholders and encourage counties to work on a collaborative framework for bases and rates across the counties. Having an agreed framework that applies across Counties may also reduce the opportunities for political interference at an individual or county-level. A key part of developing the framework will be to look at the valuation methodology and develop techniques that will be more cost effective to implement. Counties could consider alternative, more simplified methods, such as Computer-Aided Mass Appraisal, a value banding system or self-appraisal.

Practical steps and solutions to improve performance

(i) Clarification and simplification of policy and legal framework

The legal and policy framework can be simplified and clarified to aid taxpayer education, compliance and administrative efficiency. For example, by rationalising and streamlining the number and variation of rates across property types and geographic areas. The tax base and method of collection could also be strengthened, clarified and more consistent across local areas. Depending on the property market, data availability and equity considerations, it may be better to base the tax on the land value or improved site value (including buildings). Providing for the powers to collected or withhold the tax from occupiers rather than just owners can also strengthen administration.

For example, in Hargeisa, Somaliland in 2005, property tax raised about US$170,000 from a register of 15,850 properties. With help from a UN-Habitat project, satellite imagery was used to create a digital map of all buildings. A survey of property features was also undertaken to record physical characteristics, occupier and number of residents. The property tax framework included liability for occupants and a simple rate system of five classes was established based on building materials and road type. Over eight months and an investment of just under US$50,000, the property cadastre was expanded to 59,000 properties and raised US$588,754 by 2008[13].

(ii) Overcoming resistance and political interference

Public perceptions and political power relations will be different depending on the context. Nonetheless, there may be some strategies worth considering. For example:

- Build high level consensus, across local governments and within each district. This may include creating incentives between central and local government, relating to the interaction between inter-governmental transfers and local own-source revenue collections, and the need for local governments to generate revenues to access credit or investment financing opportunities[14];
- Alert the media during enforcement action, to enhance visibility, especially of 'elites' paying taxes, and to reduce opportunities for avoidance;
- Build political support for property taxation by highlighting the positive benefits;
- Encourage public, private and civil society participation and accountability in the policy-making and budgeting processes; and
- Establish a collective approach across counties to determining the tax base and allow local rate variation.

(iii) Strengthening compliance

In addition to improving public perceptions and building consensus, making taxes easier to understand and to pay will aid compliance and efficient collections, using strategies such as:

- Ease of payment options: ensure that frequency of payment and options for making payments are appropriate to the taxpayer e.g. ways to spread payments over the year, or make payments through the mobile phone – if necessary, undertake surveys to learn more about how taxpayers behave and perceptions around taxation;
- Tax enforcement actions that link to wider services, such as: link non-payment to access to services e.g. suspension of electricity service or other utilities; or require tax clearance certificates to access services; and
- Communications and education: positive taxpayer messaging that strengthens the link between taxation and visible service delivery, such as earmarking tax revenues to specific local services (e.g. street lighting or waste collection); providing outreach activities that will provide accountability for spending on services and build trust with citizens; or explaining wider benefits of property tax compliance, such as access to credit and banking services or residence rights.

(iv) Valuation methods

Valuation methods can be simplified, according to the level of capacity and available resources. Residential property typically represents 70-80% of the total tax base

13 Land and Property Tax: A Policy Guide, UN-Habitat (2011)
14 Overcoming political resistance to property tax, Ehtisham Ahmad, Giorgio Brosio and Caroline Pöschl, LSE (2014)

and is therefore a large element of the administrative cost. Commercial buildings are typically of high value, are relatively uniform, and are valued by the profession based on their income streams. Therefore, separation of commercial and residential valuation methodologies is warranted, and a low-cost solution to residential assessment holds promise. If a value-based property tax is chosen, the determination of value must be carried out either by a civil service acting in accordance with regulations, or a valuation profession self-regulated in accordance with a statutory charter. In either case, there are several alternative methodologies for making a value-based assessment.

Assessment of the value of land for taxation purposes is generally done on a 4-year cycle. In most cases, an entire property roll is prepared and published for objection and comment every four years. In some cases, re-valuation is done on a rolling basis, with one quarter of the properties valued each year. In the interim, values are adjusted to reflect new construction or development on each plot. In this event, the value of the new construction is adjusted by means of cost and price indices to reflect the value as at the date of the valuation, which might be up to four years previously to the actual development. Authorities generally avoid making a wholesale adjustment to all property values for the purposes of creating buoyancy. This is accomplished either by adjusting the tax rate from year to year (e.g. South Africa) or by adjusting an assessment ratio, i.e. the proportion of the assessed value that is considered taxable.

For example, CAMA has a long history of use in Cape Town, more recently in Cairo on a pilot basis, as well as with several Western European countries (e.g. Lithuania) which used it to transition from public to private ownership[15]. Banding is used in Great Britain and the Republic of Ireland. Self-declaration is becoming more widespread internationally (e.g. Greece, Ireland, Rwanda, Thailand and the Philippines).

Comparative summary of property valuation methods

Method	Description	Advantages	Disadvantages
Discrete valuation of properties	Professionally trained and chartered valuers are tasked with making site inspections and using market data to arrive at a valuation / assessment for each parcel.	Comparative cost-based and income approaches common and have wide international acceptance.	Expensive and relies on a well-developed property market and accompanying institutions of ownership.
Computer Aided Mass Appraisal (CAMA)	Uses software available to the valuation profession which utilises a range of adjustment factors (e.g. location, age, condition, access to amenities) to arrive at a discrete estimate of value for each property. The factors and their relative weighting is determined by statistical analysis, which is carried out on a regular cycle.	The estimate is desk-based and is therefore applicable at low cost to mass appraisal. Removes need to inspect each property. Encourages the use of a land-only tax base, as the range of factors is significantly reduced along with cost.	Relies heavily on general market and town planning data - more conducive to relatively sophisticated environments where such kinds of 'big data' is reliably available.
Value-banding of residential property	Properties are allocated into different value bands according to an estimate of their capital value. Rather than valuing the properties to a discrete figure and assigning them to a band, the property values are estimated according to a range of values or bands.	Simple structure; low cost; valuation process can be extremely quick relatively easy; e.g. utilising the private sector for collection of assessed values and valuation data; revaluations can be fairly infrequent, so less administratively and financially burdensome.	Decisions at the margin of bands become more contentious; limited range of taxable values can be seen as less fair than discrete system; if the private sector is used for assessment, quality assurance becomes an important issue.
Self-declaration of value for commercial property	Places the onus on the taxpayer to reveal information and make his or her own assessment of the market value of the property. The system relies on the tax authority to object, which it will do on a selective basis allows for the participation of the valuation profession in determining assessed value, as opposed to taxpayers challenging the assessment prepared by the Valuation Department.	Assessments can be verified by valuation profession and fraudulent declarations can be criminalised or heavily penalised; efficient way to mobilise data, which would otherwise be costly; it minimises litigation as owners are making their own declaration of value.	Requires monitoring of the declared values by the Valuation Department and early engagement with the valuation profession early in the process; cost of valuation approach would be borne by the owner/s of the property.

15 The Development of Property Taxation in Economies in Transition, Edited by Malme and Youngman (2001)

Public Resource Management in Somalia (PREMIS) Property Tax Support

Case Study

DFID's PREMIS programme. The FMS have provision to collect property tax under their respective Revenue Acts. However, there is an understanding that, in future, the property tax will be assigned to districts. Currently the Revenue Act provides only for property tax to be collected from urban areas, assigned to districts.

Registration of taxable properties has commenced on a pilot basis in one city (Kismayo) and is now being rolled out to key cities in all four states. Collaboration between district and state governments is a key feature of the initiative, with a clear intention to devolve collection to district level as administrative capacities develop. As property tax is new in Somalia and there is low capacity for property valuation, a simple, flat tax is applied to each property, with the aim of encouraging property registration. In future phases, it is anticipated that higher rates could be applied to larger properties and, over time, to expand the tax assessment to reflect property values.

Our assistance has supported Jubbaland State to map properties in Kismayo, including collecting information on occupants, type of dwelling, roofing material, proximity to water, schools and electricity. Although the Revenue Management System (RMS) can record these features of each property, they will only be used in future phases. At this stage, the focus is to undertake a plot-numbering exercise, with registration of the occupant and the person responsible for taxation.

In addition to mapping, we assisted the FMS to include property in the RMS and trained officials to train others, including district officials, which has begun. We believe this is a sustainable approach and helps build

a relationship between the FMS and district government. Payments are made either at the revenue collection points in Kismayo or through Accredited Revenue Collecting Agents who can collect door to door. For receipting via agents at the property, a system of handheld devices and printers is in development, which will improve the convenience of payment and ensures accountability in the RMS at the level of individual taxpayers to the FMS Treasury Single Account (TSA). In future, it may be possible to use mobile money payments, which is currently a commonly used and understood technology. However, presently, there is insufficient regulation and registration of mobile numbers to ensure that payments made directly to the TSA can be identified at the level of taxpayers.

Since the programme provided support to property tax in Kismayo, 26,000 properties have been registered and collections have increased from US$7,024 in FY2017 to $88,322 in FY2018. At a basic flat amount of US$50 per plot, it is expected that Jubbaland State could raise up to $600,000 in 2019, assuming a compliance rate of approximately 50%. While this revenue currently provides mainly for security and some key sector salaries, it is expected that public service provision at state level could be provided in future, as local revenues expand.

(v) Use of ICT

There are various ICT tools available to aid tax administrations, such as Geographic Information Systems (GIS) for property mapping, software with formulas to value property based on observed key features (as in CAMA, described above), systems for automated billing and payment options, such as the use of mobile money payments and handheld Point of Sale (POS) devices and systems.

Using automated IT systems also offers wider benefits from the potential to link databases to third party data and systems such as national taxpayer registers, utility company billing systems or other third party data sources, such as the governments Integrated Financial Management System (IFMS), national revenue authority taxpayer databases, land registry or company registry.

Assistance for Strengthening Property Tax Performance

There are several initiatives that are attempting to bring together financial and technical assistance and peer support to countries to improve the implementation of property taxes. For example:

The African Property Tax Initiative (APTI)[16], part of the International Centre for Tax and Development (ICTD), which is a virtual network of researchers, experts and other stakeholders to share lessons and policy research to inform the more effective use of property tax;

UN-HABITAT's land and property initiatives support a range of tools under the Global Land Tool Network (GLTN), which have a range of applications, including GIS property mapping and valuation method guides;

The Platform for Collaboration on Tax (PCT), a partnership of the International Monetary Fund (IMF), the Organisation for Economic Co-operation and Development (OECD), the United Nations (UN) and the World Bank Group (WBG), and the International Tax Compact / Addis Tax Initiative, provide coordination between development partners and developing countries to expand financing and knowledge to support domestic revenue mobilisation; and

Multilateral and bilateral ODA programmes provide direct financial and technical assistance to developing country governments in fiscal decentralisation and revenue reform initiatives.

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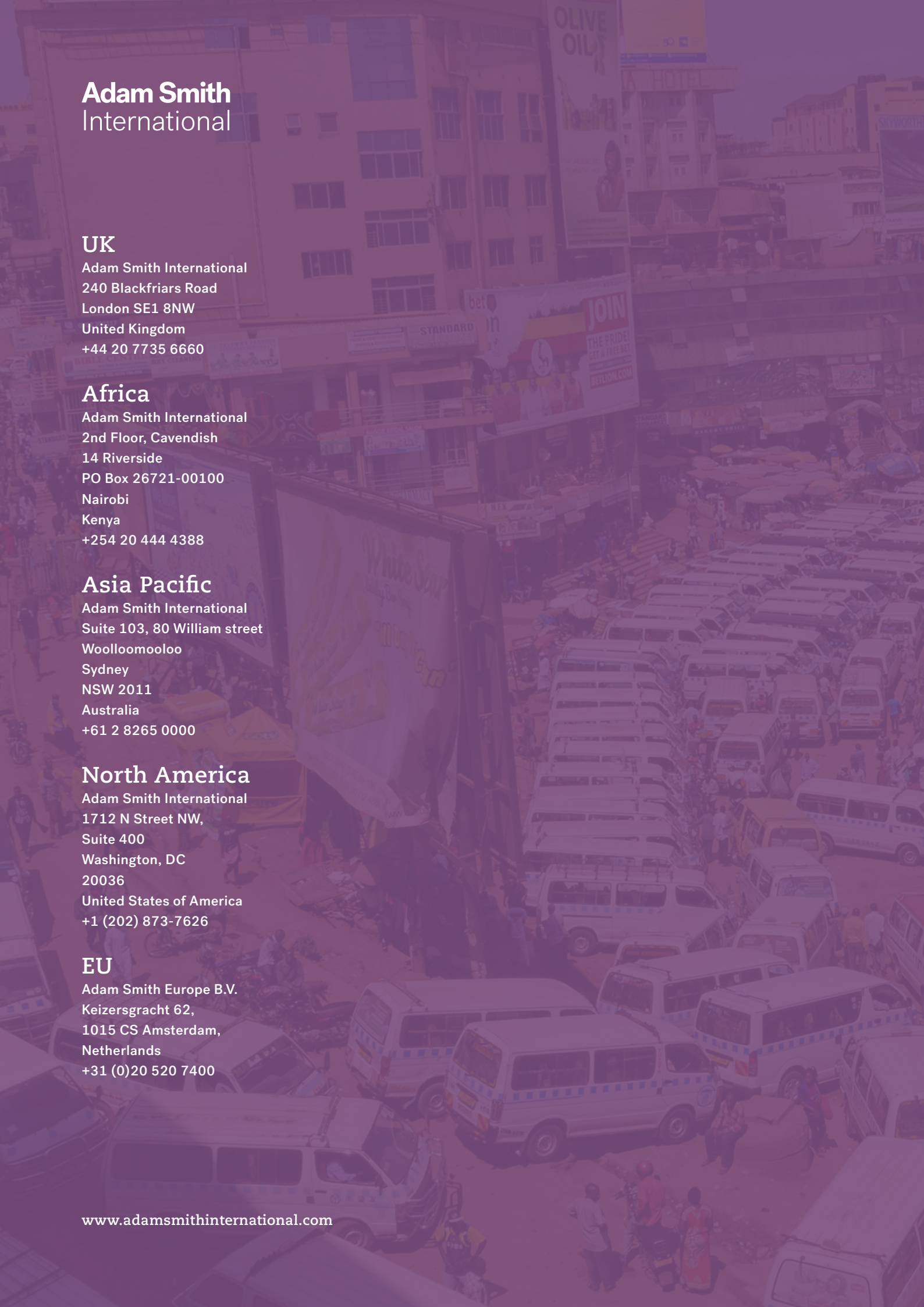
16 https://www.ictd.ac/network/apti/



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